PN-ABG-218

WASHINGTON ECONOMIC WATCH

A Digest of Development Policy Information

A Project of the Overseas Development Council

P.S. Please Note:

WASHINGTON
ECONOMIC
WATCH

A Digest of Development Policy Information

1875 Connecticut Ave. NW
Suite 1012
Washington, DC 20009

(202)234-8701
fax (202)745-0067

SUMMER 1993
ASIA

August 5, 1993

Dear Readers:

The Overseas Development Council presents the 13th edition of the Washington Economic Watch: A Digest of Development Policy Information. In this issue you will find critical testimonies, studies, and reports covering the Washington policy debate on several issues, including the environmental and labor aspects of the NAFTA agreement, the 1994 U.S. International Affairs Budget, the priorities of the U.S. Agency for International Development, and health care reform in the United States, among others; it also includes several pieces that address 'sustainable development' in aid programs. We hope you and your colleagues find the Summer 1993 issue helpful to your institution's research.

In June ODC sent your institution a questionnaire which we hope will serve several purposes. The survey is a means to assess the degree of usefulness of the WEW to our subscribers, identify institutions that publish, and explore the technological capabilitities of each institution. We encourage you to return the questionnaire as soon as possible and ask you to include any suggestions for future issues of the Washington Economic Watch. All publications, correspondence, and the aforementioned questionnaire should be forwarded to:

WEW Project c/o
Acquisitions Librarian
The American University
4400 Massachusetts Avenue, NW
Washington, DC 20016-8046
U.S.A.

We look forward to hearing from you.

Sincerely,

Christine E. Contee
Director of Public Affairs
& Fellow

O D C

A Project of the Overseas Development Council

John W. Sewell President

Washington Economic Watch Advisory Board

Gary Bombardier
U.S. Agency for International Development
Bilateral and Multilateral Assistance

Stuart Brown
Georgetown University
Eastern Europe and the Former Soviet Union

Herschelle Challenor
Africare
Africa

Peter Hakim
Inter-American Dialogue
Latin America

John Lewis
Woodrow Wilson School
Development Strategies

Catherine Mann
Federal Reserve Board
U.S. and Global Macroeconomic Trends

Kirk Talbott
World Resources Institute
Environment

Thomas Thornton
Johns Hopkins University
Asia

Stuart Tucker
Economist
Trade

Al Watkins
The World Bank
Finance

Project Director: Christine E. Contee, ODC
Project Coordinator: Dawn Murphy, ODC
Project Assistants: Beth Easley and Cee Cee Gachet, ODC

CONTACTS

I. RESEARCH ORGANIZATIONS OTHER NON-PROFITS

Academy for Educational Development
1255 23rd St., NW
Washington, DC 20037
(202) 862-1900

African American Institute
1625 Massachusetts Ave., NW
Suite 210
Washington, DC 20036
(202) 667-5636

Africare
440 R Street, NW
Washington, DC 20001
(202) 462-3614

American Enterprise Institute
1150 17th St., NW
Washington, DC 20036
(202) 862-5800

Atlantic Council of the U.S.
1616 H St., NW
Washington, DC 20036
(202) 347-9353

The Brookings Institution
1775 Massachusetts Ave., NW
Washington, DC 20036
(202) 797-6000

CARE
2025 Eye Street, NW
Suite 1024
Washington, DC 20006
(202) 223-2277

The Cato Institute
1000 Massachusetts Ave., NW
Washington, DC 20001
(202) 842-0200

Center for Immigration Studies
1815 H Street, NW
Suite 1010
Washington, DC 20006-3604
Ms. Vaughan
(202) 466-8076

Center for International Policy
1755 Massachusetts Ave., NW
Suite 324
Washington, DC 20036
(202) 232-3317

Center for International Private Enterprise
1615 H Street, NW
Washington, DC 20062
(202) 463-5901

The Centre for Our Common Future
Palais Wilson
52 Rue de Paquis
CH-1201 Geneva, SWITZERLAND
(4122) 732 71 17

Center for National Policy
317 Massachusetts Ave., NE
Washington, DC 20002
(202) 546-9300

Center for Strategic and International Studies
1800 K St., NW, Suite 400
Washington, DC 20006
(202) 887-0200

Center on Budget and Policy Priorities
777 North Capitol St., NE, Suite 710
Mr. Pytel
(202) 408-1517

Committee for Economic Development
477 Madison Avenue
New York, NY 10022
(212) 688-2063

·/

The Conference Board
845 Third Avenue
New York, NY 10022-6601
(212) 759-0900

Council of the Americas
1625 K Street, NW, Suite 1200
Washington, DC 20006
(202) 659-1547

The Development Group for
Alternative Policies, Inc.
927 15th Street, NW
4th Floor
Washington, DC 20005
(202) 898-1566

Economic Policy Institute
1730 Rhode Island Ave., NW
Suite 200
Washington, DC 20036
(202) 775-8810

Environmental Defense Fund
1875 Connecticut Ave., NW
Suite 1016
Washington, DC 20009
(202) 387-3500

Environmental & Energy Study Institute
122 C St., NW, Suite 700
Washington, DC 20001
(202) 628-1400

The Heritage Foundation
214 Massachusetts Ave., NE
Washington, DC 20002
(202) 546-4400

Institute for Democratic
Alternative for South Africa
Hill House, 1 Penzance Road
Mowbray, Cape Town
South Africa 7700
021/473-127

Institute for International Economics
11 DuPont Circle, NW
Washington, DC 20036
(202) 328-9000

Institute of International Education
809 United Nations Plaza
New York, NY 10017-3580
(212) 883-1989

Institute for International Finance
2000 Pennsylvania Ave., NW
Washington, DC 20006
(202) 857-3600

Institute for Policy Studies
1601 Connecticut Ave., NW
Washington, DC 20009
(202) 234-9382

InterAction
1717 Massachusetts Ave., NW
Suite 801
Washington, D.C. 20036
(202) 667-8227

Inter-American Dialogue
The Aspen Institute
11 Dupont Circle, NW
Washington, DC 20036
(202) 265-5350

Inter-Faith Action for Economic Justice
110 Maryland Ave., NE
Washington, DC 20002
(202) 543-2800

International Center for Research on Women
1717 Massachusetts Ave., NW
Suite 301
Washington, DC 20036
(202) 797-0007

Int'l Development Research Ctr.
60 Queen Street, Box 8500
Ottawa, CANADA K1G 3H9
(613) 236-6166

International Food Policy
Research Institute
1200 17th St., NW
Washington, DC 20036-3006
(202) 862-5600

Johns Hopkins Foreign Policy Institute
1619 Massachusetts Ave., NW
Washington, DC 20036
(202) 663-5773

National Bureau of Economic Research
1050 Massachusetts Ave.
Cambridge, MA 02138
(617) 868-3900

National Planning Association
1424 16th St., NW, Suite 700
Washington, DC 20036
(202) 265-7685

National Research Council
2101 Constitution Avenue
Washington, DC 20418-0001
(202) 334-2138

Natural Resources Defense Council
1350 New York Avenue
Suite 300
Washington, DC 20005
(202) 783-7800

The North-South Institute
200 - 55 Murray
Ottawa, CANADA K1N 5M3
(613) 236-3535

Overseas Development Council
1875 Connecticut Ave., NW
Suite 1012
Washington, DC 20009
(202) 234-8701

Overseas Development Institute
Regent's College Inner Circle
Regent's Park
London NW1 4NS, United Kingdom

Oxfam America
26 West Street
Boston, MA 02111-1206
(617) 482-1211

Panos Institute
1717 Massachusetts Ave., NW
Suite 301
Washington, DC 20036
(202) 483-0044

Population Action International
1120 19th St., NW
Washington, DC 20036
(202) 659-1833

Population Council
1 Dag Hammerskjold Plaza
New York, NY 10017
(212) 339-0500

Population Reference Bureau
1875 Connecticut Ave., NW
Suite 520
Washington, DC 20009-5728
(202) 483-1100

Rainforest Action Network
450 Sansome, Suite 700
San Francisco, CA 94111
(415) 398-4404

The Rand Corporation
1700 Main Street
Santa Monica, CA 90406-2138
(310) 393-0411

Refugee Policy Group
1424 16th St., NW, Suite 401
Washington, DC 20036
(202) 387-3015

Resources for the Future
1616 P St., NW
Washington, DC 20036
(202) 328-5000

Society for International Development
1401 New York Avenue, NW
Suite 1100
Washington, DC 20005-2121
(202)347-1800

SRI International
1611 N. Kent St.
Arlington, VA 22209
(703) 524-2053

The Stern Group
1133 Connecticut Ave., NW
Washington, DC 20036
(202) 775-2379

U.S. Institute for Peace
1550 M St., NW
Washington, DC 20005
(202) 457-1700

The Washington Institute
1015 18th St., NW
Washington, DC 20036
(202) 293-7440

Washington Office on Latin America
110 Maryland Ave., NE
Washington, DC 20002
(202) 544-8045

Woodrow Wilson International
Center for Scholars
Latin American Studies Program
1000 Jefferson Dr., SW
Washington, DC 20560
(202) 357-2429

World Policy Institute
New School for Social Research
65 Fifth Ave., Suite 413
New York, NY 10003
(212) 229-5808

World Resources Institute
1709 New York Ave., NW
Washington, DC 20006
(202) 638-6300

WorldWatch Institute
1776 Massachusetts Ave., NW
Washington, DC 20036
(202) 452-1999

II. U.S. GOVERNMENTAL ORGANIZATIONS

Agency for International Development
Department of State Bldg.
320 21st St., NW
Washington, DC 20515
(202) 647-4330

Congressional Budget Office
Publication Office
HOB Annex II
2nd & D St., SW
(202) 226-2809

Council of Economic Advisors
Old Executive Office Bldg.
17th St. & Penn Ave., NW
Washington, DC 20500
(202) 395-5107

Department of Agriculture
14th St. & Independence Ave., NW
Washington, DC 20250
(202) 447-8732

Department of Commerce
15th St. & Constitution Ave., NW
Washington, DC 20230
(202) 482-0543

Department of Energy
Forrestal Bldg.
1000 Independence Ave., SW
Washington, DC 20585
(202) 586-4917

Department of State
2201 C St., NW
Washington, DC 20520
(202) 647-6576

Department of the Treasury
1500 Pennysivania Ave., NW
Washington, DC 20220
(202) 566-2000

Drug Enforcement Agency
600 Army Navy Drive
Arlington, VA 20537
(202) 307-8100

Environmental Protection Agency
401 M St., SW
Washington, DC 20460
(202) 382-2080

Export-Import Bank of the
United States
811 Vermont Ave., NW
Washington, DC 29571
(202) 566-8990

Federal Deposit Insurance Corp.
550 17th St., NW
Washington, DC 20429
(202) 898-6996

Federal Reserve System
20th & Constitution Ave., NW
Washington, DC 20551
(202) 452-3245

Federal Trade Commission
6th St. & Penn Ave., NW
Washington, DC 20580
(202) 326-2222

General Accounting Office
441 G St., NW
Washington, DC 20548
(202) 275-6241

Inter-American Foundation
1515 Wilson Blvd.
Rosslyn, VA 22209
(703) 841-0973

International Trade Commission
500 E St., SW
Washington, DC 20436
(202) 252-1807

Joint Economic Committee
SD-G01 Dirksen SOB
Washington, DC 20510
(202) 224-5171

Executive Office of the President
17th St. & Penn. Ave., NW
Washington, DC 20550
(202) 673-2823

Executive Office of The President
17th St. & Penn. Ave., NW
Washington, DC 20550
(202) 395-3000

Office of Management and Budget
Old Executive Office Bldg.
17th St. & Penn Ave., NW
Washington, DC 20503
(202) 395-3000

Carnegie Quarterly
Carnegie Corporation of NY
437 Madison Avenue
Mr. Russell
(212) 371-3200

Challenge
80 Business Park Drive
Armonk, NY 10504
(914) 273-1800

Congressional Quarterly
1414 22nd St., NW
Washington, DC 20037
(202) 887-8500

Foreign Affairs
58 East 68th Street
New York, NY 10021
(212) 734-0400

Foreign Policy
2400 N St., NW
Washington, D.C. 20037-1196
(202) 862-7940

In Depth
The Washington Institute
1015 18th St., Nw, Suite 300
Washington, DC 20036
(202) 293-7440

International Economy
1050 Connecticut Ave., NW
Suite 1220
Washington, DC 20036
(202) 861-0770

Latin Finance
2121 Ponce de Leon Blvd.
Suite 1020
Coral Gables, FL 33134
(305) 448-6593

NACLA Report of the Americas
North American Congress on Latin America
475 Riverside Drive, Suite 454
New York, NY 10115
(212) 870-3146

National Journal
1730 M St., NW, Suite 1100
Washington, DC 20036
(202) 857-1400

The New Republic
1220 19th Street, NW
Washington, DC 20036
(202) 331-7494

Presidential Studies Quarterly
Center for the Study of the Presidency
1120 Connecticut Ave., NW, Suite 400
Washington, DC 20036
(202) 466-8213

SUR, Esquel Group Foundation
4948 St. Elmo Avenue
Suite 301
Bethesda, MD 20814
(301) 718-8870

Tomorrow
200 Broadway, Suite 273
Redwood City, CA 94063
(415) 396-0426

Zero Population Growth
1400 16th St., NW
Washington, DC 20036
(202) 332-2200

Office of Technological
Assessment
600 Pennsylvania Ave., SE
Washington, DC 20003
(202) 546-1029

Office of the United States
Trade Representative
Winder Bldg. #600
17th St., NW
Washington, DC 20506
(202) 395-3350

Overseas Private Investment
Corporation
1615 M St., NW, 4th Floor
Washington, DC 20527
(202) 336-8400

Radio Free Europe/Radio Liberty
Research Institute, US Office
1201 Connecticut Ave., NW
Suite 410
Washington, DC 20036
(202) 457-6907

III. INTERNATIONAL ORGANIZATIONS

Environment Liaison Centre International
P.O. Box 72461
Nairobi, KENYA
(254-2) 562015

Inter-American Development Bank
1300 New York Ave., NW
Washington, DC 29577
(202) 623-1753

International Monetary Fund
700 19th St., NW
Washington, DC 20431
(202) 623-7100

Organization of American States
17th St. and Constitution Ave., NW
Washington, DC 20036
(202) 458-3754

Organization for Economic
Cooperation and Development
2001 L St., NW
Suite 700
Washington, DC 20036-4095
(202) 785-6323

United Nations Association of the U.S.A.
1010 Vermont Ave., NW, Suite 904
Washington, DC 20005
(202) 347-5004

United Nations
2 United Nations Plaza
Room DC2-853, Dept. 421
New York, NY 10017
(212) 963-8302

The World Bank
1818 H St., NW
Washington, DC 20433
(202) 477-1234

IV. JOURNALS

Africa Report
833 United Nations Plaza
New York, NY 10017
(212) 949-5666

TRADE AND COMMODITIES

TRADE AND COMMODITIES

"Trade Central to America's Future in the World," Address of Michael Kantor, United States Trade Representative, before the National Press Club, Washington, DC, May 5, 1993, U.S. Department of State Dispatch, U.S. Department of State, May 17, 1993.

Carroll, Douglas F., Ed. "USTR Announces Actions and Decisions In Three Important Trade Areas," Business America, U.S. Department of Commerce, May 17, 1993.

Remarks of Lawrence H. Summers, Under Secretary of the Treasury for International Affairs, before the Bankers Association for Foreign Trade, Boca Raton, Florida, May 18, 1993, Treasury News, U.S. Department of the Treasury, May 18, 1993.

"Clinton Trade Policy and Latin America," Excerpts of Remarks of Michael Kantor, United States Trade Representative, before the Council of the Americas, Washington, DC, May 4, 1993, Washington Report, Council of the Americas, Summer 1993.

"Clinton on NAFTA," Excerpts from Remarks of President Bill Clinton before the Export-Import Bank Conference, Washington, DC, May 6, 1993, Washington Report, Council of the Americas, Summer 1993.

"Trade and the Environment," Excerpts from an address by GATT Deputy Director-General Charles R. Carlisle to the National Wildlife Federation, January 26, 1993, GATT Focus, General Agreement on Tariffs and Trade (GATT), March 1993.

Lemco, Jonathan and William B.P. Robson, Eds. "Ties Beyond Trade: Labor and Environmental Issues under the NAFTA," Canadian-American Committee, the C.D. Howe Institute and the National Planning Association, 1993.

"The North American Free Trade Agreement," Statement by the Executive Council of the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO), February 17, 1993.

Wilson, Michael G. "NAFTA Update," Mexico Watch, The Heritage Foundation, May 1993.

Stokes, Bruce. "Mexican Roulette," National Journal, May 15, 1993.

Cloud, David. "Court Ruling Jeopardizes Approval of NAFTA," Congressional Quarterly, July 3, 1993.

Michalopoulos, Constantine and David Tarr. "Energizing Trade of the States of the Former USSR," Finance and Development, The World Bank and the International Monetary Fund, March 1993.

Dhesi, Autar S. "The Emerging World Trade System - Some Implications for LDCs," Development, Society for International Development, 1993.

Barfield, Claude E. "Drifting Toward Protection?" On the Issues, American Enterprise Institute (AEI), May 1993.

"Report to Congress Concerning Extension of Waiver Authority for the People's Republic of China," The White House, Office of the Press Secretary, May 28, 1993.

Stokes, Bruce. "Not-So-Favored China," National Journal, May 15, 1993.

Trade Central to America's Future in the World

Michael Kantor, US Trade Representative

Address before the National Press Club, Washington, DC, May 5, 1993

A little over 2 months ago, at American University, President Clinton set forth his vision of America's role in the global economy. It is a vision rooted in the belief that we are at the third great moment of decision in the 20th century.

"Will we repeat the mistakes of the 1920s or the 1930s by turning inward," he asked, "or will we repeat the successes of the 1940s and the 1950s by reaching outward . . . ?" His answer was clear: We will reach outward and adapt to the new global economy. We will compete, not retreat.

Trade is central to the President's vision of America's future in the world. Trade is not an abstract concept. Trade means money in people's pockets. Trade means jobs. Trade means that working men and women in Raleigh, North Carolina, make and sell electrical products for computers in 70 countries. Trade means that a minority-owned company in California exports electromechanical products to five countries. All over this country, trade means that working people can put dinner on the table and support their families.

The benefits of trade are not limited to the United States. As the President went on to declare in his speech at American University, the fabric of commerce will also shape global prosperity: ". . . for now and for the foreseeable future," he added, "the world looks to us to be the engine of global growth and to be the leaders."

We can't live up to the twin tasks of American prosperity and global leadership unless we are competitive. The Clinton Administration is committed to making America competitive. We can only be competitive if trade policy is an integral part of economic policy.

Gone are the days when this nation could subordinate trade concerns to "national security" in the traditional sense of the term. The strategy of containment was appropriate during the Cold War, but it was a static strategy, aimed at halting Soviet expansionism. In those years, we worried about the "doomsday clock"—with hands perilously close to the midnight of nuclear war. For a long time, our strategy was mutually assured destruction.

Today our challenges are dynamic, not static. Economic strength, founded on human resources and nourished by trade, is a pillar of national security in this new Post-Cold War age. Our security interests—and those of others—are inextricably linked to the growth and fairness of the global trading system.

Economic policy begins with the President's domestic economic program. The challenges are enormous. Unemployment is still at 7%. More than 1 in 10 Americans is on food stamps. More than 16 million people are looking for full-time work and having no luck at all.

We must provide American workers with the training they need for good jobs in the industries of the future. We must reduce our structural deficit. We must provide American enterprise with the capital it needs to expand and compete. And we must provide the American economy with the stimulus of a thriving global marketplace.

The goals of the Clinton Administration's trade policy are clear. We want to open more foreign markets. We want to do more business with those whose markets are already open. We want to eliminate trade barriers that are raised against us and others.

We need to build faith in the international trading system. Too many people in the American public think that trade hurts them, that trade may take away their jobs. The truth is the opposite.

The numbers speak for themselves. Every billion dollars of exports creates 20,000 new jobs in the United States. There are now more than 7 million Americans whose weekly paychecks are related to and dependent on merchandise exports alone. A majority of those people work in the manufacturing sector, and they earn almost $3,500 per year more than the average American worker.

And when jobs in the service sector are oriented toward trade, they also provide workers with valuable incentives. The average salary for a service worker in the export field is estimated to be 20% higher than the average service worker's salary.

So trade means the hands of the clock move forward, toward higher wages and better jobs for working Americans. Take Ron Thomason, a materials expediter at Caterpillar's large bulldozer assembly plant in East Peoria, Illinois. He says, "I owe my job to exports." At the IBM facility in Rochester, Minnesota, 200 out of 900 people know that their jobs depend on exports. So do the 18 employees of a process control company in Tucson.

At the same time, we have the largest open market in the world. We take the largest share of exports from developing countries. In four major industries—textiles and apparel, steel, autos, and footwear—the United States imports from 1 to 10 times as much per capita as Japan. With this record, Americans want to be sure that no one is taking advantage of them and that others establish and maintain comparably open markets.

To achieve our trade goals we will use all the negotiating tools at our disposal. We will negotiate multilaterally, regionally, bilaterally, industry by industry. We insist only that foreign governments respect our rights under current and future international agreements. And we will respect theirs. We seek mutuality of obligation and comparability of action—terms that mean real partnership and mutual responsibility.

Americans are sometimes accused of "unilateralism" when we insist on enforcement of agreements. But holding countries to their agreements is the opposite. Enforcement strengthens Americans' support for an open trading system, and it strengthens the credibility of that trading system as well.

We cannot ask businesses and their workers to take the risks of doing business in the global marketplace unless we can guarantee that agreements will be enforced. That is the essence of real partnership and mutual responsibility. These principles are reflected in each of our major trade initiatives.

The Uruguay Round. The Uruguay Round is of primary importance because the General Agreement on Tariffs and Trade—the GATT—remains the foundation of the global trading system. These negotiations are now in their seventh year. To restore momentum, we need to make progress in market access by agreeing to remove the barriers to trade in manufactured goods, services, and agriculture; and we intend to finish the Uruguay Round by December 15.

Some are waiting for the US and the EC to show leadership in this area before making their own contributions. For our part, we and the European Community have accepted responsibility and have agreed to aim for an outline on market access. We will only be successful, however, if others—like Japan and the developing countries—are full participants.

Recent events indicate that we can work together with the European Community and move forward to complete the round. Last January, the EC unilaterally imposed community-wide requirements on government procurement that discriminated against non-European providers. There seemed no alternative but to impose sanctions under our law. Last month, after 2 days of intense talks, the United States and the EC reached agreement to open up a major segment of that procurement market to both sides. The EC will remove the discrimination against US suppliers of heavy electrical equipment. The United States will remove "buy America" preferences on certain federal power administrations, including the Tennessee Valley Authority. We will continue to negotiate on remaining barriers even as we are imposing sanctions for failure to open the telecommunications market.

The North American Free Trade Agreement. The North American Free Trade Agreement is a second key link in the trade and economy chain. In response to the lowering of trade barriers in Canada and Mexico and in anticipation of NAFTA, trade and jobs are on the rise. Exports to Canada already support an estimated 1.5 million US jobs. Export jobs related to Mexico have grown from 300,000 to 700,000 over the last 5 years, with another 200,000 predicted by 1995 if NAFTA with the supplemental agreements is implemented. These jobs pay about 12% more than the national average. And for 38 of the 50 states, Mexico is one of the top 10 customers. Five of the ten states selling the most to Mexico are northern industrial states. Without NAFTA, the United States will be unable to lock in and extend these gains.

The current negotiations are addressing several key areas: border cleanup; commissions on labor and environment, with provisions for enforcement; import surges; stronger enforcement of national laws; and promoting higher wages and productivity. In addition, the agreement we send to Congress will ensure that there is adequate adjustment assistance for workers.

Looking beyond NAFTA, we see good prospects for additional trade agreements with successful market-oriented economies throughout the Americas, beginning with Chile. The combination of political and economic reform in this region is breathtaking. US exports to the region are expanding at a rate that is three times the rate of export growth to the world as a whole.

The Pacific Rim. A high-priority area for this Administration is the Pacific Rim. We want to serve as a catalyst connecting the Pacific Rim and the Americas, the two most dynamic regions in the world today. In 1960, the nations of the Pacific accounted for 8.9% of the world's gross national product. By the year 2000, the figure will be nearly 26%. Forty percent of current US international trade is with the Pacific Basin. Last year, trade across the Pacific exceeded trans-Atlantic trade by 50%.

This year, the United States is chairing the Asia-Pacific Economic Cooperation forum, known as APEC. Our hope is that APEC will provide the framework for expanded trade and an increased investment flow throughout the region. We intend to work with our Asian partners to further these goals.

When the United States looks to the Pacific, we think first of Japan. There is no single country more important to our long-term interests. For well over a century now, history has bound our two nations closely together. We have been adversaries and allies. Today, our alliance is fundamental. Our common interests and our common challenges are extensive. That's why the issues that divide us must be openly acknowledged; squarely faced; and, ultimately, resolved.

We are now seeking to remove restrictions on access to Japan's construction and supercomputer markets. These are but two examples of deep-rooted political, social, and commercial practices and attitudes that gravely distort the workings of a free and open international trading system. When Prime Minister Miyazawa visited Washington last month, President Clinton made it clear that the time has come for Japan to take more substantial steps to open its market and play a leadership role commensurate with its economic strength. But we need to make concrete, measurable progress on a number of sectoral and structural issues. Japan and the United States have agreed to identify specific areas for bilateral negotiation when the Tokyo economic summit convenes in July of this year.

The purposes of our trade policies and actions are the same: to open markets and create trade opportunities and, in so doing, to boost the global economy; strengthen the international trading system; and, above all, ensure that American workers and American companies are and will remain competitive. Trade is not a zero-sum game; it is an engine of growth. This Administration will link all the resources at our disposal to achieve these goals. Whatever programs we have—export promotion, export finance, trade-related assistance—are tools of a comprehensive trade promotion strategy.

Fact Sheet: US National Interests and Cooperation With Mexico

For more than 200 years, the United States and Mexico have shared a continent but not a vision of the future. In the past 10 years, that has changed dramatically, as US and Mexican political, social, and economic leaders have realized that cooperation on a wide range of issues —from economic growth, to the environment, to narcotics control—benefit both countries.

Consequently, managing the bilateral relationship across the 2,000-mile border will be a critical US security challenge in the 21st century. With Mexico, the US Government has been working to address mutual concerns and will need to expand such efforts in the years ahead. Key to this cooperation will be the North American Free Trade Agreement (NAFTA).

Mexico's Importance To the US Economy

Mexico has become one of the most open, market-oriented developing countries in the world. In the Western Hemisphere, it has become an economic model for countries within the region and in Central and Eastern Europe. Recent Mexican economic reforms include reducing barriers to trade and foreign investment, privatizing most state enterprises, and improving legal protection for firms doing business in Mexico.

These reforms have spurred Mexican economic growth and benefited the United States. Mexico is the third-largest US trading partner and its fastest-growing major export market. US exports to Mexico have more than tripled, from $12.3 billion in 1986 to $40.6 billion in 1992. Furthermore, the United States had a $5.4-billion trade surplus with Mexico in 1992.

Mexico recently overtook Japan as the United States' second-largest export market for manufactured goods. Seventy cents of every $1.00 that Mexico spends for foreign products is spent on those from the United States. Under NAFTA, the remaining Mexican trade barriers will be removed, creating new export opportunities for US firms. This also will increase US employment: Every $1 billion of US exports to Mexico creates almost 20,000 jobs in America.

Continued from previous page

The trading system and its supporting institutions must adapt to the realities of the new global economy. We will need new assumptions—a whole new set of attitudes on the part of the United States and its trading partners. The fundamental fact is that the globalization of production and markets has changed the nature of international competition. Self-sufficiency is not realistic. "Imported" goods are no longer entirely produced in the exporting country; domestic production is often involved. Trade and investment are closely intertwined.

Similarly, domestic policies and regulations have become as important to the future of trade as trade measures adopted at the border. Domestic policies have become major competitive factors in world trade. Governments are competing to create high-wage, high-skill jobs through a variety of domestic measures. These new realities dictate the need to address the environment, technology, and competition policies. Each of them is interrelated with trade, and each challenges our trade institutions to be more creative, open, and flexible. Addressing them and other trade issues will require change.

The United States has always been willing to change. We embrace change, thrive on change, and depend on change. As the President has said, we must make change our friend. After World War I, we raised trade barriers, with disastrous results. After World War II, we lowered tariffs and built global institutions to expand trade and investment even as we held communism to a standstill.

The end of the Cold War is the third decisive moment in this century. We have a chance to build a new future and to make it the brightest and most enduring of all. Instead of a doomsday clock, with hands pointing toward a nuclear midnight, we want a "growth clock," with hands pointing toward noon. Instead of mutually assured destruction, we will strive for mutually assured growth. Together, we need to summon up a small portion of the wisdom, vision, courage, and sense of joint mission that our parents showed when confronted with the daunting task of defeating fascism, containing communism, and rebuilding the postwar world. I believe we are up to the challenge. ■

15

USTR Announces Actions and Decisions In Three Important Trade Areas

U.S. Trade Representative Mickey Kantor on April 30 announced decisions and initiated actions in three important trade areas: Title VII/discrimination in foreign government procurement; the initiation of a review of Japan's compliance with the provisions of the U.S.-Japan Supercomputer Agreement; and special 301/protection of intellectual property rights.

"Since assuming my responsibilities as USTR, I have repeatedly expressed my commitment to enforcing the law as Congress has written it, and insuring that our trading partners adhere to those agreements that they enter into with us," Kantor noted.

"Enforcing the law and holding countries to their agreements are crucial in several respects: to opening foreign markets to U.S. manufactured goods, agricultural products, and services; to building support here in the United States for an open trading system; and ultimately, to confidence in, and the credibility of, the trading system."

Title VII. The USTR identified Japan under Title VII provisions of the 1988 Omnibus Trade and Competitiveness Act, which calls for the identification of countries that discriminate against U.S. firms in their government procurement practices. Identification under this statute requires that negotiations to end the discrimination be initiated immediately and, absent resolution, provides for sanctions, subject to Presidential discretion.

Under Title VII, Japan was cited for discrimination in procurement of construction, architectural, and engineering services. Kantor continued the identification of the European Community on the outstanding dispute on telecommunications equipment; see box on page 11 on EC's agreement to waive discriminatory provisions on the procurement of heavy electrical equipment. He also noted procurement practices of concern in Australia, China, and Japan.

Supercomputer Review. Because of grave U.S. government concern that Japan may not be adhering to the terms of the U.S.-Japan Supercomputer Agreement, Kantor announced that USTR will undertake a special review of Japanese actions under the Agreement under section 306 of the 1974 Trade Act. Based upon this review and the conduct and outcome of procurements scheduled in the coming months, USTR will determine whether or not Japan is in compliance with the terms of the Agreement. If USTR determines that Japan is not in compliance, it will initiate trade action against Japan under section 301.

Special 301. Kantor identified Brazil, India, and Thailand as "priority foreign countries" under the "special 301" provisions of the Trade Act of 1974. These countries deny adequate and effective protection for U.S. intellectual property, such as patents, trademarks and copyrights, or fair and equitable market access for relevant U.S. products.

Kantor also announced placement of 10 trading partners on the "priority watch list." In a departure from previous practice, Kantor stated that the Administration will take new steps to resolve outstanding intellectual property rights problems by: initiating "immediate action plans" for Hungary and Taiwan; conducting "out-of-cycle" reviews for Korea, Argentina, Egypt, Poland, and Turkey; and intensifying consultations with Australia, the European Community, and Saudi Arabia. He also announced that 17 other countries had been placed on the "watch list."

Significant progress has already occurred this year as 10 countries have enacted new copyright, patent, or trademark legislation, or strengthened their existing legislation, since January, Kantor noted. These nations are Switzerland, Taiwan, Colombia, Canada, China, Greece, Malta, Cyprus, and Jamaica, and the most recent addition, Russia, which adopted a copyright law recently.

"These actions show a growing commitment to intellectual property protection around the world, which we believe will contribute to a strong intellectual property text in the Uruguay Round, and the successful completion of the Round itself," Kantor stated.

The new steps announced April 30 include a promise of a strong, speedy response for countries that fail to meet commitments, a determination to gain from U.S. trading partners a high level of protection, a vow to pay special attention to countries that do not enforce their laws and a pledge to initiate "immediate action plans" to make sure that countries do not take up permanent residence on the "special 301" lists.

Kantor declared that USTR will conduct "out-of-cycle" reviews, including deadlines and benchmarks for evaluating a country's performance, to address problems of slow legislative progress or erratic enforcement efforts. Kantor stressed the fact that the 1974 Trade Act permits the USTR to make additional identifications at any time that the facts warrant.

Background on Special 301: The USTR stressed that he was committed to giving a fresh direction to the "special 301" review process to ensure that the Administration's objectives are clear and that other countries know what we expect. "Any partner that fails to meet its commitments," Kantor said, "can expect a strong, speedy response from this Administration." Kantor

16

added, "I am determined to ensure that foreign countries provide high levels of protection because I want to make sure that we solve particular problems brought to our attention by the U.S. intellectual property community."

Kantor emphasized that it is critical that foreign governments enforce laws that they have already enacted. "Countries that do not enforce their laws can expect to receive special attention under "special 301," Kantor went on to note. "Moreover, the United States will not tolerate countries that are exporters of pirate and counterfeit goods."

"In the past, rather than steady progress we have seen an annual springtime flurry of enforcement actions," Kantor said, and he vowed to not let this continue. "Countries must make sustained progress in addressing the problem issues." To address these problems, Kantor announced that his staff, working with an interagency team of government experts, will initiate "immediate action plans" that will include deadlines and benchmarks for evaluating a country's performance.

"I am determined to enforce these deadlines and take action, if necessary, through out-of-cycle reviews of a country's status under "special 301."

Special 301 Announcements. USTR announced the following steps under "special 301":

"Priority foreign countries:

- The Administration will determine whether to initiate an investigation of Brazilian practices and will announce its decisions on or before May 30.
- Regarding India, Kantor has instructed an interagency task force to explore future actions.
- The Administration is meeting with Thai officials on intellectual property rights issues; at the same time, the interagency task force is exploring future actions, including options for appropriate retaliation.

"Priority watch list" countries:

- On Aug. 1, the Administration will decide whether Hungary and Taiwan have met the objectives of "immediate action plans." If it is determined that these objectives have not been met, the Administration will reclassify Hungary and Taiwan under "special 301" and decide what further action is appropriate.
- The Administration also announced that "out-of-cycle" reviews would be conducted with the following countries:

—*Argentina:* the United States is seeking prompt enactment of satisfactory industry property legislation.

—*Egypt:* The United States is seeking enactment of an amended patient law that provides adequate protection for pharmaceutical products.

—*Korea:* The United States is seeking improved and sustained enforcement of intellectual property laws to deter piracy of products like computer software, compact discs, and video and sound recordings and counterfeiting of trademarks on U.S. products (such as footwear and cosmetics).

—*Poland:* The United States is seeking prompt enactment of copyright and antipiracy laws, as well as improved enforcement.

—*Turkey:* The United States is seeking enactment of patent, copyright and related laws that provide effective protection.

- The Administration also placed three additional trading partners on the "priority watch list"; these are Australia, the European Community, and Saudi Arabia.

"Watch list countries":

- The Administration also announced that "out-of-cycle" reviews would be conducted with the following countries:

—*Cyprus:* The United States is seeking the lifting of the suspension of criminal penalties for copyright violations.

—*Italy:* The United States is seeking sustained enforcement of copyright laws, introduction of legislation to increase penalties and other actions to deter piracy.

—*Pakistan:* The United States is seeking effective action against trademark and copyright violations (particularly regarding textile designs).

—*Spain:* The United States is seeking elimination of market access restrictions affecting motion pictures.

—*Venezuela:* The United States is seeking fulfillment of commitments to improve patent and copyright laws.

- The Administration placed 12 other trading partners on the "watch list."

The USTR commended the progress that Greece made during the course of the past 12 months in enacting a modern copyright law, and announced the removal from the "watch list" of three countries: Canada, Germany, and Paraguay.

Background on Title VII. Title VII of the 1988 Trade Act directs the Administration to identify, in an annual report to Congress, foreign countries that are discriminating, as defined by the statute, against U.S. goods or services in their government procurement practices.

In addition to the actions involving Japan and the EC, Kantor expressed concern with specific procurement practices in the following areas:

- Australia maintains a restricted-membership, preselected "Information Systems Panel" for all federal procurements of information systems technology. The criteria for membership on this panel may include local investment and the ability to export from Australia.
- China's procurement practices remain, for the most part, secretive and inaccessible to foreign suppliers. However, China has committed to increase the transparency of its trade system by publishing rules and regulations related to trade. The changes are due to be implemented in the fall of 1993.
- The United States has continu-

ing concerns with Japanese procurement practices in the supercomputer, computer, and telecommunications sectors.

- The USTR will undertake a special review of the Japanese government's behavior under the 1990 Supercomputer Agreement and will scrutinize its conduct of upcoming supercomputer procurements.
- U.S. concerns in the computer area involve the inability of the United States and Japan to implement a statistical monitoring system to evaluate progress in the bilateral Computer Agreement. The United States is addressing the problem in a review mechanism provided for in the agreement.
- U.S. businesses have expressed frustration with the lack of opportunities outside of the NTT Agreement in the Japanese telecommunications market. The United States will continue to address these issues bilaterally.
- The United States is also concerned that a variety of countries have entered into trade or economic agreements with the European Community that require or might in the future require those countries to adopt the discriminatory provisions of the EC's *Utilities Directive*. The United States intends to monitor their actions over the coming year and review the situation in an annual Title VII review next year.

Background on Supercomputer Review. "U.S. supercomputer manufacturers are the most competitive in the world, yet they continue to be effectively shut out of the Japanese government supercomputer market," Kantor said.

Over the coming months, the Japanese government is scheduled to procure a number of supercomputers. Under section 306 of the Trade Act of 1974, USTR will undertake a comprehensive review of Japanese government behavior under the Agreement thus far and will closely scrutinize each of the upcoming procurements. If USTR determines that Japan is not in compliance, it will initiate trade action against Japan under section 301.

Over the coming months, the Japanese government is scheduled to procure a number of supercomputers. Under section 306 of the Trade Act of 1974, USTR will undertake a comprehensive review of Japanese government behavior under the Agreement thus far and will closely scrutinize each of the upcoming procurements.

"The 1990 Supercomputer Agreement obligates Japan to provide a fair and open government procurement market for supercomputers," Kantor stated. "We are determined to ensure that Japan treats our companies fairly and complies with its obligations under the Agreement." Kantor added,"We are taking this action with a view toward ensuring that, in the years ahead, the Japanese government market is fully open to new and emerging supercomputer technologies in which U.S. manufacturers have a decided lead."

Secretary Sees Progress On U.S.-EC Trade Issues

Secretary of Commerce Ronald H. Brown told the Conference on Washington and World Business, April 30, that progress is being made in ironing out areas of friction in the U.S.-European Community commercial relationship.

In a speech to the conference, sponsored by the European Council of American Chambers of Commerce in Washington, D.C., Brown noted that the United States is the EC's largest foreign supplier, exporting $103 billion to the EC last year. He also noted that sales by U.S. subsidiaries in the EC market and by EC subsidiaries operating in the U.S. market are estimated at well over $500 billion annually, accounting for an important part of each trading partner's gross domestic product.

"Of course, no relationship of that size and complexity will be without problems," the Secretary said. "These problems should not be ignored or 'managed'—they need to be addressed fairly."

Brown cited two points of friction in U.S.-EC relations: EC airbus subsidies and government procurement.

"Through enforcement of the 1992 U.S.-EC Airbus Agreement and its disciplines on government supports, we are working to ensure the competitiveness of our aircraft industry," the Secretary said. "We remain committed to the Airbus Agreement as a good starting point. But we must go further to limit government supports for the aircraft industry. We support stronger multilateral disciplines in the renegotiation of the 1979 GATT Agreement on Trade in Civil Aircraft."

The Secretary said that progress is being made on procurement. He noted that the United States and EC recently reached a partial agreement to remove the discriminatory provision of the EC's utilities directive which went into effect last Jan. 1. The directive, which covers private and public procurement of heavy electrical and telecommunications equipment, prevents U.S. exporters from selling telecommunications switches, steam turbines, and large power transformers in Europe. Meanwhile, EC companies freely sell their telecommunications switches and large power equipment in the United States.

On April 21, the EC Commission, negotiating with the U.S. Trade Representative, agreed to waive the discriminatory provisions of the EC's utilities directive for the procurement of heavy electrical equipment. (*The agreement was ratified May 10 by the EC Council of Ministers.*) The EC action opens to U.S. firms a market valued at $20 billion. For its part, the U.S. government will remove "Buy America" provisions for the Tennessee Valley Authority and the five federal power administrations of the Department of Energy. However, since the EC did not lift the discriminatory provisions against U.S. suppliers of telecommunications equipment, the United States will implement limited sanctions prohibiting EC suppliers from participating in certain U.S. government tenders.

TREASURY NEWS

Department of the Treasury Washington, D.C. Telephone 202-622-296

AS PREPARED FOR DELIVERY
FOR IMMEDIATE RELEASE
MAY 18, 1993

REMARKS OF LAWRENCE H. SUMMERS
UNDER SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE BANKERS ASSOCIATION FOR FOREIGN TRADE
BOCA RATON, FLORIDA

Let me begin by thanking the Bankers Association for Foreign Trade, its Executive Director, Mary Condeelis and the General Counsel, Tom Farmer for inviting me to speak at your Conference.

President Clinton has committed his Administration to a policy of engaged, enlightened and hard-headed economic internationalism to go along with his program of domestic renewal. We are living in an era of increasing global economic interdependence, where national economies are interconnected as never before, and domestic and foreign policies are inextricably linked. The nations of the world have the opportunity to grow and prosper together -- or stagnate and scapegoat apart.

Four Critical Challenges

Let me outline four critical policy challenges that confront the U.S. in its relationship with the international community.

First, the Administration is determined to reinvigorate macroeconomic coordination with our G-7 partners to spur economic growth. We are in the third year of sub-par growth and the prospects for sustained recovery are by no means certain. The U.S. is experiencing a modest recovery but with inadequate job creation. Growth in Europe is weak, unemployment high and recovery still in the distance. Japan is expected to grow only 1.3 percent this year, despite the stimulus program. Its trade surplus continues to grow and serves as a drag on the rest of the world.

U.S. efforts to revive the G-7 economic policy coordination process are making progress, but more has yet to be done. The President has offered a credible plan to reduce the budget deficit and improve domestic savings and investment. The markets, which are the most critical judge, have responded positively with a substantial decline in long-term interest rates. Some have suggested that the decline reflects a weak economy. However, forecasts for the economy are up, the stock market has increased and credit quality spreads have narrowed. This indicates that the decline in interest rates is due to greater confidence in deficit reduction and not to the weaker economy.

This program has brought us new credibility in the international economic arena; it has strengthened our hand in encouraging our major trading partners to take complementary actions to strengthen growth in their own countries. Our G-7 partners have begun to take the necessary steps to spur growth. The Japanese fiscal stimulus package is a useful step, but needs to be sustained and followed-up in the context of the fiscal 1994 budget to protect against renewed slippage as occurred in last year's budget. European interest rates have come down but the pace needs to quicken in the face of the current recession.

The major challenge facing the G-7 is to restore growth and to ensure that the composition of growth in the U.S. and its major trading partners contributes to reductions in external imbalances. The policies we pursue must reflect the specific conditions in each of our economies and our own national interests. Fortunately, where economic growth is concerned, national imperatives and international interests increasingly coincide. It is vital to all that international economic growth be increased.

Second, the United States must do all we can to ensure that Russia's democratic and economic reform program meets with success. History teaches several lessons. First, democracies do not wage war against each other; it is in the interests of all to support the democratic reforms in Russia. Second, democracies cannot survive hyperinflation; unless Russia's leaders can reassert macroeconomic discipline, the country could go the way of Weimar Germany or the Latin American countries during military rule. Third, democracies and free markets go hand in hand; both require a legal framework that respects personal freedom, individual initiatives and private property.

The adoption of these democratic and economic reforms must be supported by the U.S. and our allies. In cooperation with our allies, the Clinton Administration is fully engaged in developing and implementing an effective assistance package for Russia and the other states of the former Soviet Union. The task of rebuilding the Russian economy is without doubt the greatest restructuring job since the Marshall Plan.

<u>Third</u>, the United States must work to support sustainable and environmentally responsible development in the less developed world. Much has been accomplished in East Asia and Latin America in recent years, as evidenced by renewed private capital flows and improved growth. Economic reform and commercial bank debt reduction efforts have yielded success. The developing world represents the fastest growing market for U.S. exports.

At the same time, we must recognize that the future of developing countries lies with their entrepreneurs and not with the diminishing pool of foreign aid. Infrastructure development, global growth and open markets are essential to creating new opportunities for economic growth in the developing world. These efforts must be financed with the help of private sector financial institutions. Your creativity and ingenuity are needed in the developing world, as well as in Russia and the other states of the former Soviet Union.

This brings me to the <u>fourth</u> and final critical challenge. Our efforts to achieve stronger world growth and economic reform requires further opening for international trade and investment. In particular, U.S. efforts to reduce our budget and trade deficits can succeed only in the context of a world economy that is growing and markets that are open to our exports of goods and services.

The U.S. historically has supported open markets and free trade. As the world's largest and strongest economy after the Second World War, we opened our markets and promoted a multilateral framework to promote a liberal trade and investment system. These policies served the interests of <u>all</u> nations, including our own. Over the succeeding four decades, the world has changed. Other countries, which have benefitted from an open trading system, must now do more to catch up by opening their markets to create a level playing field. The world can no longer afford "free riders".

The recent debate over trade policies is often presented in terms of two stark alternatives. One group advocates what might be called a "naive" free trade policy designed to benefit consumers through lower prices and greater choice based on comparative advantage. They fail to recognize, however, that comparative advantage is created, not inherited, and that nations have an interest in promoting key industries and that they need to be able to act to deter others from erecting trade barriers. The other camp, the so-called protectionists, view imports as a threat to domestic industry without considering the cost to consumers or the benefits of competition.

There is a third way, which can be labeled the "export activist" perspective. This view recognizes that we cannot have imports without exports, or exports without imports. As the President stated in his American University speech, "we must compete, not retreat."

It is for this reason that the Administration is giving a high priority to three critical issues.

- o First, we are moving quickly to conclude the Uruguay Round in the belief that a successful negotiation will strengthen the multilateral trading system, stimulate world growth and provide more open markets for U.S. exports and the high paying jobs they support.

- o Second, we need to finalize NAFTA by concluding the supplemental agreements on the environment and labor in time to implement the Agreement by January 1, 1994. Mexico is a rapidly growing market for U.S. exports which has more than tripled since 1986. NAFTA will ensure that the Mexican market stays open to us and that Mexico continues to grow and prosper.

- o Third, we are pressing Japan to undertake a larger share of the burden of external adjustment by promoting domestic demand-led growth and undertaking structural and sectoral reforms to open its markets to foreign goods and services.

Foreign Competition in Financial Services is Welcome

Events of recent years demonstrate that a strong financial system and a healthy economy go hand in hand. The high interest rates and slow growth of the past recession contributed to the real estate collapse that undermined the position of U.S. banks. The need for the banks to restore their financial health has been an important element in the slow pace of our recovery. This situation is not unique to the United States but is also evident in the boom and bust of Japan's bubble economy and the situation in the United Kingdom.

We at Treasury recognize the key role of market access to the financial sector. The integration of the world economy has proceeded more rapidly in the financial area than in any other sector. Technological changes, innovations, market liberalization and global integration have fundamentally altered the face of financial services in the United States and abroad. They have reduced the relevance of geographical space in all businesses -- the world is smaller -- but in no business have these developments been more pronounced than financial services. And if I may quote Joseph Schumacher, "small is beautiful."

The influences of internationalization are strikingly evident in the U.S. banking market. Let me cite several statistics:

- o As of December 1992, nearly 700 foreign bank offices representing 300 bank families from 61 countries, were active in the United States.

22

- Foreign bank business loans account for more than one-third of all U.S. business loans; in New York and California, they now account for more than half of the market.

Foreign competition in the U.S. banking and financial services market provides extensive benefits to consumers, investors and domestic banks in the domestic economy:

-- consumers can borrow more for mortgages and at lower interest rates;

-- more than 200,000 jobs and nearly $11 billion in additional expenditures have been attributed to the activities of foreign banks in the U.S. markets.

Opening of foreign markets to U.S. financial firms similarly provides economic benefits to our economy. Open international financial markets provide opportunities for U.S. banks to demonstrate their technological advantages in many products, including derivatives, syndicated loans and securitization. Furthermore, these markets permit U.S. banks to diversify geographically their asset portfolio. Finally, the effects of the comparative advantages enjoyed by our financial firms help offset the U.S. merchandise trade deficit. A strong financial system may begin at home, but to the extent that foreign activities augment their performance, our economic system benefits.

The debate on market access in financial services is quite similar to the debate on trade in goods. Some argue we must preserve the traditional U.S. policy of unconditional national treatment regardless of how other countries behave. Others call for wholesale discrimination against foreign financial institutions to keep the domestic financial system in American hands. Both approaches would throw the baby out with the bath water.

A third way can be labeled the "market access activist" view which seeks to open financial markets abroad to U.S. firms, just as foreign financial firms have access to our market. Secretary Bentsen expressed this view when he voiced concern during his confirmation hearings that some foreign countries still do not give U.S. banks and securities firms a fair opportunity to compete in their financial markets.

How to Get From Here to There?

This Administration is committed to promoting the interest of U.S. financial institutions in foreign markets. Our firms are world-class competitors. They will succeed where given the opportunity to compete. Treasury's approach will be pragmatic and consists of three components; multilateral, regional and bilateral. Each has an appropriate role to play.

In seeking increased market access and national treatment for U.S. financial firms, we must be mindful that regulatory regimes and international differences in prudential standards require that our approach to financial services negotiations must differ from negotiations to remove barriers to trade in goods. Regulations are justifiable on prudential or systemic stability grounds; they should not be used to impede access by more competitive foreign financial firms. Nevertheless, there is clear scope to achieve improved market access in many countries and we must pursue this effort through multilateral and bilateral negotiations.

The Uruguay Round negotiations are now coming to a critical stage with a major effort underway to reach agreement on market access issues among the G-7 countries by the time of the Tokyo Summit. Our efforts in financial services, however, have been hampered by the nature of the Uruguay Round. Thus, the most favored nation (MFN) provision included in the Dunkel text requires countries that have open financial markets to extend these benefits to all countries, even those with closed markets. It provides little incentive for countries with significant barriers to market access to liberalize.

It is for this reason that the U.S. has taken an MFN exemption in financial services and it is our intention to retain that position unless and until others undertake significant liberalization that will provide meaningful market access for our financial firms.

In Latin America, the United States has made progress in obtaining increased market access. NAFTA represents a significant step forward that will permit U.S. firms to establish in Mexico for the first time in 50 years, enjoy full national treatment and equality of competitive opportunity after a short transition, and provide an effective dispute settlement mechanism in the hands of financial experts. The agreement is not perfect and there is scope for future improvement, particularly in the areas of direct branching and cross-border provision of services. However, the chapter provides real competitive benefits and opportunities which, of course, can only be realized when the Agreement is approved by Congress.

It is our hope that the approach to financial market liberalization embodied in NAFTA be extended to other countries in Latin America. Unfortunately, too many countries in the region continue to deny market access and equality of competitive opportunities to U.S. financial firms. Negotiations with these countries will continue.

Outside Latin America, we are engaged in intensive bilateral negotiations with Asian countries. As you know, we have been engaged in Yen-Dollar discussions with Japan for more than a decade. Some progress has been achieved, but it has slowed in recent years as concerns about the fragility of the financial sector have become paramount. Prudential and safety and soundness considerations should not be abused in order to discriminate or to protect domestic firms from foreign competition. As the second largest economy and key financial center, the time has come for Japan to do its part to help achieve a successful Uruguay Round by liberalizing access to the financial market in such areas as banking, corporate underwriting, asset management and cross-border.

During their meeting last month, President Clinton and Prime Minister Miyazawa agreed to develop a new framework for dealing with structural and sectoral issues affecting our trade relations. Intensive work is now underway with a view to having the new framework agreed by the Tokyo Summit. I am confident that, however the framework emerges, we will be in a position to address issues of financial services with new energy and directed at measurable results.

Conclusion

Our financial firms do not ask for special treatment or for protection but simply that they be permitted to meet the competition head to head. Our financial firms are steeled by the growth in foreign competition in our own market. Our market is so open and competitive that, to paraphrase Frank Sinatra, if our firms can make it here, they can make it anywhere.

The policies of the past may no longer be appropriate for the realities of today. A trade strategy based on market access activism may require new tools. The U. S. recognizes the benefit of an open trading system and is prepared to compete, not retreat. However, we insist that the playing field be level and that we have access to others' markets as they have to ours.

Thank you.

* * *

15

CLINTON TRADE POLICY AND LATIN AMERICA

Michael Kantor
United States Trade Representative

There follow excerpts of remarks before the Council's Twenty-third Annual Washington Conference, Washington, D.C., May 4, 1993.

Let me recognize three people who are critical to this organization, and also provided such leadership over the years not only in terms of the Americas but in terms of opening world markets, expanding trade, and doing all the things we need to do to grow this economy as well as make trade a viable part of the interaction between nations: David Rockefeller and John Avery and George Landau — I thank all three of you for all the help you have given past administrations and this administration, and all the help you've given me personally. And I appreciate that very, very much.

This is a great opportunity for me and this administration to be here today. All of you are critically important for what we are trying to do with Canada and Mexico in terms of creating the world's largest free trade area.

The nations of the Americas have a central place in the president's vision of global growth. United States exports to the region are expanding at three times the rate of exports to the world as a whole. Passage of NAFTA is a clear first test of our collective ability to realize the promise of the Americas.

We intend to finish the NAFTA supplement negotiations this summer. We intend to take the NAFTA to the Congress with implementing legislation. We intend to meet the January 1, 1994, deadline for the implementation of NAFTA. We will not open the text of the NAFTA for renegotiation. We will have a NAFTA by January 1, 1994.

We're optimistic about NAFTA because it is so clear that expanded trade means jobs. Let me give you an example. Export jobs related to Mexico have grown from 300,000 to 700,000 in the last five years. It is estimated the next two years, with NAFTA and with the supplemental agreements, we'll grow from 700,000 export jobs directly related to Mexico, to 900,000 jobs.

Frankly, this agreement is not only in the best interest of Mexico and Canada; it is in the best interests of the United States of America. Without the NAFTA, that 900,000 gain in U.S. jobs would turn quickly into 500,000 jobs. Frankly, there are 400,000 jobs at stake. If we don't get the NAFTA and these supplemental agreements, those exports jobs will be lost; investment will leave Mexico, and this growing consumer market will be lost to U.S. businesses. And we will pay with 400,000 jobs, something we can't afford to see happen.

We are working intensely to create supplementary agreements to the NAFTA that deal with labor rights, and protecting the environment. These are not just the concern of the Congress. They also reflect President Clinton's belief that the original agreement simply had too many serious omissions.

Let me run down the six major tenets of these supplemental agreements and of other matters that we must address before we send the NAFTA to the Congress.

- First of all, one that is unilateral to the United States: we must have an adjustment assistance program for American workers who will be dislocated. There will be some dislocations in this economy — they'll be small, they'll be localized, and they can be dealt with. But we are going to have to deal with this as a country as a whole and we're going to have to work with the Congress to get it done.
- Second, we must have border cleanup. The chief problem is how we're going to fund it.
- Third, we need to make sure that the same kinds of reforms the Mexican government has already agreed to with regard to intellectual property rights are applied to worker standards and the environment as well.
- Fourth, we should make sure that we strengthen the safeguards against import surges. Sections 801 and 802 protect against surges of imports which disrupts either employment or any particular industry. We're going to try to add some strength to those agreements with these supplementary agreements.

- Fifth, we are going to try to promote wages tied to productivity.
- Last, we are going to try to establish two commissions; one on worker standards and safety, the other on the environment. And we will have teeth at the end of this process. What does that mean? We're going to have to have some enforcement powers that don't do two things: one, tread on the sovereignty of any nation, and two, don't exercise supranational powers.

These supplementary agreements do not agree in and of themselves that NAFTA will have smooth sailing when it reaches the floor of the House and the Senate. There must be an active political constituency making a case for NAFTA.

Put simply, momentum does not happen by chance. Earlier this month, I met with your honorary chairperson, David Rockefeller. In that meeting he indicated **the strong support of the Council for the agreement. Your support for NAFTA, your willingness to make a strong case for its passage is needed at this critical juncture.**

Congress needs to know what NAFTA means in terms of jobs, investment and direct benefits to the American people. The message must be clear and simple: export, create high-wage, high skill jobs.

NAFTA should also be seen as a way to strengthen our ability to compete in the global market place. If the United States does nothing to compete as the EC gains market strength and Japan reaches out to its Asian neighbors, we will surely find ourselves at a competitive disadvantage.

NAFTA, then, represents a clear opportunity for the United States to strengthen its overall competitive position in the global economy.

"...we will proceed by expanding the NAFTA through accession or bilateral agreements to countries of Central and South America."

Let us also keep very much in mind the importance of passage of the NAFTA to the rest of Latin America and our longer-term effort to expand U.S. exports and trade in the Americas. President Clinton has already indicated his support for additional free trade agreements for successful market-oriented economies in the region.

Our efforts to secure these new agreements will come into play once NAFTA and the Uruguay Round are successfully concluded this year, and in the context of the administration's global trade policy.

Specifically, how we address the task of opening markets in the Americas is still to be decided. I am fully aware of Latin America's interest in and support for continued U.S. engagement in the region on trade and investment issues. I'm also cognizant of the U.S. private sector's view on the Americas.

We intend to remain engaged. Our overall policy towards Latin America and the Caribbean is clear: we will proceed by expanding the NAFTA through accession or bilateral agreements to countries of Central and South America. We will seek a separate fast track mechanism for trade agreements in addition to our request pertaining to the Uruguay Round.

Furthermore, the administration is committed to a free trade agreement with Chile and is interested in additional agreements with other economies in the region. Every effort should be made to create stepping stones that will eventually lead to free trade agreements with other Latin American countries. We are open to additional mini-agreements, for lack of a better term, that are consistent with GATT rules. We're prepared for example, to pursue bilateral investment treaties and bilateral intellectual property agreements.

The efforts by countries of the region to lower barriers among themselves is extremely important. We strongly encourage continuing efforts at GATT-consistent regional integration.

All of these efforts should be seen as stepping stones toward the larger goal of hemispheric free trade. Working together, we can unleash the tremendous potential for jobs, trade and investment throughout the Americas. This will fuel the growth of jobs and a growth of businesses and investment in the Untied States, and allow us to pursue our market-opening ambitions not only in South America and in the Americas, but also to provide the hub between the two fastest-growing regions in the world, Asia and the Americas.

Question and Answer Session

Q: Ambassador Kantor, your talk today is very clear, very specific, yet a lot of what we read in the newspaper doesn't seem to come across the way you came across today. Can you comment on that and why the press reports things a little distorted?

AMBASSADOR KANTOR: I think the press does a good job in reporting on this.

This administration's position on this issue, the NAFTA and the supplemental agreements, is absolutely clear. Since October 4, 1992, our position on this issue has not changed one iota.

Q: Would you consider the possibility of negotiating a free trade agreement with subregional groups such as the Andean Pact?

AMBASSADOR KANTOR: We would consider that. We've not really reached that discussion, to be frank. The President has already supported the accession of Chile to the NAFTA as soon as possible after it goes into effect.

Obviously, Argentina and Venezuela would be proper subjects for discussions after Chile. But we have not talked specifically about Andean Pact countries.

Q: Mr. Ambassador, could you comment, sir, on the state of congestion in the Congress that we will experience this coming fall with the number of major proposals which seem to be headed for decisions in that time period?

AMBASSADOR KANTOR: We hope that by the time we get to the fall, when we believe the NAFTA — with the supplemental agreements and the implementation legislation — will be in front of the Congress, that the President's economic program will be passed.

The question is whether or not the Congress and the administration can deal with so many major issues at one time. I believe the Congress and the administration are perfectly able to handle both of these issues at the same time, meaning health care and the NAFTA. Remember, the Uruguay Round is going to be, hopefully, right behind it. We intend to conclude the Uruguay Round by December 15, but, of course, there's a 120-day notice period to the Congress.

Q: What are the differences in trade policy between this administration and the previous one?

AMBASSADOR KANTOR: More active, engaged — and engaged is number one. Number two, we have tied our trade policy and international economic policy to domestic policy directly. Number three, the President has made it clear that our domestic economic strength is our national security. And number four, the President has clearly committed the United States to lead global growth. Those are just four obviously major differences, I think, between this administration and, frankly, the past two administrations.

Q: The position of this administration on trade has been described as "free trade, but" — I wonder if you could elaborate on what the "but" might mean. The term "managed trade" is often heard.

AMBASSADOR KANTOR: I've never used the term "free trade, but" — but I will be glad to try to answer the implication in your question. We are deeply committed to opening markets and expanding trade.

So, one, we want to negotiate on three different levels — bilateral, regional, and multilateral. Two, we want to enforce trade agreements to build strength and credibility in the system. And three, we would like to enhance a rule-based system which everyone lives with. What we need to do is open markets and expand trade in every way within reason.

Every time I hear someone called a name — they're protectionists, they're free traders, they're managed traders, they're results-oriented — it has no meaning for me. Frankly, I'm an agnostic when it comes to this.

What I hopefully am is pragmatic and practical, working within a vision set by a President I work for. And I want to get results. I want results and agreements. That's not results-oriented in the sense of managed trade, but results-oriented in growing markets for American businesses and workers.

Q: How can we be helpful in the education process with Congress?

AMBASSADOR KANTOR: We would love to see as much support as possible for the NAFTA, and for the Uruguay Round.

We would like to see this organization, as it has in the past — you have been engaged in these activities for years. All of you have been enormously important to it. The kinds of advocacy you can bring to building U.S. trade — bringing the Americas together — is extremely important.

Q: How do you reconcile the deficit reduction goals of this administration with the increased spending likely to result from something like border cleanup?

AMBASSADOR KANTOR: The border cleanup is going to be fairly costly. We're going to try to be somewhat creative in how we provide for a funding mechanism for that in order to: one, be successful; and two, not have a major budgetary impact.

Q: We have legislation at the moment to help the smaller nations, the Caribbean Basis countries. That help is being eroded somewhat by the shift in emphasis towards Mexico and Latin America. I'm wondering what the administration's policy will be to continue this commitment which we have to the CBI countries?

AMBASSADOR KANTOR: We're going to continue the commitment. We have obviously seen the problem, and we're trying to work on it. We have not reached a conclusion how best to intersect those two concerns.

Q: Has the administration taken a position with respect to the proposed border transaction tax?

AMBASSADOR KANTOR: No. That has been one of the ideas that has been advanced in terms of how to fund border cleanup. One of the concerns with it, of course, is that as you lower tariffs and hopefully go zero-to-zero — which the NAFTA would do — there are some people who believe that to have a border transaction tax is counterproductive because what you're trying to do is lower all tariffs between countries, not raise a transaction fee in order to cut against what you've just achieved. I believe that by the time we get to mid-July, we'll have a good package of approaches to this problem which will make the border cleanup effective.

Q: Mr. Kantor, what arguments are you and your team using in Congress with expected opponents of the NAFTA to get them to go along with NAFTA?

AMBASSADOR KANTOR: Well, the arguments we're using are the same arguments you heard here today. The arguments are about American jobs and American business. It's about growing our economy. It's about making sure that we make the largest free trade zone in the world effective.

We're arguing that the supplemental agreements — which will protect the environment and protect worker standards, will harmonize worker standards all over North America, the number of jobs we'll create, the ability then for the United States to become the hub between the Pacific Basin and the Americas — are in the best interest of the United States of America.

Q: Ambassador, you've shown a lot of optimism about NAFTA, and that is, of course, very important for Mexico, perhaps for Chile, maybe in the long run for the rest of the Latin American countries. But for the near future, for many countries of Latin America, perhaps more important than NAFTA is the Uruguay Round. I would like you to comment whether you are as optimistic with the Uruguay Round as you are for NAFTA.

AMBASSADOR KANTOR: Let's say I'm encouraged. What we're attempting to do is work on market access in the Uruguay Round and have a preliminary agreement on market access, especially in the industrial products area and the services area, prior to the G-7 meetings in Tokyo. So at the G-7 meeting we can have some positive news from those leaders about the Uruguay Round. Which will then, we hope, give great impetus to the Round itself in other areas that we'll have to negotiate subsequent to that.

Q: Mr. Ambassador, one person who poisons the well is Ross Perot. What do you think the strategy should be to neutralize. . .

AMBASSADOR KANTOR: The one question I would have for Mr. Perot is to tell me how things are going to get substantially better without the NAFTA and these supplemental agreements than with them? If he can tell me how they will get better, how we will create more jobs, how we'll clean up the border, how we'll deal with workers' standards, how we'll deal with the environment, how we'll make sure we create jobs and deal with the growing economies of the Americas without the NAFTA and the supplemental agreements, I'd be willing to listen. But I have yet to hear that from Mr. Perot. But until he has come up with such a plan, I think that we ought to concentrate on what we're trying to do and not on what he's saying.

CLINTON ON NAFTA

There follow excerpts from remarks by President Bill Clinton before the Export-Import Bank Conference, Washington, D.C., May 6, 1993.

I want to say a special word about our opportunities in our own backyard in Latin America. Latin America is reigning in its debt and what is emerging from a more stable economy is a populace clamoring for consumer products and entrepreneurs who are shopping for capital goods. It's a market for our exports that is growing at three times the rate of any other market in the world. That is why I strongly support the North American Free Trade Agreement, with the supplemental agreements we are presently negotiating with Canada and Mexico relating to labor and the environment.

NAFTA will help us to unlock a market that will create hundreds of thousands of high-paying jobs. And NAFTA, therefore, is a high priority for this administration. The reason it is so controversial is that the American people have seen 12 years in which their wages have gone down and 3 years in which we actually have fewer private sector jobs. And everybody is afraid of change. But the only way a rich country can grow richer is by exporting more and by having more partners and economic progress. And if we can make this agreement with Mexico work, then we can move forward to the other market economies of Latin America — to Chile, to Argentina, to any number of other nations who want to be a part of this kind of partnership. I think it is very, very important.

Just listen to this: exports to Canada already support 1.5 million American jobs. And in the past five years, the number of American jobs tied to Mexico have grown from 300,000 to 700,000, almost exclusively because of the unilateral reduction of trade restrictions by Mexico, which have allowed the volume of two-way trade to go up, and the trade deficit to be erased. These are very encouraging signs. We project another 200,000 good jobs if we can have a successful implementation of the NAFTA process.

29

Trade and the environment

The following are excerpts from an address by GATT Deputy Director-General Charles R. Carlisle to the National Wildlife Federation's "Synergy '93" meeting on 26 January 1993 in Washington, D.C.:

There are several important questions on the issue of trade and the environment that need to be addressed by the international community:

First, should trade restrictions be used to inhibit "production pollution"? By "production pollution" I mean the pollution that arises from making something, as distinct from "consumption pollution", which arises from the use of a product.

The GATT allows trade restrictions on products whose use or very presence causes pollution. But there is nothing in the GATT or in the draft Uruguay Round text which permits trade restrictions based on production methods.

GATT Deputy Director-General Charles R. Carlisle: for a constructive alliance.

Should there be? This is a question which governments will have to address, no doubt with a lot of input fromyou. Apart from the environmental arguments that have to be carefully thought through, restricting trade on the grounds of how a product has been harvested or manufactured raises fundamental commercial issues that business interests will have to weigh carefully and take a position on.

Second, if trade measures are to be used to enforce production pollution standards, who should set those standards? Individual governments, or the international community, acting through negotiated agreements?

It seems to me that we cannot have a system in which individual governments, however wise, however well intention, can set standards not only for themselves but for other nations as well. That would be a prescription, I should think, for continuous conflict.

If production and process standards are to be enforced by trade restrictions then those standards, I believe, will have to be agreed internationally. And GATT is not the organization in which those standards should be negotiated; that has to be done in international bodies possessing competence on environmental matters.

Third, to what extent should environmental standards be harmonized internationally? This question takes us of course to the level-playing-field argument. If environmental standards in country X are much more lenient than those in country Y, will not producers in X have a competitive advantage over those in Y, and will not producers in Y move plants to take advantage of less demanding regulations?

Perhaps some would argue for harmonization at the highest possible level, but both instinct and experience say that that is not negotiable. Indeed, I noticed that the U.S. Vice President, in his best-seller, *Earth in the Balance*, speaking about "a new generation of international agreements", says, "these agreement must be especially sensitive to the vast differences of capability and need between developed and undeveloped nations". Good advice, it seems to me.

Fourth, should the trade provisions of international environmental agreements be applied to non-signatories with GATT rights? These agreements have trade provisions for good reasons. Of course the signatories can agree to whatever they wish, but problems can arise when those trade provisions are applied to non-signatories.

Fifth, and finally, are trade restrictions the right way or the best way to enforce environmental standards? Many professional economists will argue that trade restrictions should not be used for such a purpose or used only rarely and as a last resort; money and the transfer of technology are, in their view, the preferred options.

All countries have a vital stake in strong environmental protection and thank heaven that organizations like yours are fighting hard for this goal. But it is also very much in the interest of the international community that the Uruguay Round end successfully.

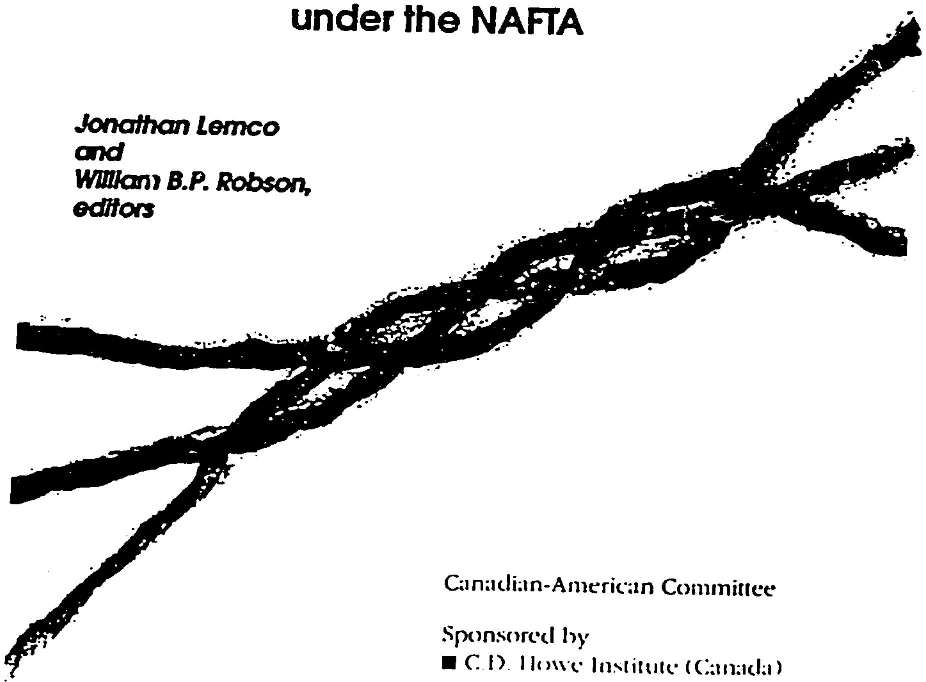
The question, it seems to me, is not which interest is paramount but how can they be reconciled? What we need to do is to forge a constructive and mutually supporting alliance between trade liberalization on the one hand and environmental protection on the other. That will not be an easy task but if we talk and reason with each other, it can be done. ■

30

TIES BEYOND TRADE

Labor and Environmental Issues under the NAFTA

Jonathan Lemco
and
William B.P. Robson,
editors



Canadian-American Committee

Sponsored by
■ C.D. Howe Institute (Canada)
■ National Planning Association (USA)

A "Social Charter" for North America?

Jonathan Lemco
and William B.P. Robson

The North American Free Trade Agreement (NAFTA) signed by Canada, the United States, and Mexico in August 1992 will, if implemented, represent a long step forward in the economic integration of North America. The agreement will eliminate most barriers to trade in goods, liberalize crossborder flows of services and capital, and open new areas of government procurement in each country to businesses in the other two. Confidence and certainty in economic relations among the three countries will be strengthened by the NAFTA's rules of origin and its protection of intellectual property and by its preservation and extension of the dispute settlement machinery of the Canada-US Free Trade Agreement (FTA). It should also be stressed that the NAFTA provides a framework within which other countries can join the free trade area.

Economic theory, bolstered by extensive experience with international trade liberalization, suggests that the new free trade area would bring important gains in incomes and output in all three countries, although there will be some job loss due to industrial restructuring. The removal of trade barriers is expected to lower prices for consumers and improve the competitiveness of existing businesses, while opening opportunities for new ventures. Mexico, in particular, would gain more secure access to the markets of trading partners. This greater security should bring new investment in its wake and enhance economic growth, which, in turn, will present new export opportunities for those partners. These arguments weigh in favor of speedy implementation of the agreement by the three countries.

Trade Liberalization: The Social Dimension

Inevitably, however, the debate over implementation of the NAFTA will force attention to broader social issues. Such issues as the distribution of income and wealth among the population generally, among different occupations, and among regions, and the ability of governments to provide social programs are considerations as central to trade initiatives as they are to any economic policy. Social goals such as these rank high on the political agendas of all democratic countries. Many countries have enshrined principles such as the right to work, the right to health care, and provision of social insurance as constitutional principles. All are regularly held accountable for their performance in these areas by voters.

The fate of international trade agreements can depend at least as much on public perceptions of their broad social consequences as on specific details of tariffs, quotas, and provisions for specific industries. The Canadian debate over the FTA illustrated this fact. Opponents argued that freer trade would bring about lower wages and greater regional disparities, lower the capacity of governments to provide health care and unemployment insurance, and debase Canada's standards for worker and consumer safety and environmental protection.[1]

Concern over the broader social goals that governments can protect and promote has again become prominent in the debate over the NAFTA. In both Canada and the United States, there are many who fear that existing protections for labor and the environment, as well as other social programs, could be threatened by freer international trade. These people suggest that the adjustment costs of freer trade in North America will fall disproportionately on certain regions, and that poorer areas will loosen their standards and cut social programs in a "race to the bottom" to attract new capital investment and jobs. Looking ahead to further trade liberalization, such concerns seem certain to be prominent, particularly given the likelihood of persistent slow global economic growth and chronic environmental stress.

1 See, for example, The Pro-Canada Network, "What's the Big Deal?" (Toronto, 1988).

Nonprotectionist Responses to Social Concerns about Freer Trade

Concern about the possible adverse effects of freer trade on broad social goals can take the form of straightforward opposition to international trade. During the second half of the twentieth century, however, all countries have become more dependent on international trade. Moreover, there is convincing evidence from around the world that outward-oriented development strategies stressing international trade provide better living standards than inward-oriented strategies. As a result, strategies seeking maximum self-sufficiency or even autarky have been largely discredited.

Instead, there has been growing attention toward a strategy of combining agreements for freer trade with agreements on other issues. One prominent candidate for inclusion is labor standards. The European Community (EC) has made a "social charter" — providing for gender equality in the workplace, support for disabled persons at work, greater worker participation in decisionmaking, health and safety requirements, and other related provisions — a part of its program of economic integration. Many in the Canadian labor movement, and some US trade unionists as well, perceive an EC-style social charter as one way of protecting worker interests in North America. The potential for an EC-style charter to provide long-term benefits is a theme of several contributors to this volume. Environmental protection is also a key area for potential inclusion in such dual agreements.[2]

2 It is worth emphasizing that a dual strategy linking freer trade with protection for labor and environmental standards is an alternative to protectionism that is quite distinct from another alternative to traditional trade barriers — "managed" or "strategic" trade policies. "Strategic" trade policies tend to be dominated by concerns about the "tilt" of the playing field — about beggar-thy-neighbor...

This outward orientation on the part of those concerned about social issues is evident in the increased level of cooperation between labor unions and environmental advocacy groups across Canada, the United States, and Mexico in pursuing their goals with regard to the NAFTA. Cross-country links in the business community are nothing new. But unions such as the Amalgamated Clothing and Textile Workers' Union and the International Ladies' Garments Workers' Union are participating in hemispheric meetings to defend the interests of their members throughout the Americas and in the Caribbean. Other unions are following suit and forming common agendas.

The text of the NAFTA agreement makes some gestures in the direction of these social concerns. In its preamble, for example, it states the commitment of the three countries to "protect, enhance and enforce basic workers' rights." It reaffirms the commitments that Mexico and the United States have made to environmental protection along their border. And its investment provisions renounce the lowering of environmental standards to attract new firms. For those concerned about a North America-wide race to the bottom in labor and environmental standards, however, these assurances are cold comfort. Whether the NAFTA should be accompanied by more specific and binding agreements in these areas — a social charter for North America — is the question addressed by the contributors to this volume.

How Broad Should the Scope of Trade Agreements Be?

In broad terms, this issue boils down to a question that is becoming familiar in all international trade forums: How far, and by what

Note 2 — cont'd.

...strategies that attempt to establish dominance in leading edge, high-value-added sectors, leaving trade partners to specialize in declining, low-value-added areas. "Social charter" strategies, on the other hand, tend to be motivated by concerns about the "level" of the playing field — about ensuring that races to the bottom are avoided so that each trading partner can have high and rising standards in areas such as labor practices and environmental protection.

means, is it legitimate for one country to use trade policies to respond to the domestic policies of its trading partners? There is nothing remarkable, for example, about a country changing its tariffs in response to changes in another country's tariffs. But what about a country changing its tariffs in response to another country's labor standards, environmental controls, or social welfare programs? The essays that follow illustrate the wide spectrum of possible responses to this question.

It is possible to argue for a minimal free trade position that makes the smallest possible demands on domestic policies. At the other extreme is a maximal position that submits a wide range of domestic policies to the control of an international agency. To anticipate some of the discussion in the essays that follow, it is useful to highlight some of the tradeoffs involved in moving across this spectrum by sketching briefly three points along it.

A Minimal Position

A minimal position would restrict the reach of international trade agreements to traditional instruments of trade policy. In this view, tariffs, quotas, and other measures that govern trade across borders are a legitimate concern of trade treaties. Other policies affecting the production and consumption of tradable goods and services are not.

Because policies such as lax emission controls for airborne pollutants have spillover effects — imposing burdens that fall not only on the population of the host country, but also on the population of its neighbors — a minimal position does recognize some basis for subjecting them to international constraints. But the onus is squarely on those who argue for international controls to demonstrate that spillover effects are a clear and pressing problem for neighboring countries.

The minimal approach has the virtue of making it hard to manipulate trade policy for protectionist ends. It limits the range of instruments that trade agreements may deal with and the types of spillovers that trading partners can react against. It thus gives few levers to special interests that might invoke lofty social principles simply to obtain protection from legitimate foreign competition. By keeping the bulk of domestic policies beyond the reach of supranational control, the minimal position also honors a principle known in the European context as "subsidiarity." Subsidiarity presumes that functions of government should be located as close to the people as is practical, rather than being exercised by central authorities. Subsidiarity offers the greatest degree of flexibility to all countries — and to regions within countries — in their search for economic development.

However, the minimal position deprives governments of tools of commercial policy that can be used to pursue a variety of social goals. Open borders increase the sensitivity of social outcomes in one country to the social policies of its partners. Whatever the virtues of subsidiarity may be — and however great respect for the choices of other countries would be in an ideal world — there are not many who would advocate unrestricted free trade with a country where, for example, slave labor was widespread. Less extreme examples also illustrate the point. Policies that affect the distribution of income among different categories of workers in one country may affect the distribution of income in countries with whom it has trading agreements in ways they do not like. A minimalist position limits the options available to those trading partners to curb those effects.

A Middle-of-the-Road Position

At the middle of the spectrum is a position that regards a range of domestic policies as potential subjects of international agreements. The commercial policies of both the United States and Canada frequently respond to actions of actual and potential trading partners that are quite far removed from traditional instruments of trade policy.[3] The introduction of subjects such as intellectual property and

3 For example, the US Generalized System of Preferences providing preferential market access to less-developed countries imposes conditions related to labor practices and protection of intellectual property.

"trade-related investment measures" into the multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT) can be seen as moving international trade relations toward this middle position.

This more expansive position is attractive for several reasons. On a technical or economic level, it recognizes that trade policy and other economic strategies are often not easily distinguishable. If a trading partner thwarts the intent of a freer trade agreement by, say, invoking consumer protection in order to erect formidable technical obstacles to imports, a trade agreement that narrowly focuses on traditional trade policy instruments would be of little help.

From a broader perspective, the more expansive position responds to the desire for governments to match losses of economic leverage in commercial policy with new economic tools elsewhere. In part, this position responds to changes in the relative importance of various policy instruments. When tariffs and other trade barriers are substantial, variations in policies such as labor standards or social benefits will have a relatively small impact on competitiveness; when trade is freer, these variations loom larger. Sensitivity also draws countries toward this position. The more a set of trading partners is exposed to the consequences of each other's policies in areas such as labor standards, the more say each will want to have in those policies. In his contribution to this volume, Peter Morici talks of "proximity" between two countries as a critical factor in determining how far trade negotiations should infringe on domestic policy prerogatives in these areas.

On a political level, more expansive trade agreements may make liberalized trade more legitimate in the mind of the public, since they enhance the sense that all countries are playing by the same rules. Many economists argue that retaliating against the "unfair" policies of a trading partner is usually more damaging than ignoring them. But the image of the unlevel playing field is powerful, and it is hard to maintain a liberal trading system in the face of widespread public perception that the other side is cheating. The proliferation of countervailing duty actions by the world's major trade powers has made international codes tying trade actions to domestic subsidies more desirable.

A more expansive position is not, however, without costs. As the range of policies that are treated as legitimate targets for trade policy widens, so does the scope for protectionism. Also, the more domestic policies are subject to binding international agreements, the less individual countries — and the area bound by the agreements as a whole — are able to benefit from the diversity of approaches to economic problems that plays such a key role in economic development over time.

A Maximal Position

At the opposite end of the spectrum from the minimal position is a view that would subject a wide variety of economic and social policies within the trade area to binding central direction. At the extreme, a maximal regime would in effect turn the area into something akin to a federal state, with the member states forming the constituent units.

The maximal position is likely to be associated with closer and more comprehensive projects of economic integration. When countries renounce the use of standard tools of commercial policy, as already noted, they increase the sensitivity of economic outcomes within their borders to events outside. When, like the members of the EC, they go further, increasing labor mobility and even planning a single currency, this sensitivity is multiplied. Accordingly, the desire to recapture at the center some of the control lost at the national level is strong. The maximal position can be justified as putting a variety of economic and social programs into a coherent "nationbuilding" package. A federalist impulse clearly underlies much of the pressure for a social charter and other elements of European political integration.

By putting broader social policies under the umbrella of a binding agreement, they may be protected from potential degradation because of increased competitive pressures of freer trade. Advocates of a social charter in the Canadian Constitution, for example, cited the need to forestall an interprovincial race to the bottom in social policies in order to attract investment in an increasingly integrated national and world economy.

The drawbacks of the maximal position emerge quite readily from this discussion. It gives protectionism a wide range of respectable covers. Also, binding central direction violates the principle of subsidiarity, imposing uniform policies on populations who may have sharply differing needs and desires and threatening to infringe national sovereignty out of proportion to the benefits obtained.

Synopsis of the Contributions

The varying approaches taken by the contributors to this volume to the question of whether the NAFTA should be accompanied by a social charter show how different the somewhat abstract skeleton just described can look when covered with the flesh and blood of the actual North American situation.

Elizabeth De Boer and Gilbert Winham open the volume with an examination of the social charter idea, drawing on its antecedents in the process of European economic and political integration and in Canada's constitutional negotiations. They provide a brief background to the EC and Canadian debates, noting that the EC's social charter is part of a program of integration and change, while in the Canadian context it is more inward-looking and nationalist. They stress that proponents of a social charter in Canada tend to oppose the NAFTA, as they did the FTA. While not advocating any specific position on the minimal/maximal spectrum, De Boer and Winham contrast the NAFTA with the more maximal EC and Canadian situations. They conclude that it is unlikely that a social charter agreement will be concluded alongside the NAFTA, but they speculate that the issue will arise again in subsequent hemispheric trade talks.

Sidney Weintraub and Jan Gilbreath take a position near the middle of the spectrum. They argue that, unlike Canada and the United States under the FTA, the three partners in the NAFTA must

35

deal with environmental and labor matters because of Mexico's much different political and economic structures. They point out the growing recognition of the link between trade and the environment, especially as they have been revealed by the problems on the US-Mexico border. They argue that Mexico has been increasing its efforts, and they discuss the US-Mexico border environmental plan in this light. The biggest obstacle to trilateral environmental standards is, in their view, the lack of infrastructure and financial resources in Mexico. The same difficulties limit Mexico's ability to react to US and Canadian criticisms of Mexican labor laws. They conclude that, as trade ties increase — as integration proceeds and incomes and living standards rise — there will be less objection on the Mexican side to concluding side agreements on social issues. Accordingly, they suggest that a tiered approach may be possible, with immediate agreement on a set of (sometimes uneven) standards in certain areas and harmonization in other areas over the longer term as higher Mexican incomes make it more realistic.

Closer to the maximal end of the spectrum is Robert Howse, who presents a comprehensive case for establishing a "right to adjustment" for displaced workers alongside the NAFTA agreement. His case rests on two principal lines of argument: first, that ethics and economic considerations favor a reliable safety net for displaced workers; second, that a commonly agreed "right to adjustment" would limit the future scope for protectionist actions by the three countries. He argues that domestic remedies should be the first recourse of displaced workers but that a trinational committee of experts could evaluate the adequacy of each country's adjustment assistance and judge appeals by displaced workers who fail to receive satisfaction from domestic authorities. He recommends that the provision of adjustment assistance should be a precondition for the imposition of trade barriers in response to job losses and that adjustment programs in each country should be protected from countervail by its partners.

William Watson, by contrast, argues for a minimal approach. He registers a number of philosophical and practical objections to what he sees as a social charter's central purpose: the forcing up of Mexican real wages. He notes the asymmetry in proposals for a social charter binding on Mexico alone, and he asks if the greater political integration implied by a charter would be acceptable to the United States and Canada if all three countries were bound equally. He stresses the economic basis for Mexico's low wages: plentiful labor supply and low productivity. Unless these conditions change, a social charter that, for example, mandates better working conditions is likely to depress other components of labor compensation. Watson concludes by noting that certain circumstances — national security or deeply offensive social policies — can justify denying market access to other countries but warns that protectionism can only be curbed if these judgments are made multilaterally and if democratic countries give each other the benefit of the doubt.

Peter Morici wraps up the volume by asking what criteria are useful in deciding how far and by what means international trade treaties should concern themselves with variations in domestic labor and environmental policies. He argues that the position of any single trade agreement on the minimal/maximal spectrum will depend on the proximity of the countries involved — particularly the degree to which one country's labor and environmental conditions are exposed to policies in the others. Like Weintraub and Gilbreath and Watson, Morici emphasizes that much of the reason that Mexico does not enforce its existing labor and environmental laws is its lack of financial and technical resources. He therefore suggests that Mexico ought to be assisted financially and technically in order to enforce standards in these areas. He argues that making implementation of the NAFTA contingent on agreement with, and enforcement of, common standards will be more effective than threats of sanctions and countervailing duties.

Drawing Conclusions

The variety of positions presented in these essays clearly rules out any hard and fast conclusions about the extent to which Canada, the

United States, and Mexico should conclude NAFTA-related agreements on labor and environmental issues. Indeed, the purpose of this volume is to air a range of opinions rather than to present firm conclusions. Nonetheless, a consideration of two themes may provide some guidance about where the three countries ought to come down on the minimal/maximal spectrum.

First, the authors generally accept that the economic case for greater trade liberalization in North America is strong. Freer trade offers a much-needed boost to Mexico's living standards, enhanced competitiveness for North American industry more generally, and benefits to consumers. There are cases — particularly along the US-Mexico border — where freer trade may be accompanied by spillovers that need bilateral or multilateral attention. In some industries, improved access by Mexican producers to US and Canadian markets will put downward pressure on US and Canadian wages. But past experience of trade liberalization suggests strongly that there is little reason to fear that reducing the remaining barriers to trade in North America will suddenly unleash a massive race to the bottom in labor and environmental standards.

The essays in this volume also reflect the belief that the NAFTA will increase the sensitivity of each partner to economic developments and policy changes in the others. Closer economic integration will increase the legitimate interest of each partner in social, labor, and environmental policies in the others that affect its own citizens. And the obligation of countries to look after those whose living standards are threatened by changes in trade policy is a prominent theme in most of these essays. The European debate over the EC's social charter and the debate in Canada over the proposal to include a social charter in the Canadian Constitution both illustrate the continuing tension in all democratic countries between two essential characteristics: citizens' freedom to pursue their own goals in a market economy and society's obligation to provide basic opportunities and safety nets. Successful economic policies — including those involving international trade agreements — must respond to both these needs.

What guidance do these two considerations offer? Those people who are enthusiastic about the gains to be had from liberalized trade in North America should not wish to put those gains at risk. Too vigorous an advocacy of a minimal approach to North American free trade, with no trilateral agreements on labor and environmental standards, may cause the NAFTA to be rejected by legislators and electorates who require evidence that labor and environmental standards are not threatened. And those people who are enthusiastic about raising labor and environmental standards in North America — and particularly in Mexico — should be mindful of the importance of strong commercial relations in achieving those ends. Too forceful a position in favor of a maximal approach to labor and environmental issues could gut the trade liberalization provisions of the NAFTA or cause it to collapse altogether. If that is the outcome, both the leverage the agreement would have provided in furthering those goals and the trade-related gains that would have made faster Mexican progress in these areas possible will be lost.

Finding the right point at which to balance these forces is the challenge now facing politicians and citizens whose task it is to evaluate the NAFTA and decide whether, and possibly how, to implement it. The NAFTA's potential to serve as a framework for a wider free trade area and the relevance of these debates to future trade liberalizations make our decision especially important.

Statement by the AFL-CIO Executive Council

on

The North American Free Trade Agreement

February 17, 1993
Bal Harbour, FL

The proposed North American Free Trade Agreement, signed by President Bush but not approved by Congress, would be a disaster for millions of working people in the United States, Canada and Mexico. It should be rejected and renegotiated to advance the overall public interest.

As drafted, NAFTA is an agreement based solely on exploitation. It would destroy jobs and depress wages in the U.S. and Canada by abetting the further transfer of jobs to Mexico. At the same time, it would do nothing to uplift the desperately low wages and harsh working conditions of the Mexican people.

While providing extensive protection for investors, the agreement ignores the rights of working people, and it would limit the ability of governments to adopt measures to promote employment and protect public health, safety and the environment.

We call on the Clinton administration to negotiate a new agreement that will stop the flight of jobs from the U.S. and will alleviate the deplorable conditions in the maquiladora areas. In order to ensure that expanded trade provides broadly-based benefits, a renegotiated NAFTA should stand up for worker rights, strong labor standards, consumer health and safety, and environmental protection.

In particular, we urge that the next round of negotiations lead to the inclusion of the following elements in the agreement:

- A measure whereby infractions of labor rights or workplace standards can be enforced by trade actions. Areas to be addressed include the right to organize and bargain collectively, the establishment of strong workplace health and safety standards, appropriate minimum wage structures, the elimination of child labor, a prohibition on forced labor, and guarantees of non-discrimination in employment.

- Provisions to address the existing environmental degradation of the border area, based on the "polluter pays" principle, as well as provisions to permit trade actions to address violations of environmental standards.

- Tougher rules of origin, so that any benefits derived from an agreement will accrue to workers and producers located in the three countries.

- The immediate elimination of duty-drawback programs.

- The immediate elimination of export performance requirements and import-licensing schemes.

- The requirement that all internationally-traded goods are marked with their country of origin.

- Safeguard provisions that protect U.S. workers against import surges.

The Heritage Foundation

Mexico Watch

No. 37 — A Review of United States-Mexican Relations — May 1993

NAFTA UPDATE

Panetta Statement Mobilizes NAFTA Supporters and Changes Nature of the Debate. Leon Panetta, the Director of the Office of Management and Budget (OMB), created an uproar in Washington when he suggested in an interview on April 27 that the North American Free Trade Agreement was "dead." Panetta added that President Clinton can salvage the NAFTA if he "defines his priorities" and carries the fight for the trade pact to the American people. Ironically, these comments have galvanized the Clinton Administration to publicly support the free trade pact. White House Press Secretary Dee Dee Myers reacted immediately to Panetta's dire predictions by claiming that the NAFTA is "alive and well," and that the OMB Director was only speculating on the agreement's prospects if it had gone up for a congressional vote at that time. Robert Reich, the Secretary of Labor, asserted at a U.S. Chamber of Commerce meeting that day that the NAFTA "is not in any way, shape, or form dead as reported," and that it "remains extremely important for both American and Mexican workers."

The remarks by Panetta also sent shockwaves throughout Mexico. His statements triggered the year's second largest plunge in the Mexican stock market, received banner headlines in most Mexico City newspapers, and startled the Mexican political leadership. The remarks also clearly underscored the free trade pact's current difficulties and the need for a much greater commitment by the Administration, supporters in Congress, and the U.S. business community. According to Representative Robert T. Matsui, the California Democrat and a strong supporter of the NAFTA, "From my perspective as someone who is trying to move the legislation out of the House, it was a good early-warning signal and I'm happy [Panetta] said it."

Gloomy predictions by Panetta and other Washington officials, combined with the uncertainty over the agreement's fate in Congress, have led NAFTA supporters to change their tactics. Until now, supporters of the NAFTA argued that the trade pact expanded U.S. exports, created more jobs, and increased economic competitiveness. Today, however, the strategic, security, and political arguments surrounding the NAFTA debate are increasingly being raised. Said David Rockefeller, the Chairman of Chase Manhattan Bank's international advisory committee and the honorary Chairman of the Americas Society, in the April 26 issue of the Mexican newspaper *El Financiero International*, "The consequences of not passing NAFTA will be so bad that I hate to contemplate them." Senator Bill Bradley, the New Jersey Democrat, warned: "If NAFTA is rejected, there will be the immediate problem of $40 billion in flight capital leaving Mexico in a matter of weeks, creating incredible instability, probably during the middle of the Mexican presidential campaign. Mexico will go back to the old politics. There will be a setback for democracy and we will have a long-term problem on our border, so much so that it could become a national security issue."

A rejection of the NAFTA will surely undermine the progress that has been made in U.S.-Mexican relations over the past six years. A defeat of the free trade agreement also will send a signal to the rest of Latin America and the Caribbean that the U.S. reneged on its economic and foreign policy commitments. This, in turn, could dampen the free market and democratic reforms which are reshaping the region and possibly even fuel the dying flames of populism and anti-Americanism.

The death of the NAFTA also would jeopardize the gains the U.S. has enjoyed since Mexico began opening its economy to U.S. products and investment. Since 1986, a $5.6 billion U.S. trade deficit with Mexico has turned into a $6 billion annual trade surplus. That trade has created a net gain of some 400,000 American jobs. According to U.S. Trade Representative Mickey Kantor, an estimated 700,000 industrial jobs currently depend on U.S. exports to Mexico. That number, he says, would rise to 900,000 by 1995 if the NAFTA is passed, but would drop to 500,000 if it is rejected. In other words, a rejection of the NAFTA will cost America 200,000 industrial jobs, which would be a severe blow to the U.S. economic recovery.

ECONOMIC NOTES

Tough Enforcement Powers Sought in Parallel Talks. The Clinton Administration has made it clear that it will not support the free trade agreement with Mexico without far-reaching parallel agreements addressing environmental and labor issues. Consequently, the White House is pressing for the creation of strong supranational commissions to enforce environmental and labor standards throughout North America. According to congressional sources, these commissions will be tasked with overseeing how the three signatory countries are complying with environmental and labor laws. They also would likely use trade and other economic sanctions to punish persistent violators. The U.S., Canada, and Mexico would have equal representation on the commissions, which would have permanent staffs.

However, the Clinton Administration's narrow focus on the parallel agreements, rather than on ratifying the already negotiated agreement itself, has many NAFTA supporters worried. During a May 13 speech at The Heritage Foundation, Republican Representative Jim Kolbe of Arizona warned that "The dilemma for President Clinton is simple: while the side agreements may be critical for obtaining Democratic support, they are not for Republicans. Indeed, it is exactly the opposite for Republicans. As the President attempts to transform NAFTA, with these negotiations, into something more palatable to Democrats, he runs a significant risk of losing NAFTA's core support among House free traders. Many Republicans are conditioning their NAFTA support on whether or not the

- The continuation of federal, state and local "Buy American" laws and regulations.

- The enforcement of strict sanitary and phyto-sanitary standards with no restriction on improvements in those standards.

- The continuation of necessary federal and state regulations concerning the provision of financial and insurance services.

- Strict limitations on the "temporary entry" of persons to provide services, including transportation services, and the prohibition of entry to affect a labor dispute. Any temporary entrant must, at minimum, be paid and work under conditions prevailing in the host country.

- A prohibition on transferring work or workers across borders in the event of a labor dispute, and a prohibition on trade while a labor dispute is in progress.

- The ability of government to adopt standards and related measures to protect public safety or the environment.

- Reciprocity in the treatment of foreign investment.

- Equal market access for cultural industries.

- Safeguards for U.S. automotive production, equivalent to safeguards present in Mexico and Canada, and the continuation of existing CAFE rules.

- Provisions that address the needs of import sensitive industries, including but not limited to textiles and apparel, electrical and electronic, glass, tuna, meat, sugar and light duty trucks.

- A five-year review of the economic impact of an agreement that would permit parties to suspend provisions when necessary to address labor market disruptions.

- Provisions for additional debt relief for Mexico, so that it can begin investing at home to improve the standard of living of its people.

- A cross border transaction tax to serve as a major funding source for needed programs including:

  - a substantial increase in funds for food safety inspection and the customs service;

  - sufficient funds to improve the infrastructure of the border area, including water treatment, electricity, and needed housing and schools;

  - a significantly improved Trade Adjustment Assistance program to provide guaranteed benefits to workers harmed by trade.

Finally, legislation should be enacted to eliminate the foreign tax credit and deferral and to deny trade benefits to companies that transfer production to Mexico. For workers dislocated by any such transfers, companies should be required to cover health insurance, pay severance, training and job search costs.

###

40

President goes too far in altering . . . a good agreement into a social or environmental charter for North America."

As a reaction to such concerns, Mickey Kantor told the Senate Commerce, Science, and Transportation Committee on May 6 that he is walking a "tightrope" between those who want tough new rules to enforce environmental and labor laws, and others who argue that such rules would be a crippling regulatory burden on U.S. businesses. Several important environmental groups, including the National Wildlife Federation and the National Audubon Society, announced on May 4 that they will support the NAFTA if supplemental agreements provide for the creation of a North American Commission on the Environment (NACE). This commission would have the power to "prepare reports and conduct investigations" on environmental matters. Moreover, these environmental advocates want signatory countries to be able to impose sanctions on violators.

Meanwhile, such NAFTA critics as House Majority Leader Richard Gephardt of Missouri and Democrat Representative Sander Levin of Michigan are softening their criticism of the trade pact, saying that they could support it if the side agreements have "real teeth." They have urged their fellow House Democrats to withhold support for the NAFTA until the Administration concludes the parallel negotiations. Republican Senators, however, in an April 29 letter to Clinton, said that they "oppose giving broad powers to three-nation commission." Senator John C. Danforth of Missouri, the organizer of the letter to the White House, said that "if [Clinton] has to create whole new levels of regulation and bureaucracy relating to environmental protection and labor laws, he will lose most of the Republicans, including myself."

POLITICAL NOTES

New U.S. Ambassador to Mexico Chosen. James R. Jones, the Chairman of the American Stock Exchange and a former Democratic Congressman from Oklahoma, has been chosen as the next U.S. Ambassador to Mexico. If confirmed by the U.S. Senate, Jones will replace John D. Negroponte, who has served in Mexico City for four years. Negroponte was highly respected by Mexican authorities and played an instrumental role in improving U.S.-Mexico relations and in promoting the NAFTA. The Clinton Administration chose Jones because it believes that his influence on Capitol Hill will be helpful in convincing Congress to support and ratify the NAFTA later this year. Moreover, Jones has broad experience in trade and investment policy that will be valuable in shaping U.S.-Mexican economic ties. During his fourteen years in Congress, Jones held various key positions, including a four-year tenure as Chairman of the powerful House Budget Committee. Before that, the Oklahoma Democrat worked as a top aid in the Johnson Administration. Reaction in Mexico City about Jones has been positive, with Mexican government officials calling the announcement an excellent choice.

Mexican Roulette

For most Capitol Hill lawmakers, the North American Free Trade Agreement is a no-win proposition. NAFTA would open up new markets for U.S. products in Mexico, but it would also give U.S. companies incentives to set up shop there. Voters are divided on the issue, but with Ross Perot on the warpath, NAFTA is in deep trouble.

BY BRUCE STOKES

Early last year, General Motors Corp. (GM) announced plans to close its assembly plant in North Tarrytown, N.Y., in 1995. At the same time, the giant automaker let it be known that it would transfer diesel engine production from its plant in Moraine, Ohio, to Toluca, Mexico.

"You can imagine the outcry in our municipality and from our 3,500 employees, who will lose their jobs," Rep. Benjamin A. Gilman, R-N.Y., said. "Everyone cites GM's action as an example of what could happen" under free trade with Mexico.

With this searing political experience fresh in his memory, Gilman is taking a hard, pragmatic look at the proposed North American Free Trade Agreement (NAFTA). He represents towns along the Hudson River and in the foothills of the Catskills northwest of New York City. Light industries—many of them vulnerable to foreign competition—are the economic heart of these communities. And Gilman hasn't decided how he will vote if NAFTA comes up for congressional approval this fall.

Gilman is by no means alone. Many of his Capitol Hill colleagues face the same quandary. By eliminating U.S. and Mexican tariffs, NAFTA would open up new markets for U.S. exports, but it would also give U.S. companies incentives to locate their production facilities in Mexico to take advantage of its cheap labor. Canada is also included in the trade pact, but despite Ottawa's presence at the negotiating table, concerns about Canada do not figure in the current debate in Washington over NAFTA.

For most Members of Congress, NAFTA is a no-win proposition politically. Voters are divided on the issue. The pact has taken on broad symbolic significance, stirring up concerns about the decline of the U.S. industrial base and criticism of Washington's traditional way of trading away economic benefits. Popular erstwhile presidential candidate Ross Perot, sensing NAFTA's increasing vulnerability, has stepped up his strident campaign against the pact.

Many Capitol Hill lawmakers fear that if they vote for the agreement, every time plants in their congressional districts close and move to Mexico, they will be the villains. At the same time, they don't expect to reap much in the way of political benefits should NAFTA allow a local company to expand production to boost its exports to Mexico. The poignant television image of a shuttered factory gate will always prove to be more powerful back home than another truckload of widgets rolling off the assembly line and heading south.

For this reason, said a Democratic lawmaker who's leaning toward voting for the agreement, "most people just want this issue to go away."

Congress's day of reckoning was mercifully postponed when, soon after taking office, President Clinton initiated a series of supplemental negotiations with Mexico to ameliorate NAFTA-induced problems relating to the environment, labor standards and import surges. Clinton had first proposed these side deals during his presidential campaign so that he could put off taking a firm stance on such a politically divisive issue. Many lawmakers hoped that the supplementals, once negotiated, would provide them with similar political cover by mollifying most of the opposition to the main accord.

But a Clinton Administration official suggested that some of them may be in for a disappointment. "These people hold out too much hope for the supplementals," he said. "They won't be a cure-all for every concern."

In the end, said Bill Cunningham, a lobbyist for the AFL-CIO, "Members will have to actually make up their own minds."

In the Senate, all sides agree that there are 65-70 votes in favor of the agreement. The real battleground will be in the House. And, as Leon E. Panetta, the director of the Office of Management and Budget, incautiously admitted several weeks ago, NAFTA would lose there if the vote is taken this spring. What's more, Administration officials privately concede that they don't think the supplementals

42

alone will give them the votes they will need.

Such political head-counting, of course, is premature. A vote on NAFTA isn't expected before the fall at the earliest.

When the vote finally comes, NAFTA's fate will be sealed by three groups: the powerful House freshman class, many of whom campaigned against the pact; Republicans, many of whom initially supported NAFTA out of loyalty to President Bush, who initiated the talks; and an ideologically diverse collection of fence-sitting Democrats.

House Majority Leader Richard A. Gephardt, D-Mo., an influential player in trade debates
"What ought to govern here is what is the best thing to do for our economy, our workers and our business."

Congressional leaders and Administration officials agree that only two people have the power to sway those votes: Clinton and House Majority Leader Richard A. Gephardt, D-Mo.

Conventional wisdom in Washington trade circles holds that NAFTA won't make it through Congress without Gephardt's support. Gephardt has long voiced serious reservations about the adverse implications of trying to integrate two such disparate economies. His endorsement of the deal and the supplementals could sway a sizable number of House Democrats. But Administration officials nervously acknowledge that even with Gephardt's support, they could still lose NAFTA.

Ultimately, the future of free trade with Mexico may rest in the President's hands. "If he wants to see it done," Gilman said, "he will have to spend a lot of political capital."

If Clinton is willing to pay that price, most experts assume that he can get his way. But the cost continues to escalate. It extends far beyond further tinkering and pork barrel dispensations to include major commitments from the Administration on an array of issues dear to specific lawmakers.

The Administration has already suffered a damaging political defeat over the President's economic stimulus plan and faces a bruising battle over budget reconciliation and aid to Russia. (*See this issue, p. 1165.*) The impending fight over NAFTA now looks as if it will be another uphill struggle.

FAMILIARITY BREEDS CONTEMPT

The more Americans know about NAFTA, the less they seem to like it. Public opinion surveys in 1991 showed that about half of those questioned favored NAFTA. But barely a fourth of registered voters surveyed by NBC News and *The Wall Street Journal* in three polls since last September now favor NAFTA, and a third oppose it.

Celinda C. Lake, a partner in the Washington-based Democratic polling firm of Mellman Lazarus Lake Inc., contends that the polling data are deceptive. "What we are seeing in focus groups is that voters are even more negative underneath," she said. "Voters think we will be taken advantage of. They believe we produce nothing in this country that the Mexicans can afford to buy."

Such visceral distrust of international economic integration is reflected in the views of Gilman's constituents, who blame NAFTA for the closing of GM's plant in North Tarrytown even though the agreement is not yet in place and there is no connection between the closing of that facility and GM's opening of a diesel engine plant in Mexico.

Moreover, NAFTA has become a symbol of how Washington is out of touch with average Americans. "The Members are hearing at just about every town meeting back home that this is yet another example of the United States doing something for other people and not for ourselves," an Administration official said. "Voters think we are attempting to improve Mexican society just at a time when Clinton talked about putting our society first."

"These issues tend to bleed over one into the other," a Democratic political consultant said. "The President is saying, 'Trust me—I will protect you when this happens.' " But focus groups of Democrats in various states have shown that Clinton's missteps on the issue of gays in the military and on his economic stimulus plan have raised new doubts about his trustworthiness on NAFTA.

With such public sentiment, a Democratic House Member warned, "This is an easy no vote."

A mid-March assessment of congressional attitudes toward NAFTA by the U.S. Alliance for NAFTA (USA-NAFTA), a business coalition, highlighted the uphill struggle that free trade with Mexico faces in the House. The survey found 115 House Members who opposed NAFTA or were leaning toward voting no, 157 who were undecided and only 152 who supported the pact or were leaning toward voting yes, according to *Inside*

U.S. Trade, a Washington-based newsletter.

Similar ambivalence exists within the House's USA-NAFTA's freshman class. According to the survey, only 38 of them either support NAFTA or are leaning toward voting for it, 24 oppose the deal or lean toward voting against it, and 47 are undecided.

"We are very close to our constituencies," said Rep. Karen Shepherd, a freshman Democrat from Utah. "Much closer than other Members of the House."

"Freshmen are scared to death," a Washington business lobbyist said. "They were not sent to Washington to endorse the Bush program. But they have never before been in a position to cast a negative vote."

To date, Republicans remain solidly behind NAFTA. USA-NAFTA's survey found only 4 of 103 House Republicans leaning toward voting no.

But Republican supporters of NAFTA warn they shouldn't be taken for granted. Conservative Republicans are concerned that the Clinton Administration's attempts to put more teeth in the enforcement of environmental and labor standards through the supplemental agreements could backfire by giving the Mexicans a way to intrude on U.S. national sovereignty.

"The Administration has a balancing act that could blow up on them," said Rep. Jim Kolbe, R-Ariz., one of NAFTA's main boosters on Capitol Hill. "Will they sacrifice Republican votes to get the votes of Democrats?"

Many analysts theorize, in fact, that it was the threat of Republican defections that led the Administration to rapidly reverse its initial tough-minded position and oppose strong enforcement powers in the environmental and labor supplementals.

The Administration's biggest challenge may be the large number of Democrats who remain uncommitted. "A lot of Democrats walked the plank for the President on the stimulus package, and they will walk it again on the budget and tax increases," a House Democratic staff aide said. How many times, he asked, will they want to fall on their swords for a President who got only 43 per cent of the vote in last year's election?

These lawmakers are withholding judgment on the agreement until they have seen the side deals. Their ambivalence places a great deal of pressure on NAFTA negotiators to craft labor and environmental accords that are all things to all people. Administration officials warn that may be asking too much.

In any free-trade arrangement between an advanced industrial country such as the United States and a newly industrial nation such as Mexico, for example, there's an implicit bargain. High-productivity, high-wage activities are expected to concentrate in the richer country and low-productivity, low-wage work to migrate to the poorer country. But Democrats who are close to organized labor are concerned about the growing evidence of pockets of excellence within the Mexican economy: automobile and semiconductor factories where workers are paid only a fraction of what their counterparts in the United States earn and yet have higher productivity.

In theory, wages in such top-flight Mexican plants would rise. But in the worst nightmares of NAFTA's opponents, U.S. wages will be forced downward to remain competitive.

"There has to be a way to review whether there is substantial progress being made on better linking Mexican wages and growth in productivity," Gephardt said. "And if there isn't, to try to figure out how benefits of the treaty can be pulled back."

U.S. trade experts say that there may be some hortatory language to that effect in the supplemental, but they warn that anything more meaningful will be difficult to achieve.

Overcoming such substantive disagreements is what politics is all about. But the legislative horse-trading that will be necessary to get NAFTA through the House is complicated by the sharp divisions between some interest groups with a stake in the outcome.

Richard A. Bloom

Rep. Jim Kolbe, R-Ariz., one of NAFTA's biggest boosters on Capitol Hill
"The Administration has a balancing act that could blow up on them."

Organized labor is generally assumed to be unalterably opposed to the agreement. "But even if [AFL-CIO president Lane] Kirkland and [secretary-treasurer Thomas R.] Donahue were predisposed to make a deal," an AFL-CIO official said, "they wouldn't be able to because of the staunch opposition to NAFTA among many union locals."

Similarly, NAFTA has opened a wide fissure between environmental groups. A number of establishment environmental organizations, including the Audubon Society, the Environmental Defense

44

Fund and the National Wildlife Federation, are expected to support NAFTA. Leaders of these mainstream groups acknowledge that once they persuaded the Administration to go the extra mile and negotiate environmental side accords, they had little choice but to support the outcome. "There has to be a political quid pro quo for doing something for you," one of them said, "or they will not do something for you on the next issue."

Nevertheless, the Citizens Trade Campaign, a coalition that includes Congress Watch and Greenpeace, remains adamantly opposed to NAFTA, claims to have full-time organizers working against the deal in 35 states and can generate grass-roots opposition to the agreement that reaches far beyond the immediate memberships of its constituent organizations. And it's not alone.

Meanwhile, NAFTA's natural constituency in the business community has fumbled the ball. "They have not been outspoken in supporting NAFTA," Rep. Kolbe complained.

The Democratic House Member agreed. "The business community has taken a duck," he said. "They are not working this issue like labor is. At the early stage, there was a vacuum. It was a big miscalculation. They basically allowed labor to work this issue without any opposition, and a lot of commitments have been made" by Members of Congress.

The business community is now scrambling to recover. USA-NAFTA recently sponsored a nine-page "advertorial" in *The New York Times*, but its annual budget is only $2 million. "What we are relying on is the energy and enthusiasm of the companies themselves," said Sandra Masur, the director of international trade policy for Eastman Kodak Co., which is a member of USA-NAFTA. "We can create the infrastructure, but the companies have to do the work."

Many on Capitol Hill, however, wonder if that will be enough.

GEPHARDT'S DILEMMA

Such disarray among interest groups heightens uncertainty in the House, placing an even greater premium on Gephardt's stance toward NAFTA.

Gephardt's endorsement in 1991 of the extension of fast-track trade negotiating authority, which permitted the completion of the NAFTA talks, is generally credited with ensuring passage of that legislation.

This year, Gephardt appears caught on the horns of a dilemma. He has long been critical of NAFTA, and it's unlikely that all of his concerns will be resolved. If he continues to harbor national political aspirations, Gephardt can ill afford to alienate his natural constituency in the labor movement, which opposes NAFTA.

But few on Capitol Hill believe that Gephardt wants to cross swords with a Democratic President so early. And Gephardt has built his legislative career on finding common ground between disparate positions.

"Gephardt will be caught between loyalty to the President and his own inclinations," said Rep. Ralph Regula, R-Ohio.

Gephardt denies such calculations. "The politics are not determinative," he said. "What ought to govern here is what is the best thing to do for our economy, our workers and our business."

In the end, those on Capitol Hill who know Gephardt best predict that he will endorse NAFTA because he believes that there is no turning back the clock. U.S. industry is already fleeing to Mexico. The border environment is already degraded. Defeating NAFTA will not halt either process. Passing NAFTA with some safeguards holds out hope of improving the situation.

Rep. Karen Shepherd, a freshman Democrat from Utah
"I see a President who will sit down with Members and say we are all on the same team."

Rep. Sherrod Brown, D-Ohio, a leading opponent of NAFTA
Clinton won't risk his political capital on the pact.

45

Rep. Ralph Regula, R-Ohio
Gephardt will be caught between competing forces.

Even though other hurdles must be cleared, Gephardt's endorsement is an essential ingredient for NAFTA's passage, Administration officials admit.

Ultimately, NAFTA is the White House's to win or lose.

"By negotiating these supplementals, Clinton has taken on the mantle of this agreement," a Republican congressional aide said. "And the pressure will be on to ensure that the embarrassment of losing this won't accrue to the President."

If, as is widely expected, the supplemental agreements do not immediately crystallize a winning majority in the House, Clinton has several options.

He could, for example, merely walk away from NAFTA. "I think the President will look at the fights he will have to make, and I predict he will not be willing to expend the amount of political capital," said Rep. Sherrod Brown, D-Ohio, a leading opponent of NAFTA.

But most observers say that the President can't afford to give up on NAFTA. "If he abandoned this, he would lose big-time in the business community," a Democratic lawmaker said. And, the lawmaker added, the White House needs the support of the business community on health care reform and future budget and tax fights.

Constrained to make NAFTA work, the President could go back to the negotiating table yet again to extract even more concessions from Mexico. Some opponents of NAFTA argue that Washington can continue to squeeze Mexico City because Mexican President Carlos Salinas de Gortari has staked his party's entire future on the agreement. But followers of Mexican politics warn that public sentiment is shifting against the agreement and that further U.S. demands could evoke a backlash.

Clinton could resort to old-fashioned presidential politics, courting House votes one by one with arm-twisting sessions in the Oval Office and promises of federal spending in individual districts.

"I would see some horse-trading," said Rep. Shepherd, reflecting on what might work with the House freshman class. "But more than that, I see a President who will sit down with Members and say we are all a member of the same team." But the problem with such an approach, Shepherd conceded, is that "we have to go up for reelection before Clinton does."

There are growing signs, however, that the price the White House might have to pay for votes could involve policy matters that extend far beyond NAFTA. Rep. Sander M. Levin, D-Mich., who's skeptical of NAFTA, wants to see a wide-ranging U.S. motor vehicle policy laid out before NAFTA is in place, to ensure that future Administrations can deal with NAFTA-generated problems in the auto industry.

Levin has introduced legislation to create a motor vehicle commission, similar to the recently formed airline commission, to craft such a policy. If such demands multiply—for the machine tool industry, the electronics industry and so forth—advocates of a national industrial policy could end up using NAFTA to leverage the creation of a far-reaching U.S. economic game plan.

To counter such pressures, the President could go over the heads of Capitol Hill lawmakers and appeal directly to voters.

"I believe NAFTA will be won wholesale, not retail," said Calman J. Cohen, a vice president of the Emergency Committee for American Trade, a group of major U.S. multinational corporations that support NAFTA. "It will be won by the President speaking out on why it serves the U.S. national interest. He has to go to the American people and provide them with a vision."

Just about everyone involved in the fight over NAFTA expects the Administration to play the foreign policy card by arguing that rejection of the pact could lead to a collapse of the Mexican economy, a left-wing takeover of the government, growing instability along the border and more illegal immigration into the United States.

But NAFTA's opponents warn that such an approach could boomerang. "Most people up here are not worried about Mr. Salinas," Rep. Levin said. "What dictates will not be whether Mr. Salinas wins, but whether the U.S. wins."

Come the fall, the greatest advantage the Administration may have in the NAFTA end game is voter apathy. Despite their misgivings, pollster Lake said, "voters absolutely assume that NAFTA is inevitable." Such sentiment suggests that the price individual Members may have to pay for supporting the President and NAFTA may not be as high as the deal's opponents imply.

U.S. trade officials argue that opposition to NAFTA has peaked, and that once the business community makes its case for the agreement, victory is assured.

The joker in the deck is Perot. The Texas billionaire is scheduled to air a half-hour anti-NAFTA "infomercial" on NBC on May 30. And NAFTA's opponents say that Perot is willing to spend whatever it takes to stop the deal.

If Perot can galvanize the latent anti-NAFTA sentiment among voters, the free-trade deal is in even bigger trouble in the House. And Clinton may have one more embarrassing defeat on his hands. ■

Clinton may play the foreign policy card by arguing that NAFTA's rejection could lead to a collapse of the Mexican economy, a left-wing takeover of the government and more illegal immigration into the United States.

CONGRESSIONAL QUARTERLY

TRADE

Court Ruling Jeopardizes Approval of NAFTA

A federal judge ruled June 30 that the Clinton administration must conduct a comprehensive review of the environmental impact of the North American Free Trade Agreement (NAFTA), a requirement that, unless reversed on appeal, could doom the controversial pact in Congress.

AP

Mickey Kantor responds to court ruling June 30.

Refusing to abandon its goal of having the pact approved by the end of the year, U.S. Trade Representative Mickey Kantor quickly announced that the administration would seek to have the ruling reversed on an expedited appeal. "It will not delay the legislative process," Kantor said.

Failing a reversal, however, it could take six months or more to assess the environmental effects and provide opponents more time and ammunition to defeat the pact, which would eliminate tariffs and other trade barriers with Mexico and Canada. "It would do great damage to NAFTA," said Rep. Robert T. Matsui, D-Calif., chairman of a special panel trying to build support for the pact in the House.

U.S. District Judge Charles R. Richey of Washington issued the ruling in a case brought by three environmental and consumer groups — the Sierra Club, Friends of the Earth, and Public Citizen — which contended that a 1970 law requiring environmental impact studies of major federal actions should apply to trade agreements. Both the Bush administration, which negotiated the pact, and the Clinton administration had argued that the law did not apply to trade agreements.

"We believe that the court's decision is not in the public's interest," Kantor said. Requiring an environmental impact study on trade pacts "interferes with the president's ability to negotiate international agreements," he said.

Completion of environmental impact studies often takes years because the law requires highly detailed analysis and gives outside groups the opportunity to challenge government findings.

By David S. Cloud

Calling the ruling a "a defining moment for the future of trade agreements," Sierra Club Chairman J. Michael McCloskey said, "We would be light years ahead with a trade agreement if there had been an environmental impact study" originally. "Instead, the former administration swept the problem under the rug," he said.

Though President Clinton endorsed NAFTA during the presidential campaign, he also said that the agreement lacks adequate provisions to protect the environment and clean up pollution in the region along the U.S.-Mexico border. He reopened negotiations with Mexico on supplemental accords to improve protections for the environment and for workers. But the negotiations have stalled over a U.S. demand that sanctions be permitted against countries that do not enforce their environmental laws.

The negotiations to strengthen the pact were intended, in part, to mollify Democrats in Congress, many of whom campaigned against NAFTA last fall, arguing that it would cost jobs and induce companies to relocate to Mexico to take advantage of looser enforcement of environmental laws. The talks were also intended to head off Ross Perot, who has campaigned hard against NAFTA.

Delay May Threaten Goal

The administration's appeal goes to the U.S. Court of Appeals for the District of Columbia Circuit, but it was unclear how quickly the higher court would rule. Even if the court decides as early as September, the delay could threaten the administration's goal of having the pact through Congress and into effect by the beginning of next year.

It seems doubtful that the administration would risk submitting the agreement to Congress for approval while the appeal was pending, although Kantor did not rule that out. Once the pact is formally submitted, Congress must vote on it within 90 days.

House Speaker Thomas S. Foley, D-Wash., said Congress could effectively overturn Richey's decision when it votes on a bill to implement the trade pact. He said the measure could include provisions easing the requirement for an environmental impact study. "Legislation would seem to me to be sufficient to solve any problems regarding impact statements," he said.

But getting NAFTA through Congress was never expected to be easy, and it could be even more difficult if opponents could charge that the administration had failed to conduct a comprehensive analysis of the environmental consequences.

"You can use the argument that where there's smoke, there's fire," said Matsui, "although that can be overcome if the administration comes up with strong side agreements."

Siding with the plaintiffs, Richey concluded that "there is a reasonable risk that the NAFTA may cause environmental injury" and that the administration is therefore obligated under the law to conduct the environmental impact study.

The decision also offers a glimpse of how detailed the study may have to be. In addition to citing grave pollution problems along the border, Richey raised the question of whether NAFTA could flood the U.S. market with lower-priced agriculture commodities, spurring U.S. farmers and ranchers to increase production in ways that would damage the environment. Finally, Richey acknowledged concerns that NAFTA will create "pollution havens" in Mexico, enticing U.S. companies to relocate.

Richey rejected the administration's argument that requiring an environmental impact study would impede the president's power to conduct foreign policy. "The NAFTA is a completed document," Richey said. "The only remaining step to be taken regarding the NAFTA is a domestic one, specifically, the submission of the NAFTA for approval by the Congress." ■

4

Energizing Trade of the States of the Former USSR

CONSTANTINE MICHALOPOULOS AND DAVID TARR

For the 15 newly independent states of the former USSR, transitional trade and payments arrangements are urgently needed to stop the precipitous decline in trade. Next steps should include a sharp cut in export controls, a reduction of state trading and a parallel expansion of inter-enterprise trading, and the development of multilateral clearing and payment mechanisms.

Since August 1991, the 15 states of the former USSR have been establishing themselves as independent nations, each embarking upon systemic reform on a different scale and at a different pace. But with a new incentive structure that discourages trade among the states of the former USSR (so-called interstate trade) and without the necessary institutions to facilitate trade, trade relations among the states have been thrown in disarray, at times verging on a collapse.

Interstate trade had traditionally accounted for the bulk of total trade of the states of the former USSR. Russia was the least dependent, with trade with the other states accounting for 61 percent of its total trade in 1990, compared with over 80 percent for the others (see table). In the aftermath of the breakdown of the USSR, precise data on trade among the New Independent States are not available. But preliminary estimates suggest that interstate trade declined by over 30 percent in 1991. Ominously, further substantial drops in this trade are widely reported for 1992 and the outlook for 1993 is grim.

Of course, some decline in trade flows was expected. After all, for the past 40 years, as in Eastern Europe, trade among these countries was not based on economic principles of comparative cost and locational advantage. Indeed, studies indicate that in the years ahead, these economies can be expected to (1) trade less with each other and more with other countries, notably those in Western Europe, and (2) import more machinery products and export more raw materials and metal products. Unlike Eastern Europe, the former Soviet states must now struggle not only with serious payment problems but also a lack of monetary coordination among those states still using the ruble, and uncertainty surrounding the creation of new currencies.

The main worry now is that the continued contraction in interstate trade will contribute to further declines in output and incomes. Thus, policymakers need to adopt transitional mechanisms that would help states restore efficient trade flows and avoid further serious disruptions of trade flows in the short term, while supporting their longer-term adjustment and integration into the world economy.

Major causes for concern

Throughout 1992, an almost chaotic situation characterized trade and payments in the former Soviet states, reflecting a variety of problems. At the root was the collapse of the monetary and payments system.

Payments regimes. During the first six months of 1992, Russia alone could print rubles, but the central banks of all the states in the ruble zone could expand the money supply by creating credit in rubles. In the absence of monetary coordination, this quickly gave rise to a "free rider" problem, because monetary restraint by some central banks could be exploited by others able to expand their money supply independently. Not only did this situation contribute to inflation but it also impeded efforts to stabilize the ruble and

For a fuller discussion, see "Trade and Payments Arrangements for States of the Former USSR," by the authors, Studies of Economies in Transformation No. 2, *The World Bank, 1992, available from World Bank Publications Services.*

posed difficulties for trade and payments. It did so by creating a disparity in incentives to export between enterprises and for the economy as a whole. Assuming enterprises felt they had as much chance of getting paid (in rubles) when exporting to another state as when selling in the domestic market—not always a valid assumption—they would be indifferent as between the two markets; but for the country as a whole, it would be less advantageous to exchange goods for rubles—after all, its central bank could create all the rubles it wanted.

As the year wore on, Russia, notwithstanding its own considerable monetary expansion, accumulated a significant trade surplus with other republics. This reflected, in part, traditional structural relationships and, in part, the relatively large upward adjustment in the price of oil—Russia's main export. To stem the outflow of goods and control the provision of credit to other states, Russia established a network of correspondent accounts for the central banks of the states, which monitored all bilateral transactions; after July 1992, credit limits were imposed on these accounts. When a country exceeded its limit, the Russian central bank would refuse to clear payments orders (like checks) of enterprises in the debtor country, meaning that Russian exporters would not be paid for the goods they shipped to that republic.

Exacerbating matters was the dramatic decline in the efficiency of the interstate banking system following the dissolution of the Gosbank, once the central bank for all the states. Exporters and importers found that it took two to three months to clear payments orders—a risky business in an environment of high inflation.

At the same time, several countries—such as Ukraine and the Baltic states—introduced their own currencies or quasi-currencies. Others plan to do so in the near future. New currencies do not pose a problem for trade, so long as they are convertible for trade transactions. But if they are not, these states will have to develop clearing and payments arrangements that support direct enterprise-to-enterprise trade. Otherwise, trade among enterprises will continue to be quite inefficient, as it would be based on barter and state-to-state agreements.

Trade regimes. Perhaps the most significant trade barrier—both for interstate and convertible currency area trade—is the widespread use of export licenses and quotas. The motivation for these controls derives from two main considerations:

- Given a lack of monetary coordination within the ruble zone, each country has a strong incentive to import goods and pay for them in rubles, which their central banks can create independently. One way countries can guard against this is to impose quantitative limits on exports.
- Given that the extent of price liberalization has varied greatly from state to state, there are significant price differences in a number of products. Moreover, many prices, notably for energy, are still well below the world level. Without export restraints, such products would be exported to world markets, or to other republics who have higher prices.

On the import side, formal restraints are quite low, as licensing has largely been removed and tariffs are either low or not applied. Competition from abroad is nonetheless weak, because those who must pay market rates for foreign exchange purchase foreign exchange with a substantially undervalued ruble. There are extensive foreign exchange subsidies, but these are available only on non-import-competing products.

Given prevailing market rates of the ruble to the US dollar in most states in 1992, workers have been earning only about 10 US dollars a month, demonstrating the very high value of convertible currency and the high cost of imports at market exchange rates. The undervaluation of the ruble is caused by a number of factors, most notably (1) policies that discourage the repatriation of foreign exchange, such as real interest rates that have remained negative, frequently by 50 percent or more; and (2) policies that discourage exports for convertible currency. The latter include licenses and taxes on exports, along with requirements to surrender foreign exchange earnings at rates much lower than those prevailing in the free market.

State trading through bilateral arrangements. In an effort to deal with interstate trade problems, countries have resorted to many of the features that characterized trade under central planning. By March 1992, an extensive network of intergovernmental bilateral trade agreements had been signed, dividing trade into three categories: "obligatory," "indicative," and enterprise-to-enterprise.

Obligatory list trade entails the intergovernmental barter of 100–150 of the most important energy products and raw materials. Commitments obligate states to fulfill their contracts, and maximum allowable prices are usually specified. Indicative list trade typically includes up to 1,000–1,500 products, such as machinery, agricul-

Intraregional trade looms large in the former Soviet states

	Foreign trade: Total[1]	Foreign trade: Intraregional[2]	Share of intraregional trade
	(percent of GNP)		
States of the former USSR (1990)			
Russian federation	18.3	11.1	60.6
Ukraine	29.0	23.8	82.1
Belarus	47.3	41.0	86.8
Uzbekistan	28.5	25.5	89.4
Kazakhstan	23.5	20.8	88.7
Georgia	28.9	24.8	85.9
Azerbaijan	33.9	29.8	87.7
Lithuania	45.5	40.9	89.7
Moldova	33.0	28.9	87.7
Latvia	41.4	36.7	88.6
Kyrgyzstan	32.3	27.7	85.7
Tajikistanian Republic	35.9	31.0	88.5
Armenia	28.4	25.6	90.1
Turkmenistan	35.6	33.0	92.5
Estonia	32.9	30.2	91.8
Eastern Europe (CMEA) (1989)			
Bulgaria	30.1	16.1	53.4
Czechoslovakia	23.0	10.9	47.2
Hungary	34.1	13.7	40.3
Poland	19.6	8.4	43.1
Romania	17.6	3.7	21.0
European Community (EC) (1990)			
Belgium	74.2	44.5	60.0
Denmark	32.7	13.7	41.7
Germany	29.8	14.4	48.2
Greece	26.8	13.3	49.4
Spain	19.8	9.0	45.3
France	23.3	13.0	55.5
Ireland	59.9	38.9	64.9
Italy	20.4	9.7	47.5
Netherlands	54.4	34.2	62.9
Portugal	42.1	24.6	58.4
United Kingdom	26.0	10.7	41.2

Sources: States of the former USSR: Goskomstat for trade data in foreign trade prices, and unpublished World Bank estimates for GNP; Eastern Europe: UNECE (1990) for trade data, and World Bank Atlas for GNP; Pisani-Ferry and Sapir for the EC. 1990 data are used for the states of the former USSR and the EC; 1989 data for Eastern Europe.

[1] Average of exports and imports as a percent of GNP.

[2] Trade within the states of the former USSR, the CMEA, and the EC, respectively.

tural, and consumer goods. Such trade differs from the obligatory kind in that, although in both cases states agree to provide licenses for enterprise contracts up to the quota amounts specified in each protocol, no trade will take place unless individual enterprises agree on the terms of the sales, including price and credit conditions. The third category includes all remaining products that can be freely traded among enterprises. In practice, however, little is traded free of restraints, as the bulk of trade in value terms is included in the first two categories.

These bilateral agreements fall far short of "solving" the myriad trade and payment problems To begin with, it is unclear how frequently and exactly how trade imbalances among the states should be settled—convertible currency, rubles, and additional goods shipment have been proposed as means of payment, with payment periods ranging from a month or shorter to a year. There are also significant problems with fulfilling obligatory trade agreements, largely as a result of the continuation of price controls, which reduce the incentive to export. At the same time, the system of state orders has either broken down or become less effective. As a result, enterprises, which either do not find it profitable or lack the needed inputs, often do not supply the agreed-upon quantities. More fundamentally, as long as trade is conducted on the basis of bilateral pacts, it is governments rather than markets that are determining the allocation of resources.

Barter. Another way of coping with the confused trade and payments situation is by resorting to barter—which appears to account for a significant, although impossible to quantify, share of interstate trade for a number of reasons. First, because of provisions in the intergovernmental protocols, price controls are prevalent in interstate trade. Second, there are now high risks and costs associated with using the banking system. Third, arrears between enterprises has been a large problem in most states, and the risk of nonpayment is even greater on interstate sales.

Terms of trade. Superimposed on these problems is a deterioration in the terms of trade for many states, as domestic prices are brought closer to world prices. Preliminary estimates suggest that those hardest hit will be Belarus, Moldova, and the Baltic states, who, depending on the actual pattern and volume of trade, might experience losses of about 10–20 percent of GDP. Furthermore, to the extent that international prices are passed on to final users, activities dependent on underpriced inputs (both in domestic and interstate trade) might need considerable restructuring. By contrast, raw material and energy exporters, such as Russia and Turkmenistan, stand to gain. And others, such as Azerbaijan, Kyrgyzstan, and Uzbekistan seem likely to suffer little or no adverse consequences.

In the end, a terms-of-trade adjustment is unavoidable—indeed it is essential for improving resource allocation and integrating these economies into the world economy. On the other hand, there is a question as to how quickly this adjustment should take place. Already, some states are trying to offset their losses by exploiting whatever monopoly power existing linkages and the transportation network give them.

Proposed transition policies

Experience has shown that, as the states of the former USSR look ahead, growth would be facilitated by the establishment of currencies that are convertible on current account (whether it be a convertible ruble zone or new currencies) and the adoption of a trade regime with low and uniform tariffs—free as much as possible of nontariff barriers—to encourage unregulated trade between enterprises. But the current situation is so far removed from this environment that the key questions now center on how best to shape transitional, often second best, arrangements that nonetheless would bring them closer to their desired longer-term goals.

Trade regime toward third countries. Experience throughout the world suggests that; in general, policies that discourage exports should be avoided. In particular, quantitative restrictions and licensing requirements would need to be removed, and exporters should not be forced to surrender foreign exchange earnings at below market exchange rates. Moreover, export taxes are not needed—except on a temporary basis for those few commodities whose domestic prices are controlled and hence below international prices at prevailing exchange rates. Even for these, export taxes should decline to zero as the domestic price moves toward the world price. If states pursue these policies, they should be able to sharply increase their prized convertible currency earnings, thanks to a higher level of exports and an exchange rate that is very favorable to exporting.

On the import side, as long as enterprises continue to trade with each other for rubles in an environment of an undervalued ruble and central allocation of foreign exchange, import competing industries are highly protected and there is no need for protection from third country imports. However, once the ruble is not undervalued or new currencies are introduced requiring convertible currency settlement among states, the incentive structure will change and domestic industries will face import competition from third countries and reduced demand for exports in the states of the former USSR. At this point, states may wish to provide some interim modest protection to domestic industries in order to ease the process of adjustment and cushion the potential costs of increased unemployment.

If there is to be protection, World Bank experience with trade suggests that it can be best provided through tariffs (not to exceed 20–30 percent) that (1) preferably do not vary by sector, or at least have a narrow high-low range, and (2) would decline over time. Such an approach will obviously result in slower adjustment to the long-run optimum and should not be viewed as an alternative to appropriate exchange rate adjustment. In an environment of uncertainty regarding price and exchange rate movements, however, a modest protective margin, provided through tariffs to industries with positive value-added, may be a useful transition device. Tariffs can also play a limited useful role in generating fiscal revenue during a time when tax revenue collection is not yet fully effective, although given the small share of imports from the rest of the world, the revenue from this taxation will not be large.

But if the tariffs are not moderate, they may actually serve to protect negative value-added industries. This would increase the transition costs, because in negative value-added industries, the economy would save convertible currency by importing the final product, exporting the intermediate inputs, and paying workers even if they did not work. And if the tariffs do not decline over time, they would hamper the full integration of the economies into the world trading environment.

State trading. For decades, this type of trading has seriously impeded the efficient allocation of resources and should be discontinued as soon as domestic prices are freed to adjust to world prices. Bilateral agreements may need to be maintained in interstate trade for only those products subject to price controls. However, such agreements should limit the obligatory list to those few products (e.g., oil and natural gas) that are adjusting to world prices on a gradual basis. Moreover, the agreements should increasingly use state procurement agencies, rather than state orders, to carry out trade in these products. For all other products, states should either stop the use of export licenses or make the licenses automatic, as is the case with the indicative list, and the licenses should not be used to balance accounts on a bilateral basis.

Governments would also want to encourage the entry of new firms in trade operations and eliminate the monopoly position of state trading organizations. This would require steps (e.g., in the availability of trade credit) to ensure that private traders are given equal opportunity to participate in trading activities.

Payments problems. To overcome payments problems that inhibit trade, countries must either adopt a fully coordinated monetary and exchange rate policy within the ruble area, or leave the area and adopt independent currencies.

Arrangements within the ruble zone. Any state wishing to remain in the ruble zone must accept the need to coordinate monetary policy and exercise restraint. For these states, it is vital to agree on the rules regarding seignorage, currency emission, monetary policy, and the levels of outstanding balances that each may be able to maintain. Otherwise, overexpansionary policies in one state could lead to significant negative balances that are automatically financed and result in net transfers of goods and services from the others without the receipt of convertible currency.

Measures will also be needed to reduce delays in processing payments orders and improve the efficiency of settlement procedures for ruble zone trade. In addition, commercial banks in each country should be allowed to establish correspondent bank accounts in the commercial banks of the others.

For countries with new currencies. Since these new currencies may be inconvertible for a time, there is a danger that barter will continue to dominate and enterprise-to-enterprise transactions will not materialize. Thus, a system of multilateral clearing with short settlement periods (a clearing union) should be introduced. Such a system would economize on the use of hard currency reserves by permitting transactions at the enterprise level to be conducted in national currencies. Only the multilateral balance within the union would be settled in convertible currency among participating central banks.

In early 1993, an alternative approach—using the ruble for settlement—was being considered by nine countries (excluding the Baltic states, Azerbaijan, Georgia, and the Tajikistanian Republic), in the context of negotiations for setting up an Interstate Bank. This bank, which at least in the beginning is not intended to play a monetary role, will have as its main objective the establishment of an institutional mechanism for multilateral clearing and settlement of interstate payments, based on a short settlement period and strict credit limits. Since different exchange rates are emerging for different "national" rubles and countries such as Ukraine are considering participation, the Interstate Bank may emerge essentially as a multilateral clearing house for countries with different currencies, rather than a ruble zone institution. Although it may fall short of including all new independent states and many of its features are clearly transitional, the Interstate Bank may serve a useful role in addressing the urgent need for establishing a regional multilateral clearing mechanism.

However, more elaborate payments arrangements that involve long settlement periods and the provision of substantial external credit (patterned after the postwar European Payments Union) are not recommended. Such arrangements raise questions as to whether the credits provided finance a structural deficit or the outcome of ineffective overall macroeconomic policies. They may also tend to discourage a movement toward convertibility and future integration into the world economy.

Interstate trade policy. At the very minimum, interstate trade relations should avoid beggar-my-neighbor policies that result in diminution of total trade in goods and services among the 15 states. The movement to world prices will undoubtedly lead to the deterioration of the terms of trade of a number of states, especially oil importers. But this can be mitigated in part by Russia providing energy supplies to other states at domestic oil and gas prices that could be expected to be adjusted to world oil prices in the near term. In parallel, energy-importing states should eschew the temptation of trying to compensate by exploiting monopolistic positions in other areas, such as transportation.

More broadly, the recommended transition tariffs should not be applied to the states of the former USSR—that is, it may be worthwhile to try to set up a customs union or free trade arrangement on a temporary basis. By providing moderate tariff preferences, such an arrangement could provide a modest incentive for maintaining interstate trade in the near future, thereby reducing unemployment costs during the transition.

A few guidelines would include: (1) allowing all states to join, irrespective of whether they desire to remain in the ruble zone—in fact, given the excessive incentive to import from within the ruble zone, the preferential trade pact would only be important for trade among those states with different currencies; and (2) reducing the tariff against third countries and eliminating tariff preferences over time to permit the various states to adjust to their long-run comparative advantage in international trade, which involves less trade dependence on each other.

If a broad-based agreement cannot be arranged, however, more narrow ones, such as a customs union among the Baltic states, may be worth exploring, and different groupings may want to establish different arrangements. The nature of the arrangements could vary, but the more comprehensive the arrangement, the more likely that it will help reduce transition costs in the medium term. Moreover, individual states, especially small ones, may choose not to join any preferential trade area because they regard the trade diversion costs as excessive (i.e., for the range of products they import, they would have to pay high prices to tariff-favored, intra-union, high-cost suppliers). However, they would need to consider the implications of not having preferential access to the area.

Next steps

In sum, as the states of the former USSR design transitional trade and payments arrangements, they will have to contend with a daunting list of intricately linked problems. Perhaps the top priorities should be:

- the reduction of state trading and the simultaneous expansion of enterprise-to-enterprise transactions;
- the elimination of disincentives to exports, such as licensing and other quantitative controls;
- the establishment of a satisfactory system of payments based either on a fully coordinated monetary policy within the ruble zone, or the adoption of new currencies; and
- the establishment of suitable multilateral clearing and payments mechanisms, both within the ruble zone and among the states with new currencies—otherwise, barter will continue to dominate.

It would be especially helpful if Russia were to take the lead in these matters because of the central role it plays in trading relations with all the states in the region. ■

Constantine Michalopoulos
a US national, is Senior Advisor in the Bank's Europe and Central Asia Department. He holds a PhD from Columbia University. Before joining the Bank staff in 1982, he was Chief Economist at USAID.

David Tarr
a US national, is a Principal Economist in the Trade Policy Division of the Bank's Country Economics Department. He holds a PhD from Brown University and has taught at Ohio State University.

DEVELOPMENT
JOURNAL OF THE SOCIETY FOR INTERNATIONAL DEVELOPMENT 1993:1

The Emerging World Trading System - Some Implications for LDCs

Autar S. Dhesi

Autar S. Dhesi reviews the major trends in world trade and the position of the less developed countries (LDCs). He explains the trend towards regionalism in the three industrial centres of the world - the Asian/ Pacific Rim, North America and Western Europe. From this world picture he draws out some policy implications for LDCs.

Challenges for LDCs

The world is in flux both in political and economic terms. It has never experienced such rapid changes as the current ones in peace time before. The old dividing lines between power/economic blocs are becoming blurred and the new ones that are emerging are of a different ilk. The recent developments in Europe, especially the disintegration of Soviet Union and metamorphosis of Eastern Europe in the wake of democratic movements, have challenged policy makers to look for new ways to understand the contours of the world's political and economic map. [1] However, the non-alignment movement is yet to indicate clearly the role it could play on the world scene in these new circumstances. And there is some muted questioning of the relevance of the non-alignment movement, as originally perceived, to the emerging world political and economic setting. Aside from rhetoric the movement's contribution has at best been marginal to the restructuring of world economic relations. That ideology is no substitute for thought is the message today for those wishing to influence world development. The following takes up this message in an examination of the present redistribution of economic power and readjustment of trade restrictions and the challenges and opportunities these present to LDCs.

LDCs role in world trade

The world economy has witnessed some discernible trends in the field of international trade in recent years. First, world trade has been expanding at a faster rate than world production. According to the GATT Annual Report for 1989, growth in the volume of merchandise trade (7 percent) outpaced growth in world production (3 percent) for the second consecutive year. Second, the world economy is becoming increasingly integrated, and provides better opportunities for gains from innovation and investment. The recent data provide ample evidence of the rising share of trade in the national production of most GATT contracting parties. (GATT, 1992)[2] Third, the share of LDCs as a whole in world exports of manufactures has continued to rise significantly in the 1980s. (GATT, 1990) Even all the GATT's "dynamic traders" are LDCs (to be more precise NICs), and the relative importance of manufactured products in the share of these countries' merchandise trade is increasing. [3]

The main features of the structure of international trade relegate the bulk of LDCs to an inferior place in the international system. Diana Tussie (1989) has summed up these features as the complementary of trade and direct investment, the concentration of trade and investment among development countries (DCs), the oligopolistic market structure of world trade, and the prevalence of intra-industry and intra-firm trade via specialization within the multiproduct. In contrast, the bulk of trade of the LDCs is concentrated in primary commodities and standardized semi-manufactures with high price sensitivity, low technological innovation, and considerable international competition. These sectors even in DCs have limited capacity to adjust to changing economic environment in the short run. The DCs find it difficult to reallocate resources smoothly when open to competition from LDCs in these sectors. The fear of losing output and employment opportunities generates pressures for trade restrictions. An important example is Multifibre Arrangements, imposing quotas on exports of textiles from LDCs to DCs. These arrangements discriminate against LDCs

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release May 28, 1993

REPORT TO CONGRESS CONCERNING EXTENSION OF WAIVER AUTHORITY FOR THE PEOPLE'S REPUBLIC OF CHINA

Pursuant to section 402(d)(1) of the Trade Act of 1974 (hereinafter "the Act"), having determined that further extension of the waiver authority granted by section 402(c) of the Act for the twelve-month period beginning July 3, 1993 will substantially promote the objectives of section 402, I have today determined that continuation of the waiver currently applicable to China will also substantially promote the objectives of section 402 of the Act.

Freedom of Emigration Determination

In FY 1992, 26,711 U.S. immigrant visas were issued in China. The U.S. numerical limitation for immigrants from China was fully met. The principal restraint on increased emigration continues to be the capacity and willingness of other nations to absorb Chinese immigrants, not Chinese policy. After considering all the relevant information, I have concluded that continuing the MFN waiver will preserve the gains already achieved on freedom of emigration and encourage further progress. There, thus, continues to be progress in freedom of emigration from China; we will continue to urge more progress.

Chinese Foreign Travel Policies

In FY 1992, 75,758 U.S. visas were issued worldwide to tourists and business visitors from China, a 35 percent increase over FY 1991 and a 76 percent increase over FY 1988. Foreign travel by Chinese-government sponsored businessmen alone increased by 48 percent in FY 1992, reflecting Deng Xiaoping's policies of accelerating China's opening to the outside world.

In FY 1992, 18,908 student visas (including exchange students) were issued, a decline from FY 1991 of 14 percent but still 8 percent greater than FY 1988. The decline was probably the result in part of a recent new directive requiring Chinese college graduates educated at state expense to work for five years before applying for privately-funded overseas study. A drop in funding from recession-strapped U.S. schools and relatives may also have played a role.

Chinese students continue to return from overseas for visits without any apparent problem. With the exception of student activist Shen Tong, we are not aware of any case in which Chinese living in the U.S. who returned to China for visits after June 1989 were prevented from leaving again. Shen was detained in September 1991 and then expelled from China two months later for trying to establish a Beijing chapter of his Fund for Chinese Democracy.

Human Rights Issues

As detailed in the Department's annual human rights report, China's human rights practices remain repressive and fall far short of internationally-accepted norms. Freedoms of speech, assembly, association, and religion are sharply restricted.

China understands that the Clinton Administration has made human rights a cornerstone of our foreign policy. We have already repeatedly raised our concerns with the Chinese authorities and we intend to press at every opportunity for observance of internationally accepted standards of human rights practice.

We have made numerous requests for information on specific human rights cases. China has provided information on some of these cases but further and more complete responses are necessary. The Chinese recently released, prior to completion of their sentences, several prominent dissidents whom we had identified on lists provided to them. These included not only Tiananmen-era demonstrators but also Democracy Wall (circa 1979) activists. We hope this is the first step toward a broad and general amnesty for all prisoners of conscience.

The Chinese promised then Secretary Baker in 1991 that all Chinese citizens, regardless of their political views, have the right to travel abroad. The only exceptions are citizens who are imprisoned, have criminal proceedings pending against them, or have received court notices concerning civil cases. A number of prominent dissidents, despite long delays, have been able to leave China. Some others have not. Those who have been able to obtain exit permits in the past year include labor leader Han Dongfang, writers Wang Ruowang and Bai Hua, scientist Wen Yuankai, journalists Wang Ruoshui, Zhang Weiguo, and Zhu Xingqing, and scholar Liu Qing. Others, like Hou Xiaotian, Yu Haocheng, and Li Honglin, continue to face difficulties in obtaining exit permission. We continue to press the Chinese on these and other cases.

Our goal is the release of all those held solely for the peaceful expression of their political and religious views. In November 1991, the Chinese confirmed to Secretary Baker the release of 133 prisoners on a list presented them earlier in June of that year. Since then, the Chinese have released additional political prisoners, including Han Dongfang, Wang Youcai, Luo Haixing, Xiong Yan, Yang Wei, Wang Zhixin, Zhang Weiguo, Wang Dan, Wang Xizhe, Gao Shan, Bao Zunxin, and a number of Catholic clergy and lesser known activists. We continue to press for a general amnesty and for permission for international humanitarian organizations to have access to Chinese prisons. We have also pressed for improvement in the conditions of those in Chinese prisons.

China has recently and for the first time admitted publicly that domestic human rights policies are a legitimate topic of international discussion. China has hosted human rights delegations from France, Australia, the U.K., and Germany. China sent several delegations to the U.S. and Europe, as well as Southeast Asia, to study foreign human rights practices and issued a "white paper" maintaining that basic human rights are observed in China and arguing that a country's human rights record should be viewed in light of its own history and culture. We reject this limited definition of human rights but believe it is a significant step forward that China is willing to debate human rights issues with its international critics.

more

American Enterprise Institute for Public Policy Research

AEI

Drifting toward Protection?

By Claude E. Barfield

1: NAFTA Side Deals: Poison Darts

There is a real danger that labor and environmental side agreements now being negotiated for the North American free-trade pact will erode many of the treaty's economic benefits and set a harmful precedent for future trade deals.

The danger is heightened by fundamental divisions over trade policy at the center of the Clinton administration. These divisions have resulted in erratic, contradictory positions, bizarrely defended by U.S. Trade Representative Mickey Kantor as a way of keeping our negotiating partners off balance.

Mr. Kantor has said repeatedly that he is not interested in trade "theology." But the history of the debate over the trade pact's side agreements shows that, at least in this case, eschewing theology merely disguises a desperate search for positions that are politically acceptable to key interest groups and to the protectionist wing of the Democratic Party.

Thus, President Clinton vowed during the election campaign not to accept the free-trade agreement without strong safeguards—that is, sanctions—against labor and the environmental rule-breakers. Yet in early March, Mr. Kantor unveiled tentative plans for trilateral commissions that would only gather facts and dispense advice.

This produced fierce opposition from some congressional Democratic leaders, so Mr. Kantor reversed himself within a week, asserting that commissions would indeed have "teeth." Four weeks later, in mid-April, the administration reversed course yet again and backed down on strong trade sanctions and cross-border enforcement powers for the new commissions.

The double-backspring flip-flops are comical; the issues are not. In the future, the United States is likely to expand its regional and bilateral free-trade agreements to South America and Asia—including a number of developing countries with lower per capita incomes and less productive work forces. Thus, the precedent set by these side agreements may have far-reaching consequences.

Behind the grab for power by labor and environmental interests—abetted by industries that hope to see the treaty go down because of disputes over the side agreements—lie real philosophical differences.

On the one side are those who argue that governments must intervene to force harmonization of wages, social welfare, and environmental standards through the use of trade sanctions. As one environmental leader recently said, "We challenge the basic assumption...that markets are capable of establishing accurate values for natural resources and environmental protection."

Similarly, the AFL-CIO has demanded future mandated increases in the Mexican minimum wage structure as a condition for approval of the trade agreement.

On the other side are those who argue that forced upward harmonization of environmental and labor standards—ahead of productivity and income gains in Mexico—is self-defeating.

The former states of East Germany present a current case study of the futility of trying to force economic change from the top down. German officials made a huge error by agreeing to equal wage levels between western and eastern Germany in 1994 even though the productivity of east German labor is only half that of west German workers. The result has been wide-scale bankruptcy of companies in the eastern states, soaring unemployment, and the prospect of costly subsidies for the extended future.

Beyond economic considerations, there is the issue of sovereignty. Mexico or Canada—or any nation that signs on later to the free-trade agreement—may well have legitimate reasons for a very different set of environmental or social welfare priorities.

For instance, given the amount of deadly air pollution over Mexico City, Mexico may well prefer very stringent air pollution regulations while tolerating less rigid rules for chemical or water pollution.

And Mexican labor may well find lower wage rates acceptable in return for more substantial health or unemployment benefits. Complete congruity of environmental, labor, and social welfare standards is neither possible nor desirable.

What many U.S. environmental and labor leaders really want when they push harmonization is replication of U.S. priorities and standards. An attempt to force such a view onto the proposed trilateral commissions would destroy the free-trade agreement—and would establish conditions to which no other nation in Central or South America could submit.

It is for this reason that commissions with extraterritorial authority and the power to impose trade sanctions are poisoned darts aimed at the free-trade pact. They should be opposed by all who want to see this agreement ratified.

[from the *Journal of Commerce*, May 3, 1993]

1150 Seventeenth Street, N.W., Washington, D.C. 20036, 202/862 5800

The U.S. continually raises with the Chinese government the need for protection of Tibet's distinctive religion and culture. We are concerned about China's heavy-handed suppression of political demonstrations in the Tibetan Autonomous Region. Demonstrations, on a smaller scale than in past years, continue to result in instances of brutal beatings and long detentions. China has admitted some foreign observers to Tibet and to the main Lhasa prison. Diplomatic reports state that the Chinese Government is providing funds for rebuilding monasteries and that monks are now provided more leeway in their religious practices. In recent years, an increasing number of non-Tibetan Chinese have moved to the Tibetan Autonomous Region in search of economic opportunity. We will continue to monitor closely reports that the PRC is encouraging involuntary emigration by non-Tibetan Chinese to areas traditionally settled by Tibetans. So far, we have found no evidence of a Chinese government policy to this effect.

Nonproliferation Issues

China's support for global nonproliferation initiatives has increased substantially since the beginning of 1992. In March 1992, China acceded to the Nuclear Non-Proliferation Treaty (NPT) and adhered to the Missile Technology Control Regime (MTCR) guidelines and parameters. In January 1993, Beijing became an original signatory to the Chemical Weapons Convention (CWC). China now is a party to all of the leading nonproliferation agreements. These commitments have influenced Chinese behavior: Beijing has refrained from selling certain sensitive items because of proliferation concerns, and nonproliferation as an issue appears to receive more senior consideration in Chinese policy-making circles.

At the same time, certain sensitive Chinese exports raise questions about PRC compliance with these commitments. At present, the greatest concern involves reports that China in November 1992 transferred MTCR-class M-11 missiles or related equipment to Pakistan. Such a transfer would violate China's MTCR commitment and trigger powerful sanctions under U.S. missile proliferation law. There also are reports that China is exercising inadequate control over sensitive nuclear, chemical, and missile technology exports to countries of proliferation concern. Even if these sales do not violate PRC obligations, they raise questions about China's appreciation of the importance of preventing the proliferation of weapons of mass destruction and their ballistic missile delivery systems.

We are also concerned that China has withdrawn from the Middle East arms control (ACME) talks. The U.S. holds that, as a permanent member of the UN Security Council, China has a special responsibility to continue in these talks.

Seeking full Chinese compliance with multilateral obligations and support for international nonproliferation goals is a top Administration priority. The U.S. is prepared to employ the resources under U.S. law and executive determinations -- including the imposition of sanctions -- if the PRC engages in irresponsible transfers

Trade Issues, Including Prison Labor

Reciprocal granting of MFN tariff status was a key element cementing the normalization of Sino-U.S. relations by providing a framework for major expansion of our economic and trade relations. In 1992 bilateral trade topped $33 billion, with Chinese exports of $25.8 billion and U.S. exports of $7.5 billion. China was our fastest growing export market in Asia in 1992 as U.S. exports to China rose by 19 percent. In turn, the United States remains China's largest export market, absorbing about 30 percent of China's total exports.

China maintains multiple, overlapping barriers to imports in an effort to protect non-competitive, state-owned industries. China also has recognized that its development goals cannot be achieved without gradually reducing protection and opening its domestic market to the stimulus for change brought by import competition.

Our market access agreement, signed October 10, 1992, if implemented by the PRC, will increase opportunities for U.S. exports by phasing-out 70 to 80 percent of China's non-tariff trade barriers over the next four years. The regular consultation process required by this agreement allows us to monitor implementation and take appropriate action should China violate its commitments. Progress has been made in opening the market to U.S. products but we still need to resolve several issues regarding implementation.

Recently, the Chinese have indicated an interest in doing more business with U.S. companies. As U.S. corporate executives are arriving in droves to explore new commercial opportunities in Beijing, at least eight Chinese delegations have been or will soon be dispatched to the U.S. with orders to "buy American". These missions have the potential to generate billions of dollars of exports of aircraft, autos, satellites, oil drilling equipment, aviation electronics, wheat, fertilizer, and other U.S. products.

Still, the large and growing U.S.-China trade deficit is unacceptable. The over $40 billion trade surplus China has accumulated with the United States since June 1989 has been very destructive to American industries, particularly the textile and footwear sectors, resulting in the loss of American jobs. It is therefore essential that the PRC implement the market access agreement we have negotiated, which would produce a much greater equilibrium and fairness in Sino-American trade.

Prison Labor

China officially banned the export of products produced by prison labor in October 1991. In August 1992, we signed a Memorandum of Understanding under which the Chinese agreed to investigate cases we presented and to allow U.S. officials access to suspect facilities in China.

The U.S. has presented the Chinese government information on 16 cases of alleged use of prison labor. The Chinese have reported back on all 16 cases, admitting that in four cases they were forced to correct the fact that prisoners were being used to produce goods exports in violation of Chinese law. U.S. officials have visited three prisons and have standing requests to visit five others, including a revisit to one facility.

In the past two years, U.S. Customs has aggressively expanded its enforcement of U.S. laws banning the import of prison labor products. Customs has issued over twenty orders banning suspected Chinese goods from entering the U.S., achieved one court conviction of a U.S. company for importing prison made machine tools and seized suspected equipment in another case.

more

Since the Prison Labor Memorandum of Understanding was signed last August, there has been no indication that goods allegedly produced by prison labor have entered the U.S. Talks with China will continue on the full enforcement of the provisions of the prison labor MOU.

Conditions for Renewal in 1994

China has made progress in recent years in the areas of human rights, nonproliferation, and trade. Nevertheless, I believe more progress is necessary and possible in each of these three areas. In considering the optimal method of encouraging further progress on these issues, I have decided to issue the attached Executive Order which outlines the areas in the field of human rights with respect to which China, in order to receive positive consideration for a renewal of MFN in 1994, will have to make overall, significant progress in the next twelve months.

In considering extension of MFN, we will take into account whether there has been overall, significant progress by China with respect to the following:

-- Respecting the fundamental human rights recognized in the Universal Declaration of Human Rights, for example, freedoms of expression, peaceful assembly and association.

-- Complying with China's commitment to allow its citizens, regardless of their political views, freedom to emigrate and travel abroad (excepting those who are imprisoned, have criminal proceedings pending against them, or have received court notices concerning civil cases).

-- Providing an acceptable accounting for and release of Chinese citizens imprisoned or detained for the peaceful expression of their political views, including Democracy Wall and Tiananmen activists.

-- Taking effective steps to ensure that forced abortion and sterilization are not used to implement China's family planning policies.

-- Ceasing religious persecution, particularly by releasing leaders and members of religious groups detained or imprisoned for expression of their religious beliefs.

-- Taking effective actions to ensure that prisoners are not being mistreated and are receiving necessary medical treatment, such as by granting access to Chinese prisons by international humanitarian organizations.

-- Seeking to resume dialogue with the Dalai Lama or his representatives, and taking measures to protect Tibet's distinctive religious and cultural heritage.

-- Ceasing the jamming of Voice of America broadcasts.

The Administration will also use tools under existing legislation and executive determinations to encourage further progress in human rights.

In addition, I wish to make clear my continuing and strong determination to pursue objectives in the areas of nonproliferation and trade, utilizing other instruments available, including appropriate legislation and executive

more

58

determinations. For example, various provisions of U.S. law contain strong measures against irresponsible proliferation of weapons of mass destruction and nuclear weapons technology. These include missile proliferation sanctions under the National Defense Authorization Act. Using these tools as necessary, we will continue to press China to implement its commitments to abide by international standards and agreements in the nonproliferation area.

In the area of trade, the Clinton Administration will continue to press for full and faithful implementation of bilateral agreements with China on market access, intellectual property rights, and prison labor. Section 301 of the 1974 Trade Act is a powerful instrument to ensure our interests are protected and advanced in the areas of market access and intellectual property rights. The Administration will also continue to implement vigorously the provisions of the Tariff Act of 1930 to prevent importation of goods made by forced labor.

# # #

A completely free community wide international free market for movement of goods, services and factors of production is the object.

The European Community brings together twelve nations with a total of 340 million people and a combined gross "national" product of US$ 3 trillion. The EC is expected to expand with Turkey, Malta, Cyprus and Austria having already applied for membership. In addition, the EC and European Free Trade Association (EFTA) recently agreed to create the "European Economic Area" free of trade restrictions. In 1993, the countries of EFTA will begin adopting EC-type laws removing tariffs and other restrictions. This will create a market of more than 380 million consumers. Further Sweden, Iceland, Finland, Norway, Switzerland and several countries in Central Europe also are keen to join the EC. Once this process of EC expansion is completed, Western and Central Europe may become the world's largest market area with concomitant economic and political power. The EC'92 has taken North America and Japan by surprise. They are examining with concern the likely impact of this regional development in Europe on the world economy and the multilateral trade negotiations in progress.[6]

Just as North America seems to be inclined towards Central and Latin America, and the Pacific Rim regions, the EC finds it desirable to look towards culturally and geographically proximate Eastern Europe for trade and investment opportunities.

Policy implications for LDCs

First, LDCs have to work out a strategy to ensure that the existing or emerging DC regional trade arrangements do not shut them out further and that their interests are attended to both through direct negotiations and more liberalized multilateral trading system. For this, they need to solicit the cooperation of those who are willing to extend them support. For example the U.S., being an efficient producer of services and knowledge, is very keen to see some liberalization of trade services, and reach an agreement for the better protection of intellectual property rights. At the same time, the U.S., supported by Australia and New Zealand is also pursuing liberalization of trade in agriculture. It strongly feels, justly to some extent, that it gave more through earlier rounds than it gained. The EC and Pacific Rim countries, which gained most from liberalization of trade in manufactures since World War II, are anxious to see that the North American market remains open to them.

The LDCs are keen to see that textiles and other labour intensive products in which they have comparative advantage are freed from non-tariff restrictions. It is inappropriate to consider the interests of LDCs in block as opposed to those of DCs. Both groups are heterogeneous.[7] There is enough elbow room for negotiations to make them a positive sum game. LDCs, individually or in groups depending a particular issue, should solicit the cooperation of those DCs who are willing to come forward in their support even if motivated to advance their own interests.

Second, the major source of their weak position in negotiations among other factors is the lack of generation of ideas matching those coming from the large epistemic community in DCs. Ironically, some of the ideas generated by DC epistemic community have been used by LDCs to advance their position in negotiations.[8] This is particularly so in case of negotiations on trade in services.[9] One possible solution is that UNCTAD is transformed into a powerful think-tank in the changed world scenario to play an effective role in advancing the interests of LDCs. So far it has had limited success in this respect for a number of reasons. (Dhesi and Benjamin, 1984)

Third, the LDCs can reduce their dependence on DCs for industrial development through export of manufactures by setting their priorities right. The top priority should be given to increase productivity in agriculture, both to feed the growing population and to supply raw materials for industrial development. Further, surplus is needed to supply savings for capital formation and generate sufficient demand for industrial goods (Dhesi, 1978). The high productivity in agriculture also induces the generation of many interrelated job creating activities in the rural and semi-rural areas. These are the essential components of the so called broad based development strategy supposedly having the desired effects on population growth and other social benefits (Dhesi, 1981). In this process, farm wage increases rapidly following Arthur Lewis (1978), it is farm productivity which determines the price of labour and factorial terms of trade internationally, a matter of serious concern for primary producing LDCs. The exports of manufactured goods in the presence of an unlimited reservior of low productivity food producers would not help in improving their factorial terms of trade. The LDCs will substitute one type of dependency for another. Trade cannot be a substitute for technical change.[10]

Fourth, efforts can be made in LDCs to gear investment and imports to strengthen their technological base, and to produce mass consumption goods curtailing the production of luxury goods. The liberalization or at least rationalization of inflow of foreign direct investment and imports having a bearing on technological development would facilitate the acquisition of comparative advantage and the eventual partial reversal of this inflow (Dhesi, 1985). This will augment the growth of reproducible wealth thus making is possible to alleviate the extremes of poverty and deprivation. This process will be facilitated if LDCs are able to eschew internal as well as intra-regional traditional rivalries and contain conflicts releasing resource and energies for development.

Fifth, generation of technical and managerial skills in the context of overall human resource development will help LDCs to maximize gains from external participation in production by developing and strengthening complementarities between the inflow of external resources and domestic inputs. (Dhesi, 1983) Some observers even contend that "industrial capacity, financial capital, technology and information are no longer the driving forces of the economy" (Crawford, 1991). It is the human capital-combination of human intelligence, talent, creativity and knowledge that is assuming the pre-eminent place. In this context, the effective adherence to the principle of collective self-reliance in various fields especially technology and human resources development will certainly make LDCs less vulnerable to the manipulations of the rich.

Autar S. Dhesi *is Professor of Economics at Guru Nanak Dev University, Amritsar 143 005, India.*

in violation of the GATT's most favoured nation clause. In any case, the imposition of quantitative restriction rather than tariffs is also in contradiction to a fundamental GATT principle.

Trends towards regionalism

The multi-lateral negotiations not withstanding, the world economic system is characterized by a growing regionalism in trade in the main industrial centres — Asian/Pacific Rim, North America and Western Europe. The recent years have witnessed a discernible move towards formation of regional and bilateral blocks, free trade areas, and customs/economic union. This represents a major surge for more open and integrated economic relations at the regional level. This is partly a consequence of dynamics of global industrialization, and partly a reaction to the slow pace and low productively of multi-lateral negotiations.[4] It may also reflect the concerns of countries to encourage or avoid dependence. In any case, most of the countries around these industrial centres are likely to be associated with them in one form or the other. As such, these regional groups have the preponderant share of trade among GATT members. Their regional evolution and intra-regional interaction will constitute a dominant influence on the development of GATT as a framework of multilateral trade.

Asian/Pacific Rim Countries

In 1982, the volume of trade across the pacific surpassed that across the Atlantic (Harris, 1991). A strong trend to regionalization has manifested itself in Asia in the rise of the Asian Rim economies under business leadership of Japan. Like EC, over 60 percent of the trade of the Pacific Rim nations stays within the area (Weidenbaum, 1992). The countries of the Pacific Rim: Japan, the newly industrializing countries or "Little dragons of East Asia" — Korea, Taiwan, Singapore and Hong Kong, and the countries of South East Asia — Indonesia, Malaysia, Thailand and Philippines have the most dynamic economies in the world. The six nations that make up the Association of South-East Asian Nations — Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand — now constitute larger market for Japan than does the U.S. (Weidenbaum, 1992). For Indonesia and Malaysia, Japan is now the leading trade Partner for exports as well as imports. By 1995, it is likely that Japan will provide the largest market for the exports and perhaps also the imports of the Asian Rim nations. No wonder, Japan is increasingly giving preference to South-East Asian countries in aid and investment.

The Association of South-East Asian Nations (ASEAN), while it does not function as a regional trade arrangement, has become an "effective interlocution for cooperation in economic matters and foreign affairs with OECD Countries. (Drake and Nicolaidis, 1992) ANZCERA, the Australia, New Zealand Closer Economic Relations Trade Arrangement, is currently the only formal Pacific Rim trade arrangement. But these two countries are keen to develop closer economic ties with North America. Japan, however, is not member of any formal trade arrangement.

North American Free Trade Area

Negotiations are underway that may turn America into the world's largest and most populous unified market. In 1989, the United States and Canada signed a free trade agreement that seeks to eliminate all tariffs and non-tariff barriers to trade by 1998. The agreement resulted from a natural increase in U.S.-Canadian trade and from a desire to create a counter weight to the EC through NAFTA. (Harris, 1991) Now negotiations are underway with Mexico to establish this larger free trade area. It will be the world's largest free market, with 364 million consumers and total output of US$ 6 trillion.

This area will encompass over 20 million square kilometers (more than twice the size of Europe) with a population larger than European Community's and three times as large as Japan's. The trade among the three nations will grow from its US$ 250 billion a year. (Fry, 1991) It is also hoped that a trilateral accord also will speed up the process of negotiating agreements with nations in Central and South America. (Fry, 1991) There is no immediate danger of shutting out the remaining world. The participants in NAFTA negotiations conduct 60 percent of their total trade with countries outside the region; each one of them depends on the GATT to safeguard its access to foreign markets and to pursue multilateral trade liberalization. As the economies of North America restructure and grow in response to the combined stimulus of domestic reforms and NAFTA Commitments, and thus become more competitive in world market, the GATT system will become even more important. The future challenge is to ensure that successful NAFTA will complement and not weaken the world trading system. (Hufbauer and Schott, 1992)

European Economic Community

At present, the world focus is on the European Community. Its move to complete the process of economic integration by the end of 1992, once completed, will effect a major structural shift in Western Europe. This phenomenon is usually referred to as EC'92 even though the actions being taken are part of an ongoing process that may continue into 1993 and beyond. [5] However, by the end of 1992, the economic integration of the EC members will be quite advanced. Of the 300 actions sanctioned by the EC in 1987, about 250 already have been presented as formal proposals, and 130 of them have been adopted by the EC Council of Ministers. (Weidenbaum, 1991) Many of the difficult measures already have been taken. These actions are intended to eliminate the physical, technical and fiscal obstacles to an integrated Europe.

TRADE

BRUCE STOKES

NOT-SO-FAVORED CHINA


Igor Kopelnitsky/INX

Mao Zedong once derided the West as a paper tiger. The United States reaffirms that contemptuous judgment every year during the annual charade that passes for a congressional debate over renewal of China's most-favored-nation (MFN) trading status.

Despite providing China with a large and growing overseas market, Washington has repeatedly concluded that using that market to exercise leverage over Beijing's policies can only backfire. When China's violation of its own citizens' human rights threatened U.S. ideals but not America's practical well-being, restraint had a crass but coherent rationale. But as the consequences of Chinese actions—with regard to arms sales, trading practices and safeguarding of the environment—increasingly have impact beyond China's borders, failure to take action may become harder and harder to defend, in the view of many analysts.

To date, those advocating withdrawal of China's MFN privileges have never convincingly demonstrated that such action would produce the intended benefits. In the future, as U.S. self-interest in Chinese behavior rises, the burden of proof may increasingly fall on the defenders of China's MFN privileges to demonstrate that maintaining the status quo has produced any meaningful results.

MFN status, accorded most U.S. trading partners, provides virtually duty-free access to the U.S. market. China's MFN privileges, first extended in 1979, must be renewed annually by presidential certification that China is complying with the human rights provisions of U.S. trade law. This year, that certification falls due on June 4. If China loses MFN treatment, its shipments to the United States could be slapped with several billion dollars in tariffs. With higher duties on Chinese-made products, many U.S. importers would undoubtedly turn elsewhere.

After the Chinese government's massacre of students in Tiananmen Square in June 1989, Congress attempted to punish Beijing by conditioning MFN on improvements in China's protection of human rights. Each year, the Bush Administration blocked such efforts, arguing that they were futile and would undermine U.S. economic and geopolitical interests.

On the campaign trail, candidate Bill Clinton promised a tougher line. But now President Clinton is backing away from that rhetoric. White House officials insist that all options are still under consideration. But most analysts on Capitol Hill and in the business community expect that the Administration will certify that China is complying with U.S. law but will attempt to preempt congressional action by issuing an executive order threatening to lift China's trade privileges next year if Beijing does not meet certain conditions.

"The Administration is looking for a way to do everything Congress might want by executive order," said Sen. Mitch McConnell, R-Ky., an opponent of lifting China's MFN privileges. He predicted that the President "will take unilateral action on missile transfers, human rights and some other things."

A Senate staff aide long critical of China predicted, "We will see a very sophisticated dance and betrayal." He speculated that the White House's conditions will look tough but be fashioned so that Beijing can get over the immediate hurdle, thus permitting MFN recertification in 1994.

In the immediate aftermath of Tiananmen, when Chinese progress on human rights was the West's main concern, such MFN maneuvering was tactically justifiable. Through similar bluster short of action, conditions in China were gradually if grudgingly improved.

But the problems facing U.S.-Chinese relations in the future may require more direct action, many analysts agree. Recent allegations that China is continuing to ship missile parts to Pakistan—a violation of its international commitments—threaten global stability. The Bush Administration argued that MFN renewal was a carrot needed to get China to sign the Missile Technology Control Regime. Now some in the Clinton Administration reason that MFN renewal is necessary to ensure compliance. Such circular logic suggests that China need never be held accountable for her actions.

China's trade surplus with the United States, which reached $18 billion in 1992, has been growing faster than America's imbalance with Japan. Last year, Beijing signed agreements granting greater protection to U.S. intellectual property and pledged to further open its markets to American-made products. Data for the first two months of this year show U.S. exports to China up 34 per cent, while imports from China increased only 12 per cent. This is an auspicious sign, but unless the trend continues, Beijing's preferred access to the U.S. market will become even more difficult to preserve.

Finally, China's generation of electrical power, which mostly depends on the burning of coal, has become one of the principal sources of the greenhouse gases that contribute to global warming, experts say. "Wait until the environmentalists interested in trade get hold of this one," a Washington trade lawyer predicted. If the Administration does not begin to use MFN to leverage more environmentally benign Chinese energy production, green activists will.

Defenders of China's MFN status argue that such actions would be futile. "I am skeptical of withholding trade relations to make a statement about something we don't like," McConnell said. "The only people you hurt when you terminate MFN are the [Chinese] democrats and capitalists."

For the past four years, just such arguments have successfully been used to ward off economic sanctions against China. As a result, America's policy toward China has been reactive. Instead of laying down meaningful markers warning Beijing of the consequences of future behavior on a range of issues that affect U.S. interests, Washington has tied itself in knots debating what to do—which usually turns out to be nothing—after those interests have been violated. But as U.S. stakes in Chinese action rise, Washington may no longer be able to afford to continue such a passive policy. ■

FINANCE

FINANCE

Neu, C.R. "International Economic Institutions and Arrangements: New Choices in a New World," Issue Paper, RAND Summer Institute, April 1993.

"Does the IMF Really Help Developing Countries?" ODI Briefing Paper, Overseas Development Institute, April 1993.

Kane, Sara. "Liberalization and the Role of the State Highlighted at World Bank Conference," IMF Survey, The International Monetary Fund, May 31, 1993.

Ahmed, Masood and Sudarshan Gooptu. "Portfolio Investment Flows to Developing Countries," Finance & Development, The International Monetary Fund and the World Bank, March 1993.

Coleman, Rozlyn. "*Staff Papers* Article Examines Latin America's Capital Inflows," IMF Survey, The International Monetary Fund, April 19, 1993.

"External Debt of Latin America and the Caribbean, 1992," CEPAL News, United Nations Economic Commission for Latin America and the Caribbean (ECLAC), April 1993.

"LDC Flows: Liberalisation and Economic Growth," The AMEX Bank Review, American Express Bank, April 26, 1993.

"Latin America and Eastern Europe: Comparing Reform Experiences," Inter-American Development Bank (IDB), March 29, 1993.

Statement of Lawrence H. Summers, Under Secretary of the Treasury for International Affairs, at the Annual Meetings of the African Development Bank Group, Abidjan, Cote d'Ivoire, May 12-14, 1993, Treasury News, U.S. Department of the Treasury, 1993.

"Capacity Building: The Missing Link in African Development," Address of Edward V. K. Jaycox, Vice President, Africa Region, The World Bank, at the African American Institute Conference, Reston, Virginia, May 20, 1993.

Patel, I.G., Ed. "Policy to Rescue Africa," The Newsletter, International Center for Economic Growth, April 1993.

Maital, Shlomo. "Kondratieff's Revenge," Across The Board, The Conference Board, May 1993.

RSI RAND Summer Institute Issue Paper

APRIL 1993

International Economic Institutions and Arrangements: New Choices in a New World

C. R. Neu

In 1944, as World War II was coming to an end, an international conference was convened in Bretton Woods, New Hampshire, to plan the structure of the postwar international economic environment. Earlier arrangements for international trade and payments had collapsed disastrously during the 1930s, and the conferees sought to devise a set of institutions and arrangements for the future that would prove more robust. The conferees also recognized that the end of hostilities would face the world with a reconstruction task of unprecedented magnitude. All nations had a stake in the success of this reconstruction, and means had to be found for channeling global resources into the reconstruction effort. The institutions and arrangements that grew out of the Bretton Woods conference—the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD or World Bank), and, less directly, the General Agreement on Tariffs and Trade (GATT)—have served as the principal pillars of the international economic environment for the past 45 years.

For the most part, these institutions and arrangements have served us well. In most of the world (or at least in most of the countries that participated in the Bretton Woods institutions), overall economic activity has expanded and material welfare has improved at rates that are high by almost any historical standard. International trade and investment have flourished. The economies devastated by World War II were rebuilt, and development assistance has been extended to many other countries. Most important, we have avoided economic catastrophes on the scale of the Great Depression.

But both the nature and the scale of international economic activity have changed enormously in 45 years, and it would be surprising indeed if institutions and arrangements first designed in 1944 were still adequate to the task of managing today's international economy. The Bretton Woods institutions have changed, of course, with the times. Old roles have been abandoned and new ones undertaken. New institutions have been created. Policies have changed in the face of new thinking, new circumstances, and new problems. Much of this change has been ad hoc in nature, though, and uncoordinated. What was once a more or less coherent set of institutions and arrangements for managing the world economy has begun to show gaps, redundancies, and misalignments. The system of international economic institutions devised at Bretton Woods is beginning to show its age, and there is a growing perception that the time has come

---

RAND Issue Papers explore topics of critical interest to the policymaking community, with the intent of stimulating discussion in a policy area. They may identify trends or present tentative observations or informed judgments based on an ongoing program of research.

for a comprehensive rethinking of how we manage the international economy.

We are today at a crossroads not entirely unlike the one perceived by the original Bretton Woods conferees. The collapse of the Soviet empire and the end of the Cold War provide an opportunity for a reconsideration of all international relations—political, military, and economic. Confronted with a new world, we have a chance to shape a new system of international economic institutions as part of a new system of overall international relations—as part of a "new world order." More ominously, the end of World War II presented the Bretton Woods conferees with the real prospect of political and social turmoil if reconstruction efforts failed. The collapse of communism presents the current generation of policymakers with a similar specter. We face, then, not only an opportunity but also an urgent need to consider the adequacy of existing international economic institutions and arrangements.

The Need for Cooperative Action

More so than ever before, national economies are interdependent. Economic forces do not stop at national boundaries, and developments in any part of the increasingly integrated global economy are likely to have consequences elsewhere. The notion is widely accepted that a smoothly functioning international economic environment is an "international public good"—an end that cannot be achieved solely through unilateral actions by individual nations—and the need for some degree of international cooperation is not disputed. The original Bretton Woods conferees recognized the need for international cooperation and concerted action to achieve three primary ends: to create a system of exchange rates and international payments that would facilitate international trade and investment; to establish a set of rules to govern international trading relations; and to provide the international credit necessary to support national efforts at economic reconstruction and development. Today, we might add to these tasks the effective regulation of transnational economic activity, which is increasingly beyond the reach of purely national authorities. Although there is general agreement about the need for some international cooperation to accomplish these four tasks, there is considerable controversy over the nature, the extent, and the specific objectives of this cooperation and over the international institutions required to manage it.

In each of the four principal areas in which international economic cooperation is potentially desirable, fundamental policy choices will have to be made in the next few years. These choices will go a long way toward determining whether and how international economic institutions and arrangements will need to be restructured to manage the world economy in the 21st century. Let us consider what these policy choices are likely to be and the fundamental differences in outlook that lie behind debates over them.

Exchange Rates, International Payments, and Macroeconomic Coordination

In 1973, the worldwide system of fixed exchange rates that had grown out of the Bretton Woods conference collapsed. With it collapsed any consensus on whether or how exchange rates should be managed. Many countries continue to fix the value of their currencies in relation to one or a group of major currencies. But since 1973, the world's major currencies—the dollar, the yen, and the deutsche mark—have floated more or less freely against each other, with exchange rates among them determined primarily by market forces.

Early proponents of floating exchange rates had hoped that market forces would bring about automatic and continuous adjustments of exchange rates. Overall exchange-rate stability would be enhanced, they hoped, because continuous adjustment of exchange rates would keep pressures for large changes from building up. The world would be spared, it was argued, the politically and economically wrenching currency crises that so often preceded exchange-rate adjustments in the overly rigid Bretton Woods system of fixed exchange rates. Floating exchange rates would also give national authorities the freedom to engineer at least temporary changes in the real purchasing power of their currencies and thereby provide opportunities to cushion somewhat the consequences of occasional supply and demand shocks.

But the theoretical promise of floating exchange rates has not been realized. Day-to-day, week-to-week, and month-to-month volatility of exchange rates has been much higher than most proponents of floating exchange rates had expected. Real exchange rates—the relative purchasing power of currencies[1]—have shown very large swings that have persisted for years at a time,

[1]Changes in the real exchange rate between two currencies are calculated by adjusting the changes in the nominal exchange rate for changes in the overall price levels in the two countries. Thus, changes in real exchange rates reflect changes in the relative purchasing power of the currencies in question. If, for example, the general price level in the United States rises by 5 percent while the general price level in Japan remains unchanged, and if the nominal yen/dollar exchange rate remains the same, then the real value of the yen will have fallen by 5 percent relative to the dollar because a fixed number of yen converted into dollars will buy 5 percent less than it did previously. Because real exchange rates reflect costs faced by consumers in one country who are contemplating buying goods produced in another country, they are viewed as important determinants of trade flows.

only to be subsequently reversed. The real value of the dollar, for example, rose 72 percent against the yen from late 1978 to early 1985 and then declined by 46 percent in a space of just three years, from early 1985 to early 1988.

Exchange rate swings of this magnitude can play havoc with investment decisions and production plans. An investor considering the construction of a new automobile plant, for example, faces the prospect that an exchange-rate change sometime during the five years or so it may take to build the plant and bring it into operation could wipe out any prospect of profitably competing with foreign auto producers. It would not be surprising in these circumstances if investors were reluctant to commit themselves. If investment in new plant and equipment lags, productivity growth will also falter. While it is impossible confidently to attribute causality in these matters, and while many other factors are obviously at work, some observers have noted that the much-discussed worldwide decline in growth rates of manufacturing productivity is at least roughly contemporaneous with the period of floating exchange rates.

When investment decisions have been made, a major exchange-rate swing can wipe out the competitive viability of entire industries. The dollar's sharp appreciation in the early 1980s made U.S. products very expensive in world markets, with dire consequences for many industries and communities in the U.S. "rust belt."

Large exchange-rate movements may also pose a threat to the maintenance of a liberal trading regime. National governments cannot easily remain indifferent to the fates of major industries injured by exchange-rate swings and may be hard pressed to resist calls for protectionist policies in the face of major exchange-rate movements. Worse, because tariffs will provide little protection against the consequences of large exchange-rate swings, governments may be increasingly prone to rely on quantitative import restrictions—generally regarded as the worst of all possible trade restrictions—to protect domestic industries threatened by exchange-rate changes. Some observers have suggested that it is no accident that we are seeing an increased reliance on quantitative trade restrictions and managed trade arrangements since the collapse of the system of fixed exchange rates.

Few would argue with the proposition that more stable and predictable exchange rates would be desirable. There is great controversy, however, over how best to pursue increased stability. One camp favors setting explicit targets for exchange rates and adjusting national economic policies as necessary to maintain them. Another camp would place renewed emphasis on efforts by all nations to pursue policies designed to foster noninflationary growth. Such policies, this second camp argues, will eventually bring more stable exchange rates, without the need for formal targets. Where one comes out on this issue hinges critically on one's beliefs about the principal problems that economic policy-makers will face in coming years.

Proponents of explicit targets for exchange rates and direct pursuit of these targets fear that continued exchange-rate instability poses a severe and immediate threat to the maintenance of a liberal, market-driven international trading regime. It may well be that sound national economic policies will eventually bring about exchange-rate stability, but we may not have the luxury of waiting for this desirable result. The threat to the trading regime is clear and present, manifested in the increasing resort to quantitative trade restrictions and preferential trading arrangements. Moreover, there is no guarantee that nations will in fact pursue the kinds of policies conducive to noninflationary growth and which will lead eventually to stable exchange rates. (Indeed, there is not yet any clear consensus on what sorts of policies will produce these desirable outcomes.) In this view, the kinds of economic shocks that are most likely in coming years will be generated by erratic national monetary policies, precisely the sorts of policy mistakes that the discipline of having to maintain stable exchange rates would make less likely. Proponents of formal arrangements to stabilize exchange rates believe that the major nonmonetary shocks—shocks in the supply of or demand for real goods and services—that affect countries differentially and necessitate major exchange-rate realignments will be rare in the future. (The most recent example of such a shock is German reunification, which placed a unique burden on Germany and in September 1992 wrought havoc with efforts to maintain fixed exchange rates among European currencies.)

Opponents of targets discount the dangers to international trade posed by floating exchange rates. The causal link, they say, between volatile exchange rates and protectionist policies has not been demonstrated; and since the postulated link is political in nature, it is most correctly broken by political measures. They argue further that the world is an uncertain place, that shocks of all sorts can come from all directions, and that it is politically naive to believe that national governments will abide by international agreements that limit their freedom of economic policy maneuver. As circumstances change, exchange rates *should* change, and no international agreement is likely to prevent a nation's going its own way when an adjusted exchange rate will serve its national interests. (The recent collapse of the European Exchange Rate Mechanism will provide a strong argument for this view.) Much better, they suggest, to take the long view, to make noninflationary growth the primary target of national and international economic policy, and to let exchange rates take care of themselves.

The International Trading Environment

The vision of an international trading structure that emerged from the Bretton Woods conference and that was later codified in the General Agreement on Tariffs and Trade (GATT) rests on the basic principles of multilateralism and nondiscrimination. Trade concessions are to be negotiated in a multilateral setting, and concessions granted to one country are generally to be granted to all countries acceding to the GATT. In recent years, however, questions have been raised about the continued viability of this approach to setting international trade rules.

Well suited to negotiating reductions in visible and easy-to-quantify trade barriers such as tariffs, the GATT process is in danger of falling victim to its own past success. The task of eliminating explicit tariffs is largely finished, and trade negotiators now must deal with a bewildering multiplicity of nontariff obstacles to trade that are almost impossible to quantify and sometimes hard even to identify. Broad agreements of the "We'll all cut tariffs by 50 percent" sort are no longer of much use. Instead, individual national policies that (intentionally or otherwise) restrict trade in specific products have to be discussed one by one and remedies identified and agreed to, often on a bilateral basis. Multilateral negotiations do not provide the best forum for such painstaking and highly specific horse trading. It is perhaps not a surprise that the current round of multilateral trade negotiations (the so-called Uruguay Round) has been effectively stalled for more than three years. Further, remedies agreed to in bilateral negotiations (for example, an agreement by the Japanese government to encourage increased imports of U.S.-made auto parts) are often inherently discriminatory, favoring the products of a particular exporting nation.

Even the most fundamental principle underlying the GATT—that trade patterns should be determined primarily by market forces and not by government policies—is under considerable attack these days. Despite serious questions about the practical effectiveness of such policies, enthusiasm seems to be growing worldwide for "strategic" trade policies, through which governments provide assistance—usually in the form of subsidies or protection from foreign competition—for "key" or "critical" industries where capturing a large share of the initial world market may bestow important competitive advantage.

For all its creakiness, however, and for all the difficulties we face in adhering to GATT principles in the modern environment, the GATT still provides the only practical foundation for trade policy in the coming years. Few serious observers question the importance of bringing the current round of GATT-sponsored trade negotiations to a successful conclusion. Surely, though, the GATT by itself will not be adequate to meet all the challenges we will face in the early years of the new century. The real policy questions are whether and how GATT should be supplemented by other kinds of international trading arrangements.

Debates have arisen about the wisdom and practicality of extending GATT coverage to agricultural trade and trade in services, both now effectively excluded from the GATT. Proposals have also been floated to create a "GATT-like" framework of rules to govern international investment. Other proposals include the establishment of some rules to define allowable governmental actions in pursuit of "strategic" trade policies and the creation of a "GATT-within-GATT" that would allow some countries to extend additional trade concessions to each other without having to wait for all countries to agree on the concessions or rules of conduct in question. Almost all observers agree that the enforcement powers of the GATT should be strengthened, but there is little consensus about specific enforcement mechanisms.

The sharpest debates over the future course of trade policy, however, are over the wisdom of pursuing, outside of the larger GATT framework, preferential trading arrangements or free-trade arrangements among small groups of countries. The models for such preferential arrangements are the single European market and the North American free-trade area. Other preferential arrangements—not all of them regional in nature—have been proposed and discussed.

Proponents of free-trade zones tend to emphasize the cumbersome nature of the GATT process and the difficulties of applying GATT principles to the realities of modern trade. To postpone all progress toward expanded international trade until all parties to the GATT can reach agreement on a broad agenda of reforms (if such agreement is in fact possible) is to needlessly delay achievable progress and to increase the danger that growing trade friction will undermine the trade we already enjoy. Proponents of preferential trading arrangements propose to seek trade expansion on a piecemeal basis, seeking mutually beneficial (although inevitably discriminatory) agreements among groups of like-minded and politically committed nations whenever the opportunity arises. At the core of support for this approach lies a judgment (or a hope) that over time, additional countries will associate themselves with free-trade arrangements and that piece-by-piece progress will cumulatively approach the ultimate objective of freer world trade. Proponents of preferential trading arrangements favor efforts by the United States and the European Community to add additional countries to their existing free-trade areas. Asian or Pacific Rim free-trade arrangements might also prove profitable.

Opponents of preferential trading arrangements consider these hopes naive and dangerous. In their view, increased trade among participants in a free-trade arrangement will come largely at the expense of countries outside the new arrangement; parties to the free-trade agreement will buy from each other what they used to buy from other countries. As these opponents see it, the creation of political and administrative mechanisms to advance the common interests of members of a trade bloc are more likely than not to lead to actions that will discriminate against and restrict imports from nonmembers. (Nonmembers, after all, will typically not have a seat at the table when members sit down to discuss trade policies.) In the natural course of political events, opponents argue, preferential trading blocs will tend to become increasingly exclusionary. Pursuit of special trading arrangements will not, therefore, advance the GATT ideal of freer world trade. It will instead promote the division of the world into a number of isolated trading zones, each maintaining barriers against imports from the others. These opponents think it foolish for the United States or the European Community to waste their political and bureaucratic energies on negotiating expansions of existing trade blocs. They urge the United States and Japan to do what they can to discourage talk of Asian or Pacific Rim free-trade areas. At the very least, these opponents argue that Article XXIV of the GATT—the article that specifically authorizes the formation of free-trade areas—be strengthened to specify that, after the formation of a free-trade area, common barriers against imports from outside the area must be no higher than the lowest barriers that prevailed in the participating countries before the preferential trading deal was concluded.[2]

Access to International Credit

At the time of the original Bretton Woods conference, private international capital and credit markets were only poorly developed and completely inadequate to meet the financing needs of countries contemplating large-scale reconstruction or development programs. Consequently, the conferees established an official source of credit for reconstruction and development efforts: a multilateral development bank, the World Bank, backed by national governments and managed by international civil servants. The multilateral nature of the World Bank allowed it to extend credit without the political baggage that might be associated with direct loans from one government to another. In the years that followed, a number of other regional but still multilateral development banks were also created.

Today, private international capital and credit markets are well developed. They can and do provide credit to developing countries in amounts far larger than can be had through official channels, and questions have legitimately arisen as to whether there is any longer a need for substantial official development lending. Underlying the debate over this issue is a fundamental difference of views about the relative abilities of official and private lenders to recognize and to fund promising development efforts.

Proponents of official lending argue that private credit and capital are not realistic possibilities for some kinds of long-term development financing needs. Direct investors will never be attracted to major infrastructure projects (like building roads, bridges, or irrigation systems) or social development efforts (like improving health facilities). And few developing countries are able to float long-term bonds. Consequently, developing and reforming economies will typically be dependent on medium-term bank credit. But international banks are fickle in their willingness to lend. Further, they can display herd-like behavior, being too willing to lend at some times and much too reluctant at others. As a result, occasional liquidity crises will threaten national development and reform efforts and international financial stability (as during the international "debt crisis" of the early and mid-1980s). Official lenders, it is argued, will be less subject to wide swings in market sentiment, can provide liquidity during credit droughts, and can thereby stabilize both development programs and international financial markets when private lenders run for cover.

Opponents of official international lending argue that the subsidy implicit in lending from these sources may encourage overborrowing by developing countries, and that the willingness of official institutions to lend allows countries to postpone needed economic reforms. The discipline of the private market, they suggest, would force a more rapid adoption of necessary reforms and hence more rapid economic development. Also troubling to opponents of official lending is the fact that, because the multilateral development banks are creations of governments, they most naturally deal with

[2] Article XXIV currently requires only that barriers to goods produced outside the area be no higher than the *average* of barriers that prevailed in the participating countries. The article does not specify how the average is to be calculated.

and lend to national governments. Increasingly, though, governments in reforming and developing economies are seen as part of the problem, not the solution. Rather than lending to entrenched governments that may have done much to cause existing problems, the argument goes, it may be preferable to lend to private enterprises, which may then set a new, more market-oriented tone for the economy.

Opponents of official lending recognize that even today all countries do not have access to private international credit markets. They argue, however, that access is denied to some countries because they are viewed (usually correctly) as poor credit risks with little prospect of repaying loans. Official assistance to such countries is desirable, and there are advantages to providing it through multilateral channels. But the assistance should properly come in the form of grants rather than loans. Making loans to coun' ies that are not creditworthy is at best dishonest (because there is little likelihood that they will be repaid) and at worst counterproductive (because debtor countries may in fact try to repay them). Bette., these opponents conclude, for official institutions to get out of the international lending business, restricting themselves to collecting, analyzing, and disseminating information about specific borrowers and specific projects, providing technical advice to developing and reforming countries, and possibly serving as a channel for grants (not loans) to countries that have no realistic access to private credit markets.

Also contentious is the role that international financial institutions—and the IMF in particular—have come to play in determining which countries have access to private credit and capital markets. Originally intended to provide short-term financing to countries facing liquidity problems arising from their responsibilities to maintain fixed exchange rates, the IMF has been searching for a new institutional purpose since the collapse of the fixed-exchange-rate system in 1973. In the 1980s, the Fund became the focal point for efforts to manage developing-country debts: helping to negotiate reschedulings and debt restructurings, providing some interim financing from its own resources, encouraging private lenders to extend further credit, setting standards for macroeconomic policy in debtor nations, and monitoring adherence to these standards. In the 1990s, the Fund is emerging as the principal international agency assisting in the restructuring of the formerly centrally planned economies. In both of these new roles, the IMF ands as the principal international arbiter of what constitutes acceptable economic policy for developing and reforming countries. Private lenders are frequently reluctant to extend credit to countries whose policies have not been vetted by the IMF. Some observers find this a useful role for the IMF; borrowing countries find it harder to escape market discipline by playing one private lender off against another. Others, however, are uncomfortable with dominance the IMF has gained in this regard. They note that there is no monopoly on wisdom about the nature of successful economic reform or development programs and that there is no reason to believe that IMF prescriptions will be optimal in all cases. They would prefer to see the IMF play a less central role in determining reform and development strategies.

International Regulation

Recent years have seen a rapid internationalization of economic activities. Firms now straddle international boundaries, fully integrating operations located in multiple countries. Production, information, finance, and people have become increasingly mobile. As a consequence, national authorities are no longer able effectively to regulate some kinds of international business.

This is not altogether a bad thing. Governments frequently attempt to over-regulate economic activities, and the ability to move activities to other countries serves to check more extreme regulatory tendencies. But in some industries (banking is a currently painful example), the need for at least some regulation is widely accepted. When banks operate in many countries, however, effective regulation by national authorities in any single country becomes problematic. The result is an occasional debacle, like the recent BCCI scandal. In such cases, some degree of international regulatory cooperation may be required.

Although there is general agreement on a number of basic principles regarding when and how to seek international regulatory cooperation, there remain intense disagreements about how to apply these principles in particular cases. Among the more controversial proposals for international cooperation are: cooperation among national tax authorities to guarantee the taxation of overseas capital and to discourage "capital flight" from national taxes or regulations; efforts to control the trade in arms and "dual-use" technology; and general efforts to "harmonize" national regulatory regimes.

In these debates, differences in outlook with regard to the competence and benignity of governments become critical. Those who believe that governments (or at least many governments) are generally to be trusted to act wisely and to advance the interests of their citizens are typically in favor of increased international regulatory cooperation. Such cooperation will allow these governments to pursue their laudable ends more effectively. On the other hand, those who are disposed to be suspicious of government motivations and methods prefer to weaken some kinds of international regulatory cooperation because they fear that concerted action will increase the ability of governments to pursue foolish or wrong-headed policies.

A New Bretton Woods?

The international economic environment is much changed from the way it was when the original Bretton Woods conference was convened in 1944. Largely, these changes have been for the better. International trade and investment have expanded rapidly, creating wider choices for consumers and new markets for producers. The global economy has become more integrated, and economic activity may now proceed with much less concern for artificial (at least for economic purposes) political boundaries. Although no one would describe the current international economic environment as tranquil, we have managed throughout the postwar years to avoid the sort of global economic collapse that marked the 1930s.

To a large extent, the salutary changes in the international economic environment came about because of the structures and institutions first envisioned at Bretton Woods. But the new environment poses challenges for the management of international economic relations well beyond what the Bretton Woods conferees imagined. The time has come to revisit the discussions and debates that shaped the original conference. Doubtless, some components of existing international economic institutions will continue to serve us well in the 21st century. Just as certainly, though, other components are in need of a major overhaul. The task of structuring the international economic environment for the 21st century is necessarily a collective undertaking. Unlike the situation in the late 1940s, when the U.S. economy dominated the world, no nation is in a position today to dictate this new structure to the rest of the world or, through its forbearance, to make the structure work despite deviations by other nations from agreed policies. The time has come to begin a new Bretton Woods process, in which scholars and policymakers from all over the world debate the character and purposes of international economic institutions in the next century.

For a more complete discussion of these issues, see C. R. *Neu,* A New Bretton Woods: Rethinking International Economic Institutions and Arrangements, *RAND, MR-116-RC, 1993.*

6

odi

Overseas Development Institute

Briefing Paper

April 1993

DOES THE IMF REALLY HELP DEVELOPING COUNTRIES?

The original Bretton Woods conference gave the International Monetary Fund wide responsibilities: to regulate the volume of international liquidity; to ensure the stability of exchange rates; to promote freedom of trade and capital transactions; to co-ordinate the economic policies of member-states; to assist members with balance of payments (BoP) difficulties. With the break-down of the Bretton Woods system in the early-1970s, some of these objectives became obsolete or unattainable, leaving the Fund with the principal task of providing BoP assistance. Until the recent emergence of former Comecon countries as borrowers, virtually all such assistance since the mid-1970s has been to developing countries (see Table 1). This situation was not envisaged in 1944 at Bretton Woods; then the Fund was expected chiefly to service industrial countries. So is the Fund ill-designed for providing effective help to developing countries? Is it even a net lender to them? How effective has its assistance been and how well has it adapted itself to dealing with these countries?[1]

Past Complaints

Past criticisms of the Fund's activities in developing countries can be grouped under four headings:

(1) *That Fund programmes are inappropriate:* Its approach to policy is preoccupied with the control of demand, too little concerned with BoP weaknesses stemming from the productive system; and it imposes large costs on borrowing countries through losses of output and employment, by further impoverishing the poor, and through the politically destabilising effects of its policy stipulations.

(2) That the Fund's *modes of operation and inflexibility in negotiations* infringe the sovereignty of states and alienate governments from the measures they are supposed to implement; that there is an increasing overlap with the World Bank; and between them that they are apt to swamp governments with policy conditions.

(3) *That its credits and programmes are too small, expensive and short-term.* The programmes are criticised as too short-term for economies whose BoP problems are rooted in structural weaknesses and who often face secular declines in their terms of trade. The credits are also criticised for their short maturity periods and the near-commercial rates of interest which they often bear; and as being too small relative to financing needs.

(4) *That the Fund is dominated by a few major industrial countries* who pay little heed to developing country views. The industrial countries, it is alleged, use their control to promote their own interests - for example, in using the Fund to impose a post-1982 approach to the debt problem which shifted a disproportionate burden onto debtor countries - and to reward 'favourites'.

The Fund's Response

The core of the IMF approach to programme design is its 'financial programming' model. This takes a broadly monetarist view, with a BoP deficit seen as caused by a surplus in the supply of money over the demand for it, emanating from excessive domestic credit expansion. Hence, the essential task of an IMF team is to analyze the money supply and demand situation and to restrict credit so as to restore BoP viability. In consequence, programmes almost always try to reduce budget deficits, to reduce governments' credit needs.

The Fund team does not confine itself to this task, however. For one thing, it regards the exchange rate as an important influence on the BoP, so that (except in currency union countries like the African member-states of the Franc Zone[2]) almost all its programmes involve devaluation. In recent years the Fund has reduced its reliance on quantified indicators of demand control, such as ceilings on credit to the public and private sectors, observance of which determine continued access to the negotiated line of credit. While such 'performance criteria' remain central to the Fund's modalities, it now makes greater use of (usually half-yearly) Review Missions, to take an overall view of programme execution and adjust programme details in light of the most recent economic data.

The Fund is also moving away from concentration on simple budgetary aggregates, such as total spending or the budget balance, in favour of paying more attention to the 'quality' of fiscal adjustment. Since the economic impact of its fiscal provisions will be much affected by which expenditures are trimmed and what is done with taxes, the Fund is becoming more insistent on knowing how a government proposes to implement promised reductions in the budget deficit, increasingly urging governments to install social safety-nets and asking awkward questions about military spending.

In other respects too it is paying more attention to achieving a better balance between demand-management and supply-side measures, even in its short-term (typically 18-month) Stand-by programmes, which now place greater weight on the goal of economic growth. In many cases, the privatisation or reform of public enterprises is stipulated - to reduce budgetary pressures but also to raise productive efficiency. Price and subsidy reforms are also common ingredients, e.g. raising petroleum prices or cutting food subsidies. And while Stand-bys remain short-term there is now a greater willingness to countenance a succession of such programmes, so that some countries (Cote d'Ivoire, Jamaica, Morocco...) have enjoyed the mixed pleasures of near-continuous support for a decade or more.

The extension of the Fund's conditionality into measures bearing directly on the productive structure is taken a good deal further in its Extended Fund Facility (EFF) - first introduced in 1974, kept in limbo during most of the 1980s but now reactivated as a major lending vehicle - and furthest of all in the Structural Adjustment Facilities (SAF and ESAF) initiated in recent years. Table 1 shows that by the end of 1992 these three facilities accounted for nearly three-quarters of the total value of all lending (see Table 2 for comparison of the terms attached to these various facilities). The EFF, SAF and ESAF have taken the Fund in the direction of medium-term lending, with the EFF

1. This paper draws upon the results of an ODI research project undertaken by Graham Bird and Tony Killick, further details of which can be provided on request.

2. See ODI *Briefing Paper*, 'Crisis in the Franc Zone' July 1990.

Table 1: Structure of IMF commitments, 1989 and 1992 (percentages of total commitments, by value)

	1989[a]				1992[b]			
	Stand-bys	EFFs	SAFs/ ESAFs	Total	Stand-bys	EFFs	SAFs/ ESAFs	Total
Low-income countries	11	3	27	41	9	-	10	19
(of which, sub-Saharan Africa)	(8)	(3)	(10)	(29)	(-)	(-)	(6)	(6)
Other developing countries	38	11	4	53	11	49	2	62
Total developing countries	49	14	31	94	20	49	12	81
Former Comecon countries	6[c]	-	-	6	8	11	-	19
GRAND TOTAL	55	14	31	100	28	61	12	100

[a] End-April 1989
[b] End-December 1992
[c] Includes a credit to Yugoslavia
Source: IMF

providing 3-4 year support largely to middle-income and former Comecon countries, and SAF-ESAF offering 3-5 year programmes to low-income countries, chiefly in Africa.

Uniquely, SAF and ESAF programmes are based on a Policy Framework Paper (PFP) setting out a three-year adjustment programme, supposedly drafted jointly by borrowing governments, the IMF and World Bank. In the early days of this innovation the involvement of governments in the drafting process was often minimal but they have gradually acquired more influence.

Under the influence of pressures from UNICEF and others, the Fund's Managing Director, Michel Camdessus, who took office in 1987, has changed its stance on the social effects of its programmes. It formerly insisted that it was for national governments to decide whether to protect the poor from hardships resulting from programmes. Now, its missions commonly discuss distributional aspects with governments when preparing programmes. PFPs are required to include measures to protect the well-being of vulnerable groups and programmes increasingly contain safety-net provisions. However, the chief examples of safety nets are in eastern Europe, and there remain doubts about how much difference these changes have made in practice.

The PFP has also provided a useful mechanism for co-ordination between the Fund and the World Bank. There is plenty of scope for disagreement between them, e.g. about the desirable levels of government investment, bank credit, imports and the exchange rate, and these tensions were heightened when the Bank increased its structural adjustment lending during the 1980s. There were some fierce turf battles and some celebrated rows over such countries as Argentina, Nigeria and Zambia, but it appears that top-management agreements on the division of labour and staff co-operation have substantially resolved these difficulties. Borrowing governments are less likely to be bewildered by conflicting 'advice' from the two institutions. Instead, they are more likely to feel confronted by a Washington monolith.

New Critiques

The Fund, then, has sought to adapt but have its efforts been sufficient? Some think not.

First, critics can point out that the Fund's use of more supply side measures has been *additional to* its traditional demand-control policies, not in substitution. The Fund has thus widened the range of its conditionality without diluting its monetarist hard core. There has been particular criticism of the especially demanding conditionality attached to ESAF credits, which frightened off potential borrowers, causing a slow take-up rate.

The Fund's approach to the supply side is criticised as blinkered: largely addressed to the reduction of price distortions and privatisation, taking a negative view of the state and associated with sharp reductions in public sector investment. Moreover, while the EFF and SAF-ESAF facilities, and toleration of repeated stand-bys, have taken the Fund into medium-term lending, these are no substitute for programmes conceived as long term.

Doubts persist about the appropriateness of the financial programming model. Its strength is that it confronts governments with the BoP and inflationary consequences of their budget deficits but the model remains open to a range of criticisms. First, it is seen as resting upon assumptions that may often not be valid for developing-country conditions. In particular, it assumes the demand for money is known and stable - so that non-expansionary levels of money supply and domestic credit can be estimated - a condition that does not always hold. Second, it requires that governments are able to hold credit within agreed ceilings, whereas their control is often highly imperfect because of unreliable data, the difficulties of forecasting and regulating budgetary outcomes, vulnerability to 'shocks', and unpredictable responses by banks and other financial institutions to governments' policy signals.

The model is criticised as too static, not well designed to cope with time lags and uncertainties, or to trace the effects of the private sector's reactions to stabilisation measures. The static nature of the model has caused the Fund particular difficulties since it was pushed in the later-1980s towards more 'growth-oriented' programmes. The incorporation of a growth objective alongside BoP viability generates a host of complications and increases the difficulties of using the model for policy purposes.

Finally, the model is criticised for focusing on only a few economic aggregates, diverting attention from important qualitative aspects of policy. Programme negotiations are often preoccupied with fruitless disputes about the merits of rival statistics and the exact numbers that should be included as performance criteria.

Yet while the specifics of IMF financial programming remain contentious, there is less controversy than formerly about the main thrust of the Fund's advice, about the importance of macroeconomic stability and of fiscal-monetary discipline to that end. Further criticisms have however arisen regarding the cost of IMF credit and its overall direction of flow.

How Effective are Fund Programmes?

Another approach to assessing the policies of the Fund in developing countries is to examine how programmes work in practice and what impact they have. There are major methodological problems here: the difficulties of disentangling programme effects from other influences on economic performance; of choosing adequate performance indicators and

71

the best period for analysis. Above all, skill is required to construct a plausible assessment of what would have happened in the absence of a programme.

Empirical research nevertheless makes it possible to offer some apparently firm generalisations about programme effects:[3]

- Fund programmes usually strengthen the BoP. Moreover, these results are not typically achieved by means of swingeing import cuts; export performance is usually improved. It takes time for these improvements to show up but they are then usually sustained into the medium-term.
- About half of programmes break down before completion (two-thirds in recent years). This does not seem to make much difference to outcomes, however, which suggests that the BoP improvements are less attributable to the programmes than to a greater concern with macroeconomic management among governments which sign Fund agreements.
- Overall, programmes do not make much difference to the inflation rate. While demand-control measures may reduce inflationary pressures, this tends to be offset by the price-raising effects of devaluations and interest-rate liberalisations.
- Programmes have a muted impact on economic growth: neither the crippling deflation which the Fund's critics complain of nor the revived expansion which the Fund seeks to achieve. Programmes often result in substantially reduced investment levels and sometimes in shortages of imported inputs.
- There is little evidence that programmes typically impose large social costs, although the urban labour force commonly suffers reduced real earnings, and cuts in budget subsidies can have serious effects. Programme effects on the distribution of income can be large but are usually complex, with the overall effect on poverty depending on country circumstances and policies. There is no systematic evidence of political destabilisation, although there have been specific instances of this.
- Many of the programmes that break down do so because of adverse external developments. In the absence of adequate contingency financing, countries get into difficulties because world prices turn against them, and quite often because of natural disasters, such as droughts and hurricanes.
- Programmes often fail to trigger additional inflows of capital from the rest of the world, despite claims that the Fund's 'seal of approval' has a catalytic effect on capital inflows. While some countries have benefitted, research shows that the BoP capital account does is not typically improve, even though debt relief and development assistance are included. Indeed, a shortage of supporting finance is a common reason for programme breakdown.
- Programmes often do not have a strong influence on fiscal and monetary policies. This helps explain the Fund's imperfect ability to achieve programme targets. However, the exchange rate is strongly influenced; programmes are associated with substantial currency depreciations, and these are sustained in real terms.
- There has been a good deal of political interference in Fund lending decisions. Successive American administrations have in particular used their weight to favour (or oppose) friendly (or hostile) developing countries. In some countries, this forced the Fund into providing effectively unconditional finance to governments with proven records of economic mismanagement (e.g. in the Philippines under Marcos, Sudan under Nimeiri and Zaire under Mobutu) swelling the number of ineffective programmes. The end of the Cold War may diminish such geo-politicking.

Fund programmes have often been surrounded by much sound and fury, yet what do these findings show? Governments are better able to resist the rigours of Fund stipulations than is often assumed; and the Fund has only limited ability to achieve its objectives, except when governments are genuinely convinced of the need for fiscal and monetary discipline.

How might we explain such muted effects? It has long been suspected that the extent of programme implementation is strongly influenced by the extent to which the borrowing government regards the programme as its own. A recent investigation by the World Bank of its own adjustment programmes corroborated this, finding a strong correlation between programme success and indicators of such government 'ownership.' Government 'ownership' was high in most programmes obtaining strong results and low in ineffective programmes, and was strongly predictive of programme success in three-quarters of all cases, with most 'deviant' cases explained by the intervention of external shocks.

There has been no equivalent research on Fund programmes but there are good reasons for expecting similar considerations to apply, not the least because many of the Bank programmes analyzed were accompanied by Fund programmes. The Fund's own tendency to attribute non-implementation to 'lack of political will' points in the same direction.

Critics attribute weak government identification with programmes to a certain arrogance in the Fund's approach. Although there is evidence of some increase in IMF negotiating flexibility, including occasional willingness to settle for technically sub-optimal but politically more sustainable programmes, it seems that the change has been only marginal. Its negotiating modalities do not help. The key negotiating document is a 'Letter of Intent' in which the borrowing government presents the policies it will undertake to strengthen the BoP and to promote other programme objectives. Herein lies the 'ownership' of the programme. But these Letters, although formally from the government, are almost invariably drafted by Fund staff, with the government left trying to negotiate modifications to a document presented to them.

However, relationships between a government and the Fund are not typically adversarial. There are other factors impeding government identification with programme measures. Much difficulty arises from the crisis conditions in which governments often turn to the IMF, the speed with which IMF staff have to prepare programmes and their often short-term nature. In such circumstances, staff do not have time to ensure that the government is fully 'on board', just as the government will often have no time to build a pro-programme political consensus. It is perhaps an *intrinsic* limitation of conditionality that it undermines the legitimacy of the stipulated policies, and hence the prospects that they will be fully implemented. However, against this should be set the tendency of some governments to use the Fund as a scapegoat, blaming it for unpopular policies which they privately know to be inescapable.

The Size and Cost of Credits

What now of the complaint that IMF credits are inadequate in value, too short term and expensive? Table 2 provides summary indicators of the financial terms attached to credits in 1991/92. This shows repayment periods of up to ten years. The *average*

Table 2: The terms of IMF credits, 1991/92

	Repayment period (years)	Interest rate (%)
Stand-by credits	3¼-5	8.0[a]
Extended facility	4½-10	8.0[a]
SAF and ESAF	5½-10	0.5

[a] higher if from borrowed rather than 'ordinary resources'.

Source: IMF [illegible]

3. For fuller substantiation see articles by Killick *et al* in *World Economy*, September 1992.

maturity period has increased in recent years due to the relative rise of EFF, SAF and ESAF lending and by 1992 was probably about eight years, against about five years in the mid-1980s, when stand-bys predominated. Table 2 also shows that, while SAF-ESAF credits bear only a nominal interest rate (subsidised by special grants and loans from industrial countries), stand-by and EFF credits are much more expensive. Indeed, the average rate of 8% in 1991/92 was little cheaper than commercial money - a considerable contrast with the position during most of the 1980s, when the Fund's rate was well below that offered by commercial banks.

Table 3: Net credit from IMF and balance of payment outturns, 1986-91[a]

(US$ billion)

	Net credit	BoP[b]
All developing countries	-2.2	-31.0
(*of which*):		
Asia	-1.2	+5.5
Sub-Saharan Africa	-0.3	-6.9
Western Hemisphere	-0.3	-12.4

[a] Annual averages [b] Balance on current account

Source: IMF

Turning to the adequacy of the credits, Table 3 shows that the annual average amount of credit to developing countries, net of return flows from them, was actually negative during 1986-91, i.e. service payments on past credits exceeded the value of new lending. This was so in each of the regions shown, even though Africa and Western Hemisphere had major current account deficits in these years. In consequence, the Fund has greatly reduced its proportional exposure in Africa (see Table 1). In this sense the Fund could be seen as adding to the financing problems of the developing world rather than reducing them.

However, the result is different if the test is confined to countries which actually borrowed from the Fund. Calculations for a sample of 17 developing countries showed that, even on a net basis, Fund credits covered nearly a third of their deficits. However, coverage was much smaller - less than a fifth - for countries whose programmes subsequently broke down, suggesting that under-funding contributed to the failure rate.

From these mixed results perhaps the safest conclusion is that Fund credits *can* be quite generous in size and cost for countries which qualify for favourable treatment, but for others credits may be quite inadequate, and that the short maturities of credits can easily leave a country having to make net transfers to the Fund despite continuing BoP deficits.

Partly for this reason, the new phenomenon emerged during the 1980s of countries falling into arrears in servicing their IMF debts. As at April 1992 ten countries owed a total of $4.8 billion - equivalent to over an eighth of the Fund's total outstanding credits. Although the Fund has devised a 'rights' scheme for helping countries work off their arrears and so become eligible for new credits, only Peru has so far successfully completed this process. The Fund's insistence that its credits cannot be rescheduled, let alone forgiven, prevents it from responding more adequately to the needs of the poorer countries in arrears.

Conclusions

So does the IMF really help developing countries? From the evidence on programme effects, it seems that the effects of Fund programmes, and the extent of their influence on macroeconomic policy, are over-rated. The Fund is able to secure sustained improvements in the BoP. But it is unable to achieve its secondary objectives on growth and inflation, or to exert decisive influence on fiscal outcomes and credit expansion. A high proportion of its programmes break down before the end of their intended life.

By the same token, exaggerated fears have been held of deflationary, poverty-aggravating and destabilising programme effects. While there are instances of each of these, programmes do not typically have the potency to impose such costs on a large scale. Developing-country governments have increasingly become persuaded of the importance of financial discipline, so that the broad thrust of what the Fund seeks to do has become less controversial. Managing Director Camdessus can justifiably speak of a 'silent revolution' in the attitudes of many member governments - a change most obvious in Latin America.

In various ways the Fund has in recent years sought to respond to past criticisms and to adapt to changing conditions. It has become somewhat more sensitive to the potential social harmfulness of its programmes. It has reduced its reliance on a small number of demand-management indicators. It has found ways of providing soft, medium-term finance to low-income members, and of addressing some structural economic weaknesses.

These policy changes are making a difference to programmes. But in many cases the difference is modest - a good deal smaller than the extensive reforms of economic policies of many of its developing-country members. High failure rates and a paucity of 'success stories' leave particular questions about the Fund's ability to operate successfully in African and other low-income countries. Political determination of country lending decisions remains a weakness. The Fund in recent years has been associated with a net return flow of finance from debtor developing countries and there is evidence of programme under-funding. The effects of the Fund on capital inflows from other sources varies greatly and its claims to exert a catalytic effect are exaggerated.

Shortages of supporting finance, and requirements upon countries to undertake adjustment measures even in response to natural disasters, are among the severest constraints on the ability of the IMF offer more effective help, although the Fund now believes there is little danger for the next few years that increased lending to former Comecon countries will be at the expense of developing countries. Renewal of the ESAF 'soft window,' which expires in November 1993, will be essential for a continued Fund presence in Africa and other low-income countries, but is not yet assured.

Ultimately, it is the governments of the OECD countries which decide the Fund's policies and which determine its stance towards developing countries. Since the USA exerts particularly strong influence, disproportionate to its importance in world trade, to say nothing of its record as persistent producer of the world's largest budget deficit, the policies of the Clinton administration will be crucial in this regard.

For further information please contact Tony Killick at ODI

Liberalization and the Role of the State Highlighted at World Bank Conference

The emerging consensus on development favors private sector initiative, reduced government presence, and surrender to market forces. But, according to I. G. Patel, former director of the London School of Economics and Political Science and keynote speaker at the World Bank's Annual Conference on Development Economics, no matter how widely accepted the consensus, we must never lose sight of the limits that specific circumstances impose on general applications of theory.

The appropriate degree and intensity of the state's presence in the context of general liberalization was a major theme in this year's conference, held in Washington on May 3–4. Other related themes included the role of government in financial markets, the appropriate pace of liberalization in socialist economies, and the energy sector and the environment.

Freeing Financial Markets

The general trend toward reduced government presence in the economic life of a country has coincided with the development of highly sophisticated capital markets. Yet, according to Joseph E. Stiglitz of Stanford University and the U.S. Council of Economic Advisers, financial institutions in all countries have been beset by problems and continue to have to be bailed out by their governments. In the prevailing climate of liberalization, then, what role should the state play in ensuring the solvency and stability of its financial institutions? Stiglitz's thesis was that the state did have a role to play and that various forms of government intervention could be beneficial and even welfare enhancing.

According to Stiglitz, the "impetus for liberalization is not based on a sound economic understanding either of how financial markets work or of the potential scope for government intervention, but on an ideological commitment to markets, grounded in neither economic theory nor fact." Financial markets do not fit comfortably under this blanket commitment, not only because financial markets are more prone to failure than other markets, but also because government regulation can make them function better and also improve the overall performance of the economy. Although critics have blamed recent market debacles on overregulation, Stiglitz said the real problem was deregulation—the collapse of the savings and loan associations in the United States for example—and the solution was better designed regulation.

Stiglitz: the problem is not the presence of regulations but their design.

According to Stiglitz, financial markets play a much wider role than the one traditionally ascribed to them, particularly in the developing countries—mobilizing savings and lending them out as investment for industrialization. Capital markets, in effect, "entail the allocation of resources," and serve as the "'brain' of the entire economic system." If they do not perform this function well, the performance of the entire economic system could be affected. And how well they do perform is based on how well they carry out their other related functions—transferring, sharing, and pooling risks and producing, disseminating, and using information.

In economic theory, competitive markets are efficient because information is perfect; that is, information cannot be altered by individual actions taken by participants in the market. In reality, however, information is not perfect, and certainly not in markets where risk is an integral element, as in financial markets. Information about the solvency of financial institutions, for example, is of considerable value to potential investors. However, if efforts to mon... the solvency of institutions are limited, some institutions that are not being monitored may be tempted to undertake risky actions. Investors, for their part, may shy away from a market whose institutions are not being sufficiently monitored; as a result, fewer of the resources that society needs will be allocated through these institutions.

Disruptions to the financial system, which Stiglitz characterized as "ubiquitous and frequent events," have serious and extensive macroeconomic consequences. In his view, these consequences provide the major rationale for government intervention. This rationale is actually an imperative, since a potential consequence of financial disruptions is the possibility of economic collapse: "governments cannot sit idly by when faced with an impending collapse of one or more of the major financial institutions; they almost all engage in some kind of rescue." This imperative makes the government perforce an insurer and gives rise to problems of moral hazard—if institutions can count on being bailed out, they may be less inclined to behave prudentially.

Stiglitz suggested that the moral hazard problem can be handled in the same way that insurance companies handle it—by imposing restrictions on the insured. What importantly distinguishes the government from a private insurer, however, is that the government cannot refuse to commit itself to provide insurance, and the beneficiaries of the insurance cannot commit themselves to refrain from asking for a bailout.

According to Stiglitz, government intervention in financial markets can take several forms. For developing countries, the most important action has been the creation of financial institutions that can provide funds for long-term investment. Government intervention can also be seen as pursuing "social" objectives, such as ensuring competition, directing resource allocation, and stimulating growth.

Government regulation of financial markets is a public policy issue, and, Stiglitz maintained, "the essential problem of public policy is ascertaining those situations, those forms of intervention, where the strengths of government can most directly be brought to bear, to improve the workings of the market." Therefore, the principles governing financial market regulation should be based both on the government's strengths and on its limitations compared with the private sector.

In particular, the government, through its powers of compulsion and proscription, can "do things that the private sector cannot." While conceding that the circumstances and requirements of individual countries will dictate the most appropriate regulatory structure, Stiglitz said that regulations should generally be based on the recognition that "monitoring banks is costly and necessarily imperfect; and monitoring agencies face severe information problems." These regulatory problems argue "strongly for simple regulatory structures, leaving relatively little scope for discretion."

Stiglitz extended his analysis of government intervention to include financial repression, which, he argued, had merit, despite the prevailing bias against it. For the last 25 years, governments of developing countries have routinely been told to avoid financial repression because, since low interest rates reduce savings, capital accumulation—"a central engine of economic growth"—atrophies, inhibiting economic growth. However, studies of savings have been unable to find much of a relationship between national savings and interest rates, suggesting that the argument "that financial repression depresses the savings rate is at best suspect."

McKinnon: China's gradual approach provides valuable lessons.

Stiglitz supported his case for small financial repressions by citing examples of successful applications in Japan, the Republic of Korea, and Taiwan Province of China.

What, finally, is the government's incentive to intervene if the private sector lacks incentives and resources to monitor itself? According to Stiglitz, macroeconomic instability is a major cause of defaults, and "making sure that government bears some of the consequences may provide it with greater incentives for stabilizing the economy. By the same token, making sure that the government bears some of the consequences for failed institutions provides it with greater incentives to monitor them effectively."

Liberalization—Gradual or "Big Bang"

For the formerly centrally planned economies of Eastern Europe and the former Soviet Union, liberalization has become a necessity. Although the objective of liberalization is clear—to achieve output growth while maintaining price stability—what the appropriate pace of liberalization should be is still an open question. According to Ronald I. McKinnon of Stanford University, who compared the economic liberalization undertaken by China in the late 1970s with that undertaken by the former Soviet Union in the late 1980s and early 1990s, the gradualist approach adopted by China provides valuable lessons for those Eastern European countries that opted instead for the "big bang" approach.

As McKinnon pointed out, from 1989 through 1992, the rapid liberalizations undertaken by Russia (before and after the dissolution of the Soviet Union) as well as by most of the other Eastern European countries have been associated in virtually all cases with sharp decreases in output accompanied by high, often explosive, inflation. In contrast, output in China rose sharply after 1978, and throughout the early 1980s, inflation remained low.

Building on its large agrarian population, China embarked on liberalization in 1978 by breaking up the traditional agricultural communes. Within four or five years, farm output was growing at the rate of 8–10 percent a year. Improved cash positions meant farmers could finance their on-farm investments without borrowing from the state banking system; a severe constraint on lending to farmers guaranteed a voluntary buildup of savings deposits by rural households. "More by accident than design," said McKinnon, "farmers became big net lenders to the government through the state banking system."

With the focus shifting in 1984 to rural light industry, the labor force released by the improvements in agricultural productivity was quickly absorbed into "hundreds and thousands" of newly created township and village manufacturing enterprises. These enterprises, driven by market forces and "outside the web of official price and output controls" contributed to the already sharp buildup in rural income.

Liberalization of foreign trade was also gradual. Rather than throwing open the whole economy to international competition, the Chinese set up special economic zones that operated outside the state trading monopolies.

The success of the Chinese liberalization must have been evident by 1989. Why, then, McKinnon asked, when the move to more market-based economies became a necessity, "did the Eastern Europeans in general, and Russia in particular, attempt more of a 'big-bang' approach?" It is true, he said, that reform governments had to contend with political and economic circumstances that not only differed markedly from those in China, but that "were largely beyond their economic control." For one thing, the Eastern European countries, which were more industrialized than China, lacked a large agrarian sector that could be liberalized as a first step and begin to generate immediate increases

Currency Units per SDR

Currency	April 20	21	22	23	26	27	28	29	30	May 3
Deutsche mark	2.2537	2.26676	2.26833	2.26262	2.24472	2.24968	2.25621	2.24504	2.24924	2.2566
French franc	7.62832	7.65006	7.65534	7.64532	7.57767	7.59621	7.60004	7.6547	7.57386	7.61063
Japanese yen	157.012	155.885	158.137	156.522	157.856	157.763	158.547	...	158.21	...
Pound sterling	0.914834	0.918012	0.915966	0.909685	0.897576	0.899081	0.902631	0.903256	0.904027	...
U.S. dollar	1.42028	1.41328	1.417	1.41777	1.42921	1.42837	1.41686	1.42019	1.42339	1.42175
Argentine peso	...	...	...	...	...	...	...	...	1.41485	...
Australian dollar	1.97179	1.97166	1.98487	1.99433	1.99249	1.98247	1.98636	1.98361	2.00027	2.01011
Austrian schilling	15.8659	15.9404	15.9626	15.8904	15.7813	15.8363	15.8648	15.8067	15.8167	15.8852
Bahrain dinar	0.534025	0.531393	0.532792	0.533082	0.537383	0.537087	0.532739	0.533991	0.535196	0.534578
Bangladesh taka	55.3909	55.1179	55.263	55.293	56.8628	56.8491	56.391	56.5236	56.6509	56.5857
Belgian franc	46.4006	46.5252	46.6406	46.5136	46.1563	46.2863	46.4234	46.1988	46.2815	46.4272
Brazilian cruzeiro	41246.4	...	41708.4	42297.	43207.2	43741.7	43972.3	44664.3	45350.6	45875.8
Canadian dollar	1.78501	1.77782	1.78811	1.78798	1.79796	1.8156	1.80409	1.80677	1.80771	1.80207
Colombian peso	1196.23	1191.	1194.74	1195.93	1206.15	1206.03	1196.91	1200.26	1203.53	1202.77
Danish krone	8.64453	8.66623	8.69117	8.67179	8.60364	8.66449	8.69173	8.6618	8.65848	8.68192
Finnish markka	7.73925	7.80639	7.84366	7.79391	7.68629	7.65578	7.69072	7.69175	7.74822	7.74468
Greek drachma	307.59	308.095	306.665	304.282	306.465	306.343	305.758	304.73	...	306.799
Indian rupee	44.4832	44.2639	44.3804	44.4048	44.8468	44.8506	44.5038	44.523	44.5863	44.5292
Indonesian rupiah	2939.98	2925.49	2934.61	2936.2	2961.32	2959.58	2938.57	2945.47	2952.11	2948.71
Iranian rial	...	...	2329.56	2330.81	2349.62	2348.24	2329.32	2334.79	2340.06	2337.36
Iraqi dinar	0.441504	0.439328	0.440485	0.440724	0.44428	0.444019	0.440441	0.441476	0.442471	0.441961
Irish pound	0.925746	0.929484	0.929119	0.928224	0.919636	0.92272	0.923878	0.919395	0.922482	0.926403
Italian lira	2163.71	2168.01	2165.49	2124.98	2097.48	2091.36	2096.81	2087.96	2104.57	2106.1
Korean won	1130.54	1124.59	1127.37	1128.54	1137.80	1137.13	1127.82	1130.33	1132.88	1131.71
Kuwaiti dinar	0.427163	0.425058	0.426177	...	0.428935	0.428682	0.42568	0.426881	...	[illegible]
Libyan dinar	0.414286	0.414286	0.414286	0.414286	0.414286	0.414286	0.414286	0.414286	0.414286	0.414286
Malaysian ringgit	3.65367	3.63568	3.64608	3.64367	3.67121	3.67063	3.64374	3.65117	3.65689	...
Maltese lira	0.52601	0.523205	0.524757	0.523182	0.522487	0.521703	0.520636	0.520369	0.521904	0.522401
Nepalese rupee	70.2613	69.915	70.1132	70.1513	70.7173	70.6757	70.1062	70.271	70.4293	70.334
Netherlands guilder	2.53648	2.5456	2.54706	2.5449	2.52184	2.52779	2.5316	2.51785	..	2.5364
New Zealand dollar	2.61996	2.61236	2.61536	2.62113	2.61952	2.61176	2.60404	2.6092	2.62328	2.628
Norwegian krone	9.5528	9.57568	9.60584	9.56569	9.48424	9.51223	9.53406	9.49326	9.52319	9.54066
Omani rial	0.546096	0.543406	0.544837	0.545133	0.549631	0.549208	0.544783	0.546063	0.547293	0.546663
Pakistan rupee	38.0184	37.829	37.9286	37.9492	38.2554	38.2329	37.9248	38.0139	38.0996	38.0657
Portuguese escudo	206.503	209.176	210.327	210.086	208.379	209.308	209.129	207.968	208.389	208.71
Qatar riyal	5.16982	5.14434	5.15768	5.16068	5.20232	5.19927	5.15737	5.16949	5.18114	5.17517
Saudi Arabian riyal	5.31896	5.29273	5.30667	5.30965	5.35239	5.34925	5.30614	5.31861	5.3306	5.32445
Singapore dollar	2.30114	2.28937	2.29426	2.29324	2.30917	2.30763	2.28966	2.29417	2.29892	2.29613
South African rand	4.49184	4.47796	4.48836	4.47236	4.487	4.48966	4.47515	4.4807	4.49678	4.50624
Spanish peseta	163.219	164.082	164.763	167.58	165.745	166.134	164.862	164.046	164.644	164.661
Sri Lanka rupee	68.1734	67.8374	68.0605	68.0246	68.5449	68.5048	67.9961	68.1549	68.28	68.2156
Swedish krona	...	10.4491	10.5299	10.4397	10.296	10.3035	10.3431	10.3036	10.3661	10.4214
Swiss franc	2.06509	2.06198	2.06528	2.05151	2.02806	2.02757	2.04028	2.03087	2.03146	2.04021
Thai baht	35.7911	35.5864	35.7084	35.6994	35.9589	35.9378	35.719	35.803	35.8894	...
Trinidad and Tobago dollar	6.05128	6.02148	6.03731	6.04059	6.08933	6.08575	6.03871	6.0509	6.18179	..
U.A.E. dirham	5.21365	5.18815	5.20181	5.20463	5.24863	5.24365	5.20129	5.21352	5.22526	5.21924
Venezuelan bolivar	121.079	120.553	121.012	121.191	122.34	122.411	121.567	121.923	122.34	122.199

Notes: 1. The value of U.S. dollar in terms of the SDR is the reciprocal of the sum of the dollar values, based on market exchange rates, of specified quantities of the first five currencies shown. The exchange rates used for this purpose are noon rates in the London foreign exchange market. When the London market is closed, noon rates in the New York market are used. Frankfurt fixing rates are used when the New York market is closed. 2. The value in terms of the SDR of each of the other currencies shown above is derived from that currency's representative exchange rate against the U.S. dollar as reported by the issuing central bank and the SDR value of the U.S. dollar, except for the Iranian rial and the Libyan dinar, the values of which are officially expressed directly in terms of the domestic currency units per SDR.

Data: IMF Treasurer's Department

in output. Also, it was difficult for the various governments to maintain the control necessary for a gradual external and domestic liberalization in the wake of the collapse of the Council for Mutual Economic Assistance, the weakening of domestic centralized authority, and the breakup of the Communist party. Finally, most of the Eastern European economies had to burn off a monetary overhang through a onetime inflation, whereas when China undertook its reform in the late 1970s, there was no evidence of significantly repressed inflation and, hence, no monetary overhang.

In contrast to the Eastern Europe liberalization,China did not liberalize or privatize state-owned industry, mainly, according to McKinnon, because of the "dire social consequences" and economic costs that would follow on the collapse of parts of the "old heavy industrial sector" that were not able to survive decontrol and rationalization. Therefore, the central government "continued to prop up much of state-owned industry by low-cost bank loans and other subsidies." With the soft budget constraints that such subsidization implied and in the absence of competition from a hard budget nonstate sector, McKinnon said the Chinese authorities rightly decided to retain price controls to anchor producer prices. Once the cash-constrained nonstate sector became large enough to compete vigorously with the old state sector in product markets, the Government could relax prices.

The liberalization process in China has not extended to the banking system, mainly because the Government "is leaning on the state banking system as a crutch to cover its own fiscal deficits." According to McKinnon, if the Government were to throw away the crutch, it would be met with an inflationary explosion of the sort that engulfed the former Soviet Union, and the decline in the fiscal position would be neither sustainable nor desirable. "The Chinese Central Government must quickly institute an internal revenue service capable of directly taxing all industries—Central Government, local government, and private—as well as the agricultural sector."

With regard to Russia, McKinnon noted that, while state enterprises were not financially restrained, wage controls kept households cash-constrained. However, the controls did not prevent an inflationary explosion in wholesale prices in the trade among state enterprises in 1992. Thus, as McKinnon pointed out, "as long as the money and credit position of the old state enterprises remains soft, direct price controls in the enterprise sector will remain necessary until a cash-constrained nonstate sector becomes large enough to be an effective competitor."

McKinnon's prescription for "getting the inflation genie back into the bottle" was a major recentralization of the Government's control over money and credit; a reassertion of the primacy of the state-controlled banking system; and recentralization of producer price setting—including the exchange rate. Finally, as with the Chinese, a drastic improvement in the Government's ability to collect tax revenue is necessary for macroeconomic stabilization and for sustaining the longer-term, market-oriented and institutional reforms.

Issues relating to climate have virtually disappeared from the literature on economic development

The Climate and Economic Development

According to William D. Nordhaus of Yale University, the complicated relationship between growth, development, and the environment has added to the long agenda of developmental problems a host of potential problems caused by the harm we are doing to "our natural environment through a multitude of interventions." Nordhaus, who spoke on the relationships between economic development and "climates present" and between economic prospects and "climates future," said the issue of climate change had to be seen in the context of the history of economic development. Until this century, he said, climate has been perceived as an important determinant of a nation's character and development. For example, Ellsworth Huntington, an eminent geographer, wrote in 1915: "The climate of many countries seems to be one of the great reasons why idleness, dishonesty, immorality, stupidity, and weakness of will prevail." However, since the middle of the twentieth century, Nordhaus maintained, "climate has virtually disappeared from the economic development literature." Huntington's "climatic hypothesis of civilization" has been replaced by what Nordhaus suggested should be called the "adaptive theory of climatic impact," which holds "that in the very long run, humans are essentially nomadic toolmakers."

What the adaptive theory is really saying is that humans are capable of thriving in any climate once they have

Photo Credits: Denio Zara and Padraic Hughes for the IMF, pages 161, 172, and 173; Michele Iannacci for the World Bank, page 176.

adapted to it, and, over the long run, climate has little effect on economic performance or success. However, recent concern about the warming properties of the greenhouse effect has "thrust climate back onto center stage."

Nordhaus's main concern was with the role economists should assume: first, in analyzing the possible size and intensity of the projected climate change; second, in measuring the potential impact; and, third, in finding the most cost-effective measures to offset the impact. In his view, an attempt to base future action on the predictions of climate models was risky: "climate models resemble large macroeconomic models in their ability to answer virtually any question that modelers care to ask; it is not clear that their reliability for forecasting climate change is any better." However, the unreliability of these models is not an argument for doing nothing; rather, policy decisions need to be taken in the context of the "likely impact of projected climate changes."

Unfortunately, as Nordhaus noted, "impact studies are in their infancy, and studies of low-income regions are virtually nonexistent." In the high-income industrialized countries, developments in technology have insulated all but a small fraction of economic activity from "the vagaries of climate." But the developing countries, which have a much heavier concentration in agriculture, would be far more vulnerable to climate change.

The greenhouse effect, said Nordhaus, "is the granddaddy of public goods problems: emissions will affect the global climate globally for centuries to come," but market forces are powerless to ensure that individual economic agents will produce efficient levels of greenhouse gases. If we accept that global warming is inevitable over the next century, then we must come up with the most balanced way to confront this externality. From the perspective of the economist, cost-effectiveness is of key importance: "structuring policies to get the maximal reduction in harmful climatic change for a given level of expenditure."

Nordhaus: policy decisions should take climate changes into account.

But "plain vanilla" cost-benefit analysis may not be broad enough to embrace all eventualities that lie outside the "smooth changes foreseen by climate models." These models cannot foresee catastrophic upsets, nor can they predict unmeasurable effects. "Should we not, then, be ultraconservative and tilt toward preserving the natural world at the expense of economic growth and development? Do we dare put human betterment before the preservation of natural systems? Should we trust that human ingenuity will bail us out should nature deal us a nasty hand?"

These questions, as Nordhaus conceded, may be ultimately unanswerable. But the absence of complete information should not rule out what he called "reasoned decision making under uncertainty"—"choosing the action that maximizes the expected value or utility of the outcome."

At the same time, development economists cannot neglect to ask how poorer regions already overburdened with immediate and severe economic worries can be expected to take on the added burden of "a costly climate-change agenda that will produce some ill-defined and conjectural benefit for future generations." In the end, he said, "societies, like people, must be careful in their choice of enemies."

Sara Kane,
IMF External Relations Department

May 31, 1993 • Volume 22, Number 11

Gerald R. Rosen, *Editor*

Paul Gleason • Vikram R. Khanna • Sheila Meehan • Margaret Casey • Elisa Diehl • Sharon Metzger • Susan Scott • Philip Torsani
Assistant Editor *Assistant Editor* *Assistant Editor* *Senior Editorial Assistants* *Editorial Assistant* *Art Editor* *Graphic Artist*

The *IMF Survey* (ISSN 0047-083X) is published by the International Monetary Fund 23 times a year, ordinarily on alternate Mondays, in addition to an annual *Supplement on the Fund*, an annual Index, and other occasional supplements. Editions are also published in French (*Bulletin*) and Spanish (*Boletin*). The opinions and materials contained in the *IMF Survey*, including any legal aspects, do not necessarily reflect the official views of the IMF. Editorial correspondence should be addressed to Current Publications Division, Room IS5-1500, International Monetary Fund, Washington, D.C. 20431, U.S.A. Telephone: (202) 623-8585. The *IMF Survey* is distributed by first-class mail in Canada, Mexico, and the United States, and by airspeed elsewhere. Private firms and individuals are charged an annual rate of US$60.00. Apply for subscriptions to Publication Services, Box S-99, IMF, Washington, D.C., 20431, U.S.A. Telephone (202) 623-7430. Cable: Interfund. Facsimile: (202) 623-7201.

Portfolio Investment Flows to Developing Countries

MASOOD AHMED AND

SUDARSHAN GOOPTU

Portfolio investment flows have recently been the fastest growing form of external finance for developing countries, accounting for one fifth of all capital flows to the developing world. Currently, these flows are heavily concentrated in a handful of economies (mainly in Latin America). But the potential for their expansion to other countries is theoretically enormous—although it is likely to be limited, in practice, by investor perceptions of country creditworthiness and limited investment opportunities in still generally small emerging markets.

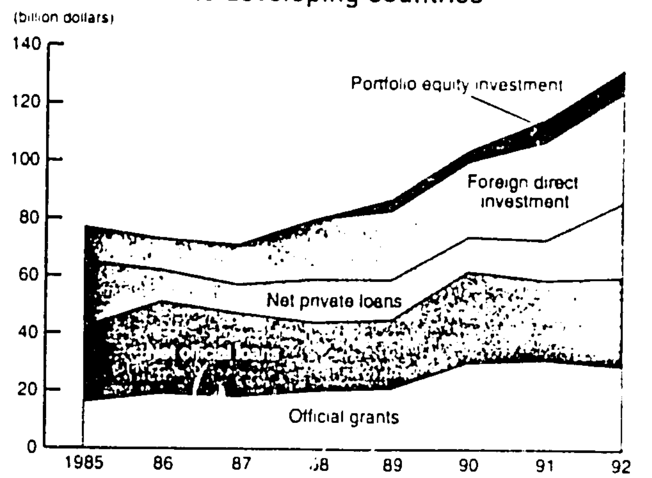
The past three years have witnessed an unprecedented increase in private portfolio investment flows to developing countries, increasing from $7.6 billion in 1989 to $20.3 billion in 1991, and are estimated to have reached over $27 billion in 1992. According to data in the World Bank's *World Debt Tables 1992-93*:

Aggregate net resource flows to developing countries

Aggregate net resource flows to developing countries increased by 17 percent in 1992 over the previous year and the pattern of external finance changed significantly. Of the $134 billion in real aggregate net resource flows that took place in 1992, foreign direct investment (FDI) and portfolio investment accounted for the bulk of the increase over previous years. Most of these flows were directed to the middle-income countries ($89 billion), with flows to low-income countries remaining broadly unchanged ($44 billion) in 1992. The large increase in flows to middle-income countries (130) percent over the previous year) stemmed mainly from the upturn in private flows. In addition, within these flows there has been a shift from debt to equity financing, comprising FDI and portfolio investment, and from bank to nonbank sources. Most low-income countries, especially those severely indebted, remain heavily dependent on official financing.

Thus, while there are legitimate concerns about the volatility and sustainability of some portfolio flows, developing countries that are receiving these flows can maximize their benefits by taking a variety of steps. These include: (1) listing at least a few stocks internationally; (2) strengthening supervisory and regulatory policies; (3) conforming to generally accepted accounting and disclosure standards; (4) ensuring investor protection; and (5) improving the efficiency of settlement and clearing procedures. Regulatory changes in industrial countries that ease entry restrictions into their securities markets (such as the US SEC Ruling 144A) without jeopardizing prudential standards are encouraged.

Real aggregate net resource flows to developing countries



Source: *World Bank Debt Tables 1991-92*

Note: All flows are deflated by the import unit value index (IMF, WEO) at constant 1992 dollars. 1992 deflator is a World Bank staff estimate; data for portfolio equity investment are World Bank estimates, available since 1989 only.

Source: *World Bank Debt Tables 1991–92.*

• Portfolio equity investment (comprising external stock offerings in the form of depository receipts, country funds, and direct equity purchases by foreign investors) increased 15-fold, from $0.4 billion in 1989 to over $6.0 billion in 1991, and are estimated to have reached $5.2 billion in 1992.

• International bond financing by developing countries, which started from a stronger base in the late 1980s, also showed remarkable growth in 1991–92, accounting for nearly $20 billion of gross inflows in 1992 (see charts).

The recent surge in portfolio flows is of interest to developing country policymakers for a variety of reasons. First, as part of a broader resumption of private market financing, these flows signal the return to market access after the decade of the debt crisis for a number of mainly middle-income developing countries. Second, the very different nature of these flows—compared with the syndicated bank lending of the 1970s and the early 1980s—reflects important structural changes that have taken place on both the borrowing and lending sides over the past decade. These changes include the growing importance of institutional investors as the source of long-term finance, even as commercial banks have cut back their activities in this area. And in the developing countries themselves, there has been a parallel movement away from public sector dominated borrowing to a more balanced mix of access to foreign capital by private corporations and sovereign borrower alike. Portfolio equity flows also help to reduce the cost of capital for companies in emerging markets and introduce an important element of risk sharing between international investor and host country.

The short three-year history makes it difficult to extrapolate the future magnitude and behavior of portfolio investment flows. But the observed rapid increase in these flows to developing countries has given rise to some legitimate concerns on the part of policymakers in the recipient countries as well as those in other developing countries who wish to benefit from this experience in an endeavor to attract and deal with similar portfolio investment inflows from abroad without jeopardizing their adjustment efforts and domestic policy agenda.

The portfolio investment flows have, however, been concentrated in a few countries, primarily in Latin America. Five countries—Argentina, Brazil, Mexico, South Korea, and Turkey—accounted for over two thirds of the cumulative total gross portfolio investment flows between 1989 and 1992. Mexico, which led the process of restoring access to voluntary financing by previously debt-distressed countries, was the largest recipient of both portfolio equity and bond financing flows. Moreover, most of the increase in the supply of private funds went to private borrowers, especially "blue chip" companies that have a good credit rating in their own right in international capital markets.

Portfolio investment, as distinct from foreign direct investment (FDI), comprises financial instruments that can be acquired by foreign investors either in the international securities exchanges, the US private placement market, or through direct purchases in the developing country's stock market. These instruments can be classified in two groups: equity and debt instruments (see box for details). Country Funds accounted for the bulk of the portfolio equity flows in 1989 and 1990, partly because in several developing countries, they were the only permitted instrument for foreign investors. Their importance has declined more recently as many countries have relaxed restrictions of foreign equity investment and as investors themselves have become more interested in picking individual stocks rather than a slice of the overall market. At less than $200 million, the value of new emerging market funds launched in 1992 represents less than one tenth of the corresponding figure two years earlier.

American Depository Receipts (ADRs) have grown in popularity for many of the same reasons that led to a declining interest in country funds. There are currently more than 800 ADR programs in the United States and capital raising through ADR issues accounted for some $10 billion in 1992. The growth in ADRs was greatly facilitated by rule 144A of the US Securities Exchange Commission (SEC), which has enabled this instrument to be used by a number of smaller, first-time foreign issuers in the US equity market.

In terms of debt instruments, Mexico became the first debt-distressed country to raise voluntary financing from abroad since the debt crisis, with an unsecured international bond issue of $100 million in June 1989. Since then, Argentina, Brazil, and South Korea have also tapped the international bond market extensively and bond issues now account for the largest share (about two thirds) of portfolio in-

80

vestment flows to developing countries.

Commercial Paper (CP) issues have also increased drastically in the 1990s as more and more firms that are unable to raise longer-term financing turn to this vehicle. Maturities are generally of 3, 6, and 12 months, although note issuances of shorter maturities of a few days are not out of the ordinary. About $1.4 billion of CP issues were made by entities in developing countries in 1991, of which $1.2 billion was issued by those in Latin America alone.

The investors

Much of the initial growth in portfolio investment was financed by returning flight capital. Domestic nationals with substantial overseas holdings also continue to be a major investor category, particularly for portfolio flows to Latin America. But these individual investors have been joined by a more diverse—and potentially much bigger—group of institutional investors. These institutional investors, which include pension funds and life insurance companies, are motivated primarily by the portfolio diversification benefits that accrue from investing a small part of their large overall holdings in developing country obligations. They generally have a longer-term investment horizon and look for stability and long-term growth prospects in the market in which they invest. Recent research has shown that even though developing country stock markets are more volatile than developed markets, they have not been found to be correlated with one another or with developed markets. Global institutional investors will, therefore, lower their portfolio risk by diversifying their portfolios into these emerging markets.

To date, institutional investors have allocated only a small fraction of their investible portfolio to these markets, especially in countries such as Chile and Mexico, which have a favorable track record of domestic policy reforms. These institutions have typically invested less than 5 percent of their foreign equity holdings in developing country equities (which is less than 0.2 percent of their total asset portfolios). There is considerable variation across institutional investors, with some investing as much as 6 percent of their portfolio in emerging markets and others not investing in them at all.

As of the end of 1991, pension funds and insurance companies had an estimated $12–15 billion invested in emerging market stocks (which was about 3 percent of the market capitalization of all emerging stock markets combined at the time). US institutional investors appear to favor Latin American securities, UK institutions seem to favor portfolio investments in the Far East, while Japanese institutional investors appear to favor Southeast Asian securities.

Other actors in the market include:

- ***managed investment funds*** (closed-end country funds and mutual funds—see box), whose portfolio managers buy and sell high-yield instruments in one or more emerging markets for trading activity geared toward achieving a portfolio yield that is better than some benchmark (the Standard & Poor's 500 index, for example);
- ***foreign banks and brokerage houses***, who allocate their own portfolios for inventory and trading purposes; and
- ***retail clients of Eurobond houses***, who are involved in emerging securities markets for portfolio diversification motives.

Why the rapid increase?

The reasons behind the sharp growth in portfolio investment flows have been the subject of vigorous debate among academic economists and policymakers. Some explain the increase primarily in terms of the "push" effect of the unusually low interest rates prevailing in the United States, arguing that the boom in flows coincided with a sharp decline in US interest rates and the drying up of the so-called junk bond market, which offered investors a domestic alternative in the high risk/high return arena.

Other analysts emphasize the "pull" of investment opportunities in the emerging markets themselves. They point to the wide ranging economic reforms that a number of Latin American countries have undertaken in the aftermath of the debt crisis; these reforms, coupled in several countries with commercial debt-reduction agreements, have generated greater investor confidence in the growth and creditworthiness prospects for these countries. They also cite the steady access of East Asian economies to bond financing in the period before international interest rates declined in the late 1980s.

As is often the case, the true explanation lies in a combination of the two. The decline in interest rates in home markets certainly provided an added impetus to investors searching for high-return instruments to look at the very attractive yields available in both fixed-return and equity investments in emerging markets. Lower interest rates in the United States also improved the short-term creditworthiness indicators of developing countries by reducing their debt-service obligations. But lower interest rates or other supply side factors do not explain why portfolio flows have not been dispersed randomly to all emerging markets, or why countries such as Mexico, with an established track record of sound economic management, are able to

The instruments

The instruments through which portfolio investment takes place can be classified in two groups: Equity instruments and debt instruments. Equity instruments include:

Country Funds, which allow foreign investors to pool resources and invest in the emerging stock markets in, for example, Brazil, Chile, India, South Korea, Mexico, and Thailand. Funds can be invested in all emerging markets (through global funds), in specific regions (Regional funds), or in specific countries (country funds). Closed-end funds make an initial share offering for public trading on organized exchanges but are not redeemable unless the fund is liquidated or changed (with stockholders' consent) to an open-ended fund (or mutual fund), which can issue and redeem shares to meet investor demand.

American Depository Receipts (ADRs), which are negotiable equity-based instruments, issued by a non-US corporation, publicly traded in the US securities markets and backed by a trust containing shares of the corporation. ADR holders have the same rights, including voting rights, as if they held the underlying shares.

Global Depository Receipts (GDRs), which are similar to ADRs but can be simultaneously issued in securities exchanges all over the world.

Direct purchase of shares by foreign investors, which, where permitted by developing country governments, is increasingly important in attracting resources from abroad.

Debt instruments include:

International bond issues, which have been a steady feature of developing country financing for many decades, but which were displaced by the growth in syndicated bank loans in the 1970s and early 1980s.

Commercial Paper (CPs), which are short-term instruments that have been issued by entities in developing countries in the Euromarkets and in the United States.

Certificates of Deposit (CDs), which have also been used by developing countries to raise resources in the international markets.

issue bonds at 300 basis points below the rate required by investors of comparable bond issues in other developing countries.

In the case of equity flows, the recent growth has also been facilitated by institutional changes in developing and developed countries that have taken place in light of the widespread efforts toward global integration of securities markets and increasing financial deregulation measures. In the industrial countries, developments such as US SEC Rule 144A, which allow foreign issuers easier access into the US securities markets largely by easing restrictions on the resale of privately placed securities, have simplified trading in foreign equities by eliminating costly settlement delays, registration difficulties, and dividend payment problems. The recent raising of ceilings on foreign investment imposed by the New York State regulator of insurance companies has also helped increase cross-border trading with some emerging stock markets. (Other countries—notably Germany—have much more binding ceilings on the fraction of assets that pension funds and insurance companies can invest abroad.)

Gross portfolio investment flows
(billion dollars)

	1989	1990	1991	1992 (est.)	Total 1989-92
Portfolio equity investment	3.5	3.8	7.6	8.2	23.0
Of which:					
Country funds	2.2	2.9	1.2	0.[illegible]	6.9
Depository receipts	0.0	0.1	4.9	5.8	10.7
Direct equity investment	1.3	0.8	1.5	1.9	5.4
Bonds, CPs, and CDs	4.1	5.6	12.7	19.1	41.5
Total	**7.6**	**9.3**	**20.3**	**27.3**	**64.5**

Source: World Bank, *World Debt Tables, 1992-93.*
Note: Excludes "New Money Bonds" that were issued in Brady-type debt and debt-service reduction operations.

Developing countries, too, are doing more to encourage foreigners through fewer regulatory restrictions, better settlement and clearance, and reduced taxes and fees on transactions. For example, in South Korea, the Securities Supervisory Board relaxed the registration procedures for foreign institutional investors, individuals, and corporations in March 1992. In India, the government has announced plans to abolish the Office of the Controller of Capital Issues and firms will be able to determine the pricing and timing of new issues, including share issues abroad, and to arrange joint ventures. In some markets, such as Chile, Hong Kong, Singapore, and Taiwan Province of China, domestic institutional investors (pension funds and social security administrations) have played an important role in developing capital markets.

Policy issues

While policymakers in recipient countries have generally welcomed the substantial inflows of portfolio investment, they have also come to recognize that these flows pose significant issues of both macroeconomic and financial sector management. At the macroeconomic level, the main concern is how to deal with the effects of sudden large capital inflows and the possibility of equally sudden outflows in terms of real exchange rate fluctuations or the monetary implications of substantial changes in reserve levels. Some economists have argued for a tax to discourage speculative short-term inflows or other measures to offset the expansionary impact on the money supply; others caution against any action that might also discourage genuine investors and would be difficult to apply in practice. Preliminary evidence on the major Latin American recipients of portfolio flows shows that although country responses to these large portfolio investment flows have been varied, the general tendency of policymakers has been to regard these inflows as temporary. As a result, these countries have tried to limit the extent of real appreciation by intervening in the foreign exchange market or by sterilizing part of these inflows by issuing domestic debt.

At the financial sector level, one important issue is whether allowing foreign investors into small equity markets might exacerbate volatility or "overheating" (artificial increases in market capitalization as a result of sharp increases in the prices of the shares of a few companies that are traded internationally on the developing country stock markets). Financial policymakers are also worried about the potential dislocation that might be caused by a subsequent precipitous withdrawal by foreign investors for reasons beyond the host country's control.

These concerns reflect the nascent state of many emerging markets and weaknesses in the regulatory framework under which they operate. Despite their rapid growth, emerging markets—with a capitalized value of near $650 billion—account for only about 6 percent of industrial country stock markets. A result of a limited supply of stocks of corporations with large market capitalizations, most emerging equity markets also remain relatively illiquid and have a high concentration (the ten largest stocks account for over 30 percent of market capitalization in most of these markets; the comparable figure for the United States is 15 percent). Moreover, these markets have been quite volatile, with plus or minus 50 percent annual changes in market indexes in a number of markets during a given year. Some of these factors can only be addressed as these markets mature, but steps can be taken to address some issues now. For example, the recent stock market riots in China and irregularities in India's stock market have shown that there must be better regulation, registration, and monitoring of stock market transactions.

Accounting practices and disclosure requirements must also be raised in many cases and insider trading remains an issue of serious concern to both foreign and "outsider" domestic investors. To contain the disruptive effects on the domestic financial system of any sudden withdrawal of foreign investors, consideration should also be given to limiting the role that banks are allowed to play in equity markets, or the extent to which equity assets can be used as collateral for bank lending. Finally, it would be useful to assess ways to increase the involvement of large institutional investors, who typically have longer-term investment objectives in the financing of portfolio flows. The way to achieve this lies in a sustained and demonstrated commitment to sound economic management and financial sector regulation at the national level. ■


Masood Ahmed
Pakistani, is Chief of the Debt and International Finance Division in the Bank's International Economics Department. Before joining the Bank staff, he studied and taught at the London School of Economics.


Sudarshan Gooptu
Indian, is an Economist in the Debt and International Finance Division of the Bank's International Economics Department. He holds a PhD in Economics from the University of Illinois, Urbana-Champaign.

82

SELECTED TOPICS

Staff Papers Article Examines Latin America's Capital Inflows

Nearly a decade after the debt crisis erupted, large amounts of capital have begun to flow to Latin America again. Certainly, the economic and political reforms undertaken across the region deserve much credit for this renaissance. But, according to an article in the March issue of *IMF Staff Papers*, important economic developments outside Latin America, notably in the United States, may also be encouraging the capital flows. Two other papers in the journal consider the importance of market discipline in preventing excessive borrowing, and the validity of the monetary model of the exchange rate.

In their paper, "Capital Inflows and Real Exchange Rate Appreciation in Latin America," Guillermo Calvo, Leonardo Leiderman, and Carmen M. Reinhart describe the recent capital flows to Latin America. In the late 1980s, about $8 billion flowed to the region annually; that figure surged to $24 billion in 1990 and to $40 billion in 1991. Changing economic conditions in Latin America deserve partial credit for the recovery: real GDP rose by 3 percent in 1991, fiscal deficits have come down, inflation has dropped markedly, and the region's external debt has been contained.

The authors point out, however, that all Latin American countries appear to be sharing in the boom—regardless of their reform program and performance. They add that domestic reforms by themselves, although important, cannot explain the movement of capital to each country.

External factors may explain the universality of the flows. "Falling interest rates, a continuing recession, and balance of payments developments in the United States have encouraged investors to shift resources to Latin America," explain the authors. In particular, U.S. short-term interest rates are at their lowest point since the 1960s, stimulating the repatriation of capital and increased Latin American borrowing.

The extent to which the capital flows have forced Latin American countries to adjust their policies and their investment goals is extremely important to the future viability of the region's economic recovery. The authors point out that if the capital flows are motivated largely by external developments, these economies become highly vulnerable to a sudden reversal of the flows. An unexpectedly strong recovery in the industrial countries or a price shock—any development that would produce sharply higher interest rates—could turn the tide of capital away from Latin America.

The recent behavior of exchange rates and rates of return reflects the capital inflows. Five of the ten Latin American countries saw appreciation in their currencies before 1991, and all of them, except Brazil, have experienced real exchange rate appreciation since January 1991. The authors conclude that there is "an important degree of co-movement in these variables across countries, despite their wide differences in policies and institutions."

To investigate the role of external developments more rigorously, the authors first examine the behavior of international reserves and the real exchange rate. They find evidence of parallel movements in these variables across a number of Latin American countries.

Second, the authors establish a strong connection between economic developments in Latin America and the United States. They determine that, in eight of the ten Latin American countries "foreign" (U.S.) factors influence performance, although these factors are generally better at explaining the changes in countries that did not make major adjustments in their domestic policies during 1988–91.

Turning to the policy concerns caused by the flows, the authors note that a major issue facing Latin American policymakers is the health of their export sectors. The real exchange rate appreciation that is associated with capital inflows can erode competitiveness.

A second major concern is the intermediation of capital flows. Proper intermediation can be confounded by speculative "bubbles," lack of policy credibility, improperly priced government insurance, or market failure.

A final concern facing policymakers is the possibility that the capital flows will suddenly reverse, a prospect that can create a domestic financial crisis, exacerbate any improper intermediation, lead to a perception by outside lenders of a negative supply shock, and cause losses on investment projects.

The authors discuss five policies for meeting these concerns: taxing capital imports, changes in trade policy; tightening fiscal policy; sterilized and nonsterilized intervention by the central bank; and insulating the banking system from the capital inflows.

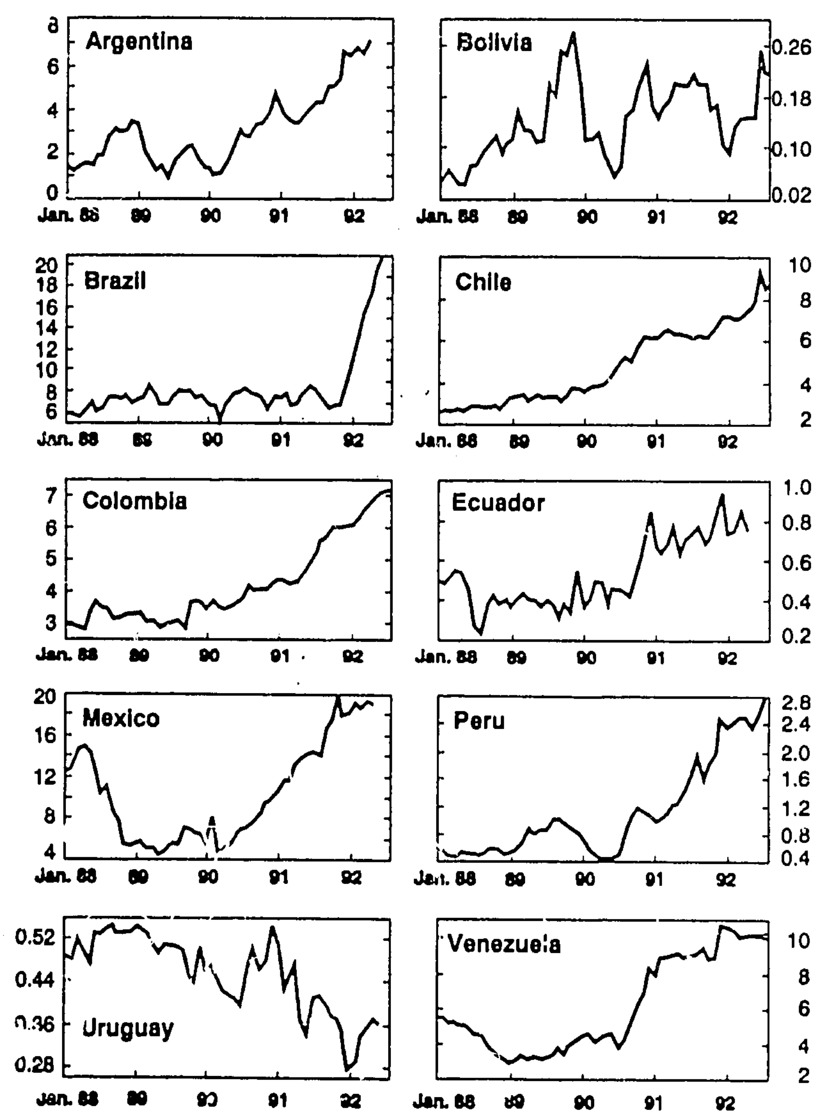
Taxing capital imports might be effective in the short run, according to the authors, but they add that the private sector will ultimately find ways to dodge the taxes.

The authors cautiously support *changes in trade policy* but note that these would entail increases in export subsidies and import tariffs of the same proportion—to avoid distortions between external and internal terms of trade—and an announcement that these subsidies and tariffs will be phased out in the future. Trade policy changes would thus require credible policy commitments and price forecasts.

As a means of *tightening fiscal policy*, the authors suggest that expenditure cuts are preferable to tax increases, because widely available credit can interfere with the desired effect of lowering aggregate demand.

With respect to *intervention*, the au-

Most Latin American Countries' Reserves Have Risen
Total Reserves Minus Gold, January 1988 – July 1992
(billion U.S. dollars)



Data: *Staff Papers*, March 1993

thors note that sterilized intervention (the sale of government bonds by the central bank in exchange for foreign currencies and securities) was the most popular policy response in Latin America to the recent rise in capital inflows. Sterilization insulates the stock of domestic money from variations associated with capital flows, which tends to increase domestic interest rates, lower aggregate demand, and mitigate real exchange rate appreciation.

The authors note, however, that one serious drawback of sterilization is its tendency to cause a higher differential between the interest rate on domestic government debt and that on international reserves, thus creating a fiscal deficit. As such, sterilization can perpetuate the capital inflow.

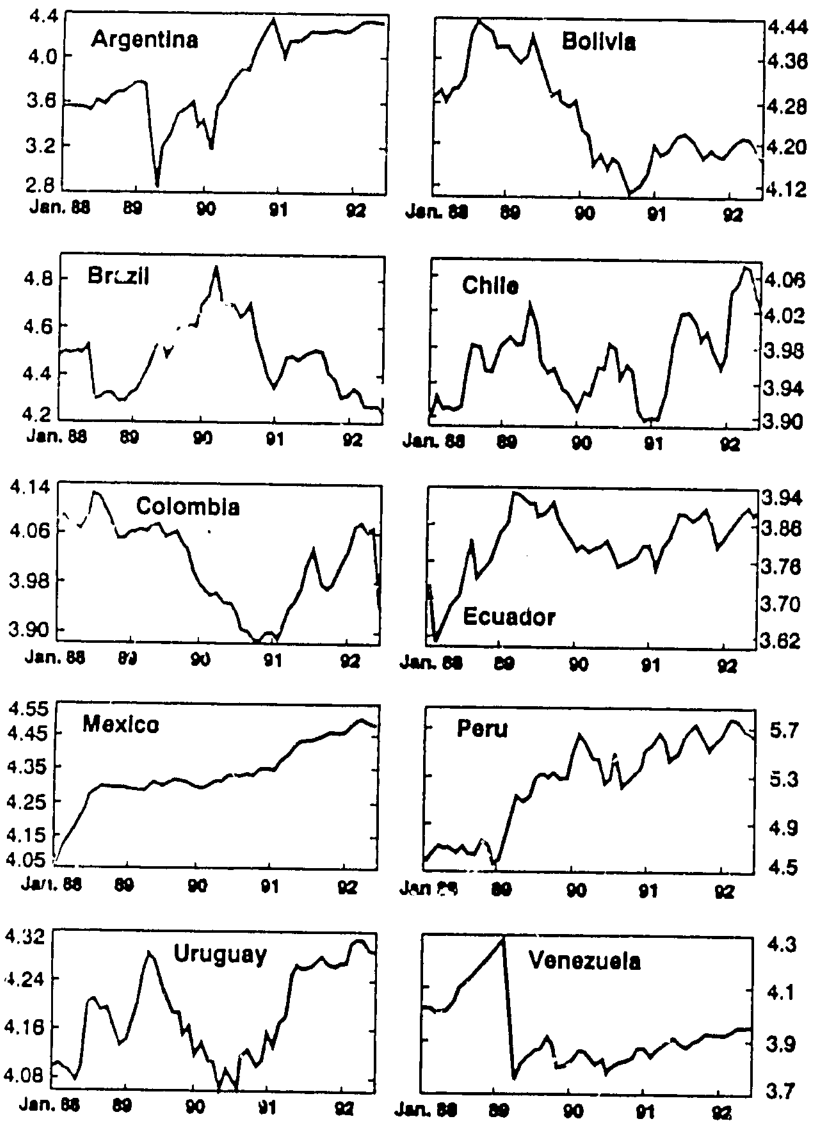
Nonsterilized intervention means the central bank uses domestic currency to purchase foreign exchange. The authors point out that although this policy avoids nominal exchange rate appreciation and a higher domestic-foreign interest rate differential, it can fuel inflationary pressures. Here again, credibility is important in managing the real exchange rate appreciation. A floating-rate regime is more likely to permit a flexible policy response to inflation.

With regard to *insulating the banking system*, the authors suggest that, in cases where a sudden reversal of the capital inflows might threaten the banking system, stricter banking regulations might be appropriate. Sharply higher marginal reserve requirements could result in some disintermediation of the capital inflows and decrease banks' exposure. Regulating banks' investments in the equity and real estate markets could also help insulate them from the effects of a sudden reversal.

The authors conclude that "there are grounds to support a mix of policy intervention based on the imposition of a tax on short-term capital imports, on enhancing the flexibility of exchange rates, and on raising marginal reserve requirements on short-term deposits." They see less of a case for sterilized intervention and caution that, in choosing policy, the authorities should consider the risk of a sudden, large capital outflow.

Nearly All Latin American Countries' Real Exchange Rates Have Appreciated Since 1991

Effective Exchange Rate
January 1988 – July 1992



Data: *Staff Papers*, March 1993

Market Discipline

Timothy D. Lane describes the role of market discipline in preventing unsustainable borrowing. According to him, "market discipline means that financial markets provide signals that lead borrowers to behave in a manner consistent with their *solvency*."

The need for effective market discipline is pervasive, Lane suggests. It is necessary at the level of firms—financial intermediaries must lend prudently and firms must borrow in ways that do not undermine their long-term solvency. Market discipline also affects the quality of sovereign lending. The private lending market must be able to discourage sovereign borrowers from pursuing policies inconsistent with solvency. And, at the global level, economic integration and stable economic relations depend on effective market discipline.

Lane points out that market discipline, when effective, works through the lending market. As borrowing increases, the market initially insists on a higher interest rate spread and eventually excludes the borrower from further lending. Effective market discipline requires that capital markets be open, that information on the borrower's existing liabilities be readily available, that no bailout be anticipated, and that the borrower respond to market signals.

Perhaps the most crucial of these conditions, according to Lane, is a credible no-bailout commitment. Bailouts protect lenders from absorbing losses associated with their loans. Indeed, the promise of a bailout can create perverse incentives for lenders: since lenders face little or no risk, they may undertake the riskiest lending possible because it promises the greatest return. Among the myriad forms of bailouts are

- deposit insurance;
- interregional transfers within an economic union (which may constitute an implicit bailout of the high-deficit countries);
- tax deductions for loan write-offs;
- exchange rate management intended to protect a country from its deficit policies;

Lane: market discipline can prevent unsustainable borrowing.

- lending by international financial institutions (IFIs) that allows bank loans to be paid off while the IFI loans are not; and
- the distortion of subsidies and credit policies in formerly planned economies.

Using the case of the prospective European monetary union to examine market discipline, Lane points out that the large fiscal imbalances in the European Community and its small central budget may overwhelm market discipline and require direct policy coordination. On the other hand, the goals of inflation convergence and liberalization of the capital markets may mitigate some of the existing imbalances causing the fiscal deficits.

In a similar case study of sovereign debtors, Lane maintains that several extenuating factors explain the breakdown of market discipline. The external shocks were large; adjustment financing enabled debtor countries to reschedule rather than cancel loans; and deposit insurance, combined with the tax deductibility of loan losses, may have created the perception of an indirect bailout. More recently, however, Lane sees evidence that markets are becoming more effective: they now discriminate among borrowers, and the link between interest rate spreads and sovereign borrowing appears stronger.

Lane concludes that one cannot rely solely on market forces to prevent unsustainable behavior, but to the extent that institutions are designed to work with market forces, discipline is likely to be enhanced.

Exchange Rate Model

In a third paper, Ronald MacDonald and Mark Taylor examine the validity of the monetary model of the exchange rate, focusing on the forward-looking rational expectations on which the model is founded. The basic starting point of the monetary model is its reliance on a relative money-market equilibrium, which links domestic and foreign prices as well as domestic and foreign interest rates.

Using data for the deutsche mark-U.S. dollar exchange rate during 1976–90, the authors draw a number of conclusions. First, because a stable long-run statistical relationship exists that corresponds to the static monetary approach, the model has long-run validity. Second, the monetary model is rejected when it is combined with the assumption of rational expectations, a result that cannot be attributed to speculative bubbles. Finally, and most important, the model can generate forecasts of the exchange rate that are more useful than those generated by forecasting models that assume random variability of exchange rates.

Rozlyn Coleman,
IMF External Relations Department

Staff Papers is a quarterly publication of the IMF. The subscription rate is US$46.00 for the four issues (US$23.00 for full-time university faculty and students.) Individual copies are US$15.00 each. Please write to Publication Services, Box S-370, International Monetary Fund, Washington, D.C 20431, U.S.A.

96

CEPAL news

Washington Office of the United Nations Economic Commission for Latin America and the Caribbean (ECLAC)
1735 Eye Street, N.W., Suite 809, Washington, D.C. 20006 Tel: (202) 955-5613

Vol XIII
No. 4

April
1993

In This Issue

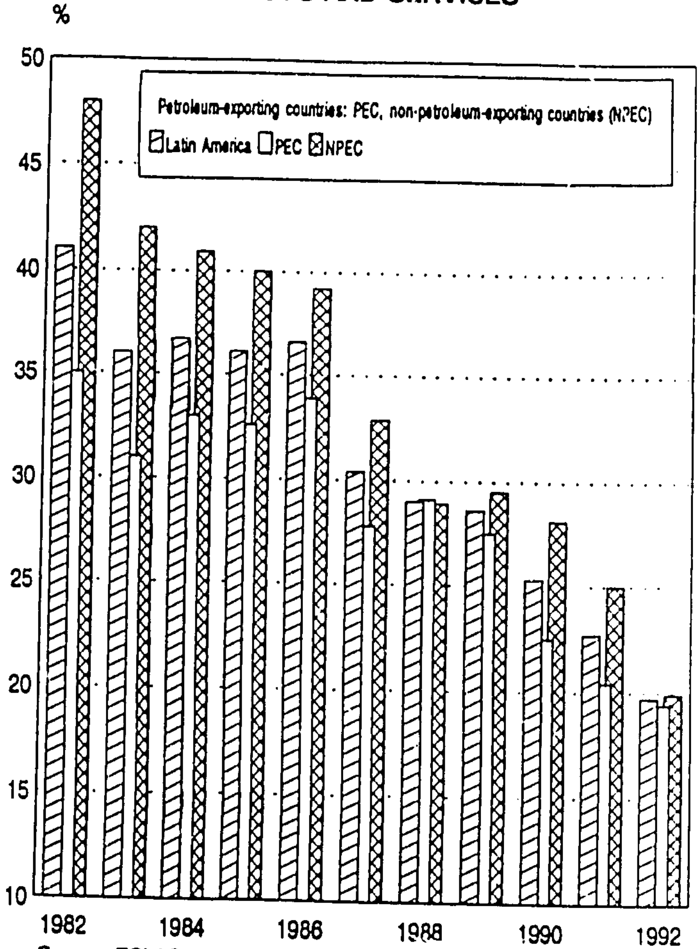
CEPAL News is published monthly by
United Nations Economic Commission for Latin America and the Caribbean (ECLAC)
Washington Office
1735 Eye Street, NW
Suite 809
Washington, DC 20006 USA
Telephone: (202) 955-5613

Ines Bustillo, Editor
Isaac Cohen, Director

EXTERNAL DEBT OF LATIN AMERICA AND THE CARIBBEAN, 1992

After stagnating in 1991, the region's external debt rose 2% in 1992, reaching a total of US$ 451 billion towards the year's end. Various factors led to this expansion, notably new bond placements abroad which amounted to US$ 10 billion in late 1992, official credits, a proliferation of short-term credit operations and accumulated arrears in interest payments. The two main contractionary factors were the dollar's recent rise in international exchange markets which reduced the dollar value of the debt denominated in other currencies, and the various debt-reduction schemes implemented in many countries of the region.

LATIN AMERICA AND THE CARIBBEAN: TOTAL INTEREST DUE, AS A PERCENTAGE OF EXPORTS OF GOODS AND SERVICES



Source: ECLAC, on the basis of official figures.

Lastly, the debt's growth was somewhat retrained by the dynamism of non-debt-related capital movements, especially foreign direct and indirect investment in equity capital, as well as the flow of resources to short-term deposits in the region's banking systems, reflecting in part a repatriation of capital.

• MAIN TRENDS

Whereas in 1991, 14 countries of the region had recorded an absolute reduction of the amount of their foreign obligations, in 1992, only four countries--Argentina, the Dominican Republic, Paraguay and Honduras-- experienced such a decrease. Although Argentina managed to consolidate its access to the international capital market by placing US$1.5 billion in bonds abroad, its total debt declined for the third year in a row, this time by 3%. The decrease was due both to the effect of an ambitious privatization program, under which promissory notes for the public debt were accepted as a means of payment, and to a Brady Plan accord on the reduction of bank debt.

The marked reduction of -21% in the balance of Paraguay's external debt basically reflected the Government's partial elimination of its debt-servicing arrears. The Dominican Republic, for its part, reduced the balance of its obligations by 2% through the buy-back of commercial debt paper on the secondary market. The 0.4% decline in Hondura's overall obligations was a result of debt-reduction exercises with official lenders.

Among the countries whose foreign debt grew in 1992, the highest growth rate, was recorded in Chile, largely reflecting the expansion of short-term credit operations related to trade. Nicaragua also experienced a notable increase in external obligations of 7%, as a consequence of new official credits and accumulated arrears in interest payments to certain governments and to private banks. Venezuela's external liabilities rose 6%, owing basically to public-sector transactions, particularly by the State-owned petroleum enterprise, which placed nearly US$1 billion in bonds on the international market during the first half of the year. El Salvador's external debt expanded almost 5% as it contracted additional official credits which had shown a net decrease in 1991. The increase of over 4% in Brazil's external debt reflected public and private enterprises' active participation in international bond markets where they placed US$3 billion worth of obligations, as well as the expansion of short-term credit lines, especially to finance exports, and the accumulation of more arrears in interest payments on the debt with private banks.

• THE DEBT BURDEN

Indicators of the region's external debt burden continued to fall in 1992, prolonging the improving trend observed in recent years. Thus, the coefficient reflecting interest due on the external debt as a percentage of the region's total exports of goods and services fell for the sixth year in a row, to 20%; this was the lowest percentage recorded since 1980 and was exactly half the maximum coefficient recorded in 1982, the year the external-payments crisis broke out. However, even with such a dramatic decrease, interest payments still absorbed an excessive proportion of the region's export earnings, and therefore efforts must continue to reduce the service of the debt.

In 1992, the decline of the region's interest/exports coefficient was basically attributable to the fall in interest payments, since foreign sales were relatively sluggish and contributed only marginally to the lower ratio. The contraction of interest payments from US$33 billion in 1991 to US$30 billion in 1992 was due in part to the reduction of private bank and official debt, but basically reflected the marked fall in international interest rates; for example, the LIBOR fell below 4% in late 1992, compared to 6% one year earlier and over 8% in 1990.

Nevertheless, two factors helped attenuate the impact of this considerable reduction in international interest rates on the region's interest payments: the prior conversion, under the Brady Plan, of US$34 billion of floating-rate bank debt into par-value bonds with fixed interest rates that are currently higher than the market rate; and the growing weight of multilateral debt, which carries variable interest rates that are relatively inelastic in the short term with respect to trends in the dollar-based credit market.

In 1992, the ratio of interest to exports of goods and services fell in all but five countries of the region. The lower level of interest due on the debt was the main cause of this decline, except in Brazil, Chile, Costa Rica and Honduras, where the upswing in the value of exports was also a decisive factor. In Venezuela, Paraguay and Nicaragua, the ratio increased as a result of higher interest payments and sagging exports; in Haiti, it rose exclusively because of decreased exports; and i. ie Dominican Republic its growth as due to higher interest payments.

While the evolution of the interest/export coefficient has been quite favorable in recent years, the relation between total debt and exports a more structural indicator of the debt burden has fallen relatively little over the same period. In 1992, the latter coefficient was 282% for the region as a whole, compared to 290% in 1991 and 310% in 1989. The 1992 level, though still extraordinarily high, is 34% less than the peak of 427% recorded in 1986. Moreover, the coefficient does not reflect the improvement in the structure of debt payments on account of the extension of payback periods under various official restructuring exercises. Most of the countries still have a debt-export coefficient that exceeds the critical threshold of 200%.

LATIN AMERICA AND THE CARIBBEAN: TOTAL DISBURSED EXTERNAL DEBT

(Millions of dollars and growth rates)

	Year-end balance			Annual growth rates				
	1990	1991	1992	1979-1981	1982-1983	1984-1990	1991	1992
Latin America and the Caribbean	**440 948**	**442 571**	**450 875**	**22.9**	**11.3**	**3.0**	**0.4**	**1.9**
Oil-exporting countries	**189 075**	**195 877**	**198 780**	**24.7**	**10.7**	**2.0**	**3.6**	**1.5**
Bolivia	3 779	3 628	3 685	14.3	9.4	2.5	-4.0	1.6
Colombia	17 556	16 975	17 105	28.0	16.0	6.3	-3.3	0.8
Ecuador	11 856	12 271	12 600	21.0	18.3	7.0	3.5	2.7
Mexico	99 700	105 800	106 000	30.2	11.9	0.9	6.1	0.2
Peru	19 762	20 735	20 890	1.0	13.8	6.9	4.9	0.7
Trinidad and Tobago	2 520	2 431	2 500	29.3	16.3	8.5	-3.5	2.8
Venezuela	33 902	34 037	36 000	24.7	4.0	-0.3	0.4	5.8
Non-oil-exporting countries	**251 873**	**246 694**	**252 095**	**21.5**	**11.7**	**3.9**	**-2.1**	**2.2**
South America	**212 841**	**208 103**	**212 395**	**21.9**	**11.1**	**3.4**	**-2.2**	**2.1**
Argentina	60 973	60 000	58 000	41.9	12.4	4.4	-1.6	-3.3
Brazil	122 200	119 709	124 700	14.4	10.6	3.2	-2.0	4.2
Chile	18 576	17 360	18 775	30.5	7.6	0.4	-6.5	8.2
Guyana	1 984	2 063	2 190	28.1	17.8	9.4	4.0	6.2
Paraguay	1 725	1 788	1 420	12.3	24.5	2.3	3.7	-20.6
Uruguay	7 383	7 183	7 310	35.9	21.2	7.1	-2.7	1.8
Central America and the Caribbean	**39 032**	**38 591**	**39 700**	**18.7**	**16.1**	**6.7**	**-1.1**	**2.9**
Costa Rica	3 874	4 000	4 075	12.8	14.7	1.3	3.3	1.9
El Salvador	2 226	2 216	2 315	17.7	8.4	2.4	-0.4	4.5
Guatemala	2 602	2 561	2 565	19.0	24.8	2.7	-1.6	0.2
Haiti	861	826	845	21.0	21.7	6.6	-4.1	2.3
Honduras	3 526	3 174	3 160	17.5	16.7	7.2	-10.0	-0.4
Jamaica	4 152	3 874	3 940	22.6	14.9	5.2	-6.7	1.7
Nicaragua	10 616	10 454	11 200	27.1	21.5	15.9	-1.5	7.1
Panama	6 676	6 900	7 100	13.3	14.2	6.2	3.4	2.9
Dominican Republic	4 499	4 586	4 500	24.2	14.0	4.4	1.9	-1.9

Source: ECLAC, on the basis of official figures.

The AMEX® BANK review

4

April 20th 1993
Volume 20 Number 4
ISSN 0 265-945X

LDC Flows: Liberalisation and Economic Growth

Overview

Investment flows to LDCs are rising

The recovery of the economies of Latin America and the continued strong growth of Asian economies is proving attractive to international investors. Financing flows to LDCs are once again on the rise, accompanied by a shift away from a dependence on debt towards increased inflows of direct and portfolio investment.

Latin America is leading this trend, with the stabilisation and liberalisation of those economies resulting in record portfolio inflows and good returns for investors. In Asia, where countries have enjoyed uninterrupted access to international capital markets, debt still plays a key role. The opening up of financial markets in this region is expected to see a growing proportion of inflows coming from portfolio investment in the future.

With the shift to equity-related flows, commercial banks play a smaller role as providers of finance for LDCs and Latin America no longer dominates banks' LDC exposure. Securitised lending has risen sharply, with bond finance now accounting for close to half of all funds raised in the international capital markets. There has also been a shift within LDCs from the public to the private sector as debtors.

For the LDCs, the increased inflows are a mixed blessing. There is concern over the potential volatility of these flows as a significant proportion, in some countries, is short term or "hot money", taking advantage of good returns and speculative opportunities. Large inflows have in many cases led to appreciating exchange rates and the consequent loss of national competitiveness, raising doubts over the sustainability of the large current account deficits. Over the longer term there is also concern over the ability of countries to meet their growing obligations. These are all legitimate worries but the nature of the inflows, the use to which they are being put and the improved domestic environments suggest that growth in LDCs and their trade will keep pace with the increase in external obligations.

As the composition of capital flows mature, financing pressures will be revealed in the exchange rate, rather than showing up in a discontinuity of external financing. Indications are that signs of problems will be listened to sooner rather than later, therefore the adjustments needed will be less disruptive to growth than in past financing crises.

Readers are reminded that the deadline for entries for the 1993 essay competition, *The Amex Bank Review Awards in memory of Robert Marjolin*, is June 1st 1993. Entry forms, distributed with the January Review, are available from the Editors. This year the awards Presentation Dinner and Prize Winners' Forum will take place in Singapore, on November 15th-16th.

AMERICAN EXPRESS BANK

New Trends and Opportunities

Themes and Conclusions

The recovery in Latin America and continued strong growth in Asia has increased LDCs' demand for foreign savings. At the same time, new opportunities and the prospect of good returns are attracting foreign investors, thus meeting this demand.

"countries which avoided the debt crisis have enjoyed continued access to international capital markets"

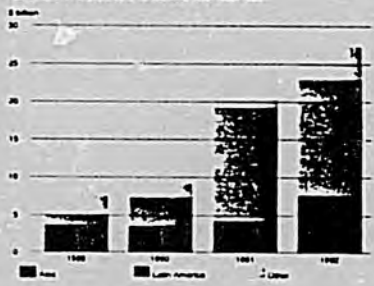
Investment Flows on the Rise

Capital flows to LDCs have risen over the last 3-4 years, accompanied by a shift in emphasis, away from debt towards direct and portfolio investment. Debt now provides only 40% of total flows compared with well over half in the latter part of the 1980s *(see Global Analysis, pages 4 and 5)*. The makeup of debt financing has also changed with a move towards securitised lending and a smaller role for commercial banks as providers of external financing for LDCs.

Latin America has been the major recipient of these higher investment inflows, attracted by the improved domestic investment environment and the more promising outlook for growth in the region. The private sector is now the main user of foreign savings and domestic investment is on the rise.

"economic reform programmes have created attractive environments for investors"

Gross Portfolio Flows to LDCs



The countries in Asia, in contrast, have enjoyed market access without any interruptions and as the region has been growing strongly, demand for foreign savings has risen. The large current account deficits have been financed by increased borrowing, and Asia now accounts for 45% of banks' exposure to LDCs. This is now the same level as Latin America - the big difference being that debt is rising in Asia and falling in Latin America.

Portfolio flows to LDCs, defined as investments in local stock and debt markets, are only just beginning, although have risen fast in the last couple of years, reaching $27 billion in 1992 *(see chart opposite)*. Over half of these flows have been going into Latin America, with a large proportion to Mexico *(see page 7)*.

Common Themes

Country by country analysis *(see pages 6 to 11)* shows a range of experiences although common themes emerge.

First, developing countries which avoided the debt crisis have enjoyed continued access to international capital markets. They have been able to finance large and persistent current account deficits without difficulty and without any deterioration in their debt ratios. In Thailand, Indonesia, Korea, Malaysia and China *(see pages 8, 9 and 11)* borrowing has been accompanied by growth in exports and rising domestic investment and so debt burdens have not become onerous.

Secondly, countries which experienced a debt crisis in the 1980s are now more open to foreign investors, both through direct investment and portfolio investment. The economic reform programmes adopted by the countries, whether as a result of home grown conviction or the discipline imposed by creditors, have created attractive environments for investors. The stabilisation of the economy through prudent fiscal and monetary policies set the scene for liberalisation of both financial markets and trade regimes. Interest rates became positive once again and greater foreign exchange reserves improved liquidity and reduced worries over possible devaluations. A further plank to reform has been wide-reaching privatisation, offering attractive opportunities for investors. The stock markets of Latin America are much more accessible to foreigner investors than the Asian markets *(see back page)*.

Thirdly, economic reform and recovery suggest the prospect of attractive returns. Returns in emerging stock markets have been good although with a high degree of volatility *(see table below)*.

Emerging Stock Markets:
Total Returns in US$

% annual averages	Global Index 1985-89	Global Index 1989-92	Global Index 1992	Investable Index* 1989-92	Investable Index* 1992
Argentine	44.8	56.8	-38.0	63.2	-25.7
Brazil	13.6	5.9	-10.9	9.9	1.0
Chile	80.0	47.8	13.1	53.2	18.0
Mexico	50.5	55.3	27.3	64.4	16.7
LATIN AMERICA	27.1	34.7	-0.4	47.7	3.4
Thailand	52.3	25.7	0.3	27.0	38.5
Malaysia	12.7	15.7	16.8	16.2	24.6
Korea	51.5	-9.9	2.0	-	-
India	19.4	15.7	22.1	-	-
ASIA	41.0	-2.6	-7.3	13.5	18.5
Turkey	228.1[1]	49.9	-55.0	-35.0[2]	-50.7
TOTAL	32.9	5.5	-4.8	22.1	3.1

* see back page for discussion, [1]1987-89, [2]1990-92
Source: International Finance Corporation

Fourthly, there is evidence that a significant proportion of the flows come from nationals who are repatriating flight capital. Overvalued exchange rates and poor economic policy encouraged capital flight. As investment opportunities arise at home this capital is coming back.

And *lastly*, healthy capital flows have set up a virtuous cycle of improving liquidity and strengthening currencies which encourage yet further inflows.

External Financing Worries

Large inflows of foreign exchange are a mixed blessing for LDCs. The most immediate concern, illustrated by the Mexican case, is the worry over how "hot" the inflows are. A significant portion of Mexico's inflows go into short term government paper and would be ready to leave if there was a perceived risk of a devaluation, which outweighed the current interest advantage. Possibly a better measure of the country's vulnerability is the dependence on foreign inflows relative to export earnings *(see table below)*. On this basis, Mexico, Chile, India and Egypt look most at risk. A longer term and more fundamental worry is whether countries are building up obligations they will be unable to meet, leading to a financing crisis in the future. Growing obligations are being matched by growth in the economy and in trade. As the composition of flows changes, any weakness will show up in pressure on the exchange rate and domestic financial markets rather than in an interruption in external financing. Any real deterioration in a country's creditworthiness will be dealt with in the market, sooner rather than later.

Domestic Policy Concerns

The inflows not only put upward pressure on the exchange rate, reducing competitiveness, but can also be inflationary. So far countries have managed the problem relatively well. Both Mexico and Chile - the two countries with the highest inflows - have been able to reduce inflation.

First, an appreciating exchange rate reduces import costs and forces domestic producers to compete by reducing prices. *Secondly*, interest rates have been kept high and there has been no fiscal stimulus, which reduces demand pressures, as well as making it easier to issue public debt to sterilise the foreign exchange inflows. And *finally*, the inflation mentality has been broken as the exchange rate provides an anchor for price rises.

Financing Flows: Country Analysis

(1989-92)	Current Account as % GDP	DFI (as % total flows)	Portfolio (as % total flows)	Debt (as % total flows)	Inflows as % FX earnings
Argentina	-2.4	99	26	-24	14.1
Brazil	+0.2	164	23	-187	1.3
Chile	-1.0	25	31	44	16.4
Mexico	-4.4	38	35	27	24.6
Thailand	-7.0	38	12	51	14.3
Malaysia	-5.4	68	20	12	10.8
Indonesia	-3.0	28	2	74	14.0
Korea	-1.0	2	6	43	4.4
China	-2.0	62	-53	91	8.5
India	-2.2	13	3	94	20.6
Egypt	+1.2	33	50	17	18.3
Turkey	-0.5	24	37	39	12.1

Source: World Bank, IMF and Review estimates

April 1993

"healthy capital flows set up a virtuous cycle of improving liquidity and strengthening currencies"

"direct investment to Latin America is equal to 75% of all medium term financing"

"for Asia debt still plays a key role"

"large inflows of foreign exchange are a mixed blessing"

The AMEX BANK Review

CAPITAL FLOWS TO LDCS

Changing Patterns in Financing Flows

Global Analysis

Financing for LDCs has been rising fast with an increasing emphasis on investment and portfolio flows. Latin America is enjoying large inflows of investment while the Asian countries are now the major borrowers.

Capital Inflows Rise

Net capital flows to developing countries have risen fast over the last couple of years, and in 1992 reached 3.5% of LDCs' GNP compared with an average of 2.3% in the period 1985-89 *(see table below)*. Net capital flows, less interest and dividend payments, have moved even more dramatically, from being negative for most of the latter half of the 1980s, to positive flows of over $50 billion or 1.5% of GNP in 1992. Lower world interest rates played the key role but falling debt burdens also helped.

Change in Sources of Capital

The increase in the flow of capital has been accompanied by a shift in the source, from debt towards equity.

Net Capital Flows to LDCs: By Source

Annual averages ($ billion)	1985-89	1990	1991	1992	% share 1985	% share 1992
TOTAL[3]	73	98	115	134	100	100
Loans/Bonds[1]	39	42	42	57	53	43
Official	25	31	28	31	34	23
Private	14	11	14	26	19	19
Direct Investment	16	24	34	38	22	28
Portfolio Investment[2]	-	4	8	8	-	6
Total Flows as % GNP	2.3	2.8	3.0	3.3		

Net capital flows = gross inflows of debt and investment less repayments
[1]Debt creating flows
[2]Direct equity investments + Country funds + ADRs
[3]Includes grants
Source: World Bank Debt Tables

Between 1985 and 1989 debt provided over half of LDCs' financing needs but by 1992 this was down to around 40% *(see table above)*. Equity finance, particularly direct foreign investment (DFI), has been growing strongly, accounting for almost 30% of the total in 1992, after increasing by 50% in just two years. When foreign investment in emerging stock markets is included this source of capital now provides well over a third of all financing for LDCs. The potential for further portfolio flows looks very good, with the main constraint being the inaccessibility of many of these markets to foreigners *(see back page)*.

Direct Foreign Investment in Latin America

Latin America is responsible for the spurt in direct foreign investment to LDCs, with direct investment rising from a low point of under $4 billion in 1986 to an estimated net flow of close to $14 billion in 1992. This is equal to 75% of all medium term financing in Latin America. Over the same period debt financing has fallen from around half, to just 12% of the total.

Debt Financing For Asia

The picture for Asia is quite different and debt still plays a key role in providing finance, accounting for a steady 50% of medium term financing, with a further third coming from foreign investment. Direct foreign investment has been falling as a proportion of the total over the last couple of years, in part reflecting the outward flows of investment from some of the more developed countries in this group, most notably Korea *(see page 9)*.

Bank Debt Less Important

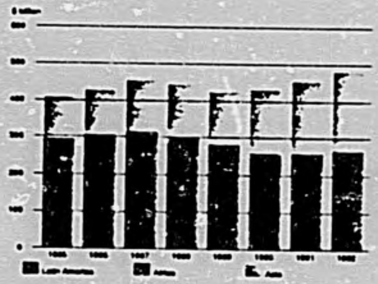
LDCs' commercial bank debt has remained stable over the last 7-8 years and countries' debt burdens have fallen. Banks' exposure to Asia has risen however, both in absolute and relative terms, and now accounts for 45% of total exposure to LDCs compared with under 30% in 1985. Exposure to Latin America is around same level but in

4

contrast this has fallen from over 60%.

There has been a move towards securitised lending, implying a rise in debt instruments held by investors, other than commercial banks. Bond finance rose to nearly $8 billion in 1991, compared to an average of $4 billion in the previous few years, and commercial bank loans of $4 billion. Gross bond finance rose to $14 billion in 1992, accounting for over 40% of funds raised by LDCs in international markets.

Debt to Banks



Portfolio Flows are Just Beginning

Portfolio flows to LDCs have risen sharply over the last four years, totalling $64 billion, although only $23 billion of that has gone into equity investment with the balance going into domestic debt. Of that $23 billion, Latin America has received $13 billion. Around half of portfolio equity investment is in the form of American Depository Receipts (ADRs) - whereby the local company issues shares on a USA stock exchange - 30% of portfolio investment through country funds and the remaining 20% in the form of direct equity holdings.

Net Capital Flows to LDCs: By Region

($ billion) average 1991-1992	DFI	Debt	Portfolio Flows
Argentina	2.5	0.4	2.4
Brazil	1.8	0.8	0.2
Chile	0.7	0.5	-
Mexico	5.4	2.5	9.7
LATIN AMERICA	13.2	4.5	15.2*
Thailand	1.7	3.3	0.3
Malaysia	3.5	1.8	1.8
Indonesia	1.6	2.7	-
Korea	-0.3	4.1	7.7
China	4.3	4.0	-5.7
India	1.3	5.2	0.2
ASIA	14.4	23.4	5.9*
Egypt	1.4	0.5	2.5
Turkey	0.8	1.3	1.2
TOTAL LDCs including others	36.1	49.5	23.8*

* Gross flows
Source: World Bank Debt Tables, Review estimates

"there has been a move towards securitised lending"

"every country has a different story to tell"

news release

Inter-American Development Bank
1300 New York Avenue, N.W., Washington, D.C. 20577 (202) 623-1000

NR-61/93

FOR IMMEDIATE RELEASE March 29, 1993

LATIN AMERICA AND EASTERN EUROPE: COMPARING REFORM EXPERIENCES

Seminar held prior to Annual Meeting of Inter-American Development Bank

The economic reform experiences of Latin America and Central and Eastern Europe are not comparable despite important similarities, concluded participants at a seminar held on March 26 in Hamburg, Germany.

The seminar was organized by the Inter-American Development Bank, the ING Bank, the European Bank for Reconstruction and Development, and the German Federal Ministry for Economic Cooperation and Development. It took place before the XXXIV Annual Meeting of the Board of Governors of the Inter-American Development Bank in Hamburg, which will be held March 29-30.

The challenges of Latin America's economic reforms, on the one hand, and those of Central and Eastern Europe, on the other, "are not comparable," stated José Angel Gurria, president of the Mexican bank Bancamex and one of the architects of his country's economic reforms. "The starting points were different," he said.

Gurria noted that while the countries of Central and Eastern Europe are confronting the need to create market economies from the ground up, the Latin American countries are reforming economic systems that already have basic investment and market mechanisms.

This explains why Latin America is very advanced in comparison with the countries of Central and Eastern Europe, having already completed such reforms as the opening their economies to international competition and the privatization of state enterprises, said Gurria. "We are now carrying out second and third stages of the reforms: we are not dealing so much with privatizing enterprises as with privatizing enterprises that were previously reserved to the State: water, infrastructure, ports and airports, roads, electric generation plants, refineries."

Gurria rejected the notion that there is some kind of competition for resources between Latin America and the countries of Central and Eastern Europe. "There is no race," he said.

Gurria also pointed out that the economic reform processes in Latin America are "more homogenous" than those of the formerly communist countries. The great challenge that remains for the Latin American countries, he maintained, is to reform their capital markets to ensure financing for economic development.

In this respect, he was in agreement with all of the participants on the need to reform national financial systems.

Another theme on which panelists agreed was that privatization should not lead to the substitution of state monopolies by private monopolies and in that privatization should be a vehicle for the technical and administrative improvement of the firms, according to Ciro de Falco, manager of the IDB's Plans and Programs Department.

The Minister of International Economic Relations of Hungary, Bela Kadar, noted that among the great differences between the two regions is that Latin America had a much smoother transition to democratic government than did Central and Eastern Europe.

Similarly, the Latin American economies are already more integrated into the world economy and have experience in private domestic and foreign investment. In addition, at the start of the reform process, the Latin Americans had sums deposited overseas, in marked contract to Central and Eastern Europeans.

Kadar also noted that the countries of Central and Eastern Europe had to completely reorient themselves as regard foreign trade after the economic agreements among the former socialist bloc were dissolved. In contrast, Latin America's agreements continued in force.

Other panelists noted similarities between the experiences of both regions.

Mario Sarcinelli, vicepresident of DERD, noted the interest of both regions in increasing their exports and pushing ahead with the integration of their economies. Examples he cited included the Southern Cone Common Market, and the integration efforts of Central Europe. According to Sarcinelli, other important similarities are the transition to democracy and the withdrawal of the state from the economy.

The Venezuelan Minister of Coordination and Planning, Ricardo Hausmann, cited examples of integration efforts being carried out by his country, among them between Venezuela and Colombia, the Andean countries, Chile and Mexico and Venezuela's interest in the North American Free Trade Agreement.

Hausmann cited parallels between the processes of reform of the two regions, such as the opening to foreign investment, the withdrawal of the state from the economy, tax system reform and the elimination of indirect subsidies in favor of direct subsidies with specific objectives.

IDB President Enrique V. Iglesias opened the meeting with a review of the reforms Latin America is carrying out, which were made possible by a new generation of leaders in the region. Other participants in the seminar included Chile's Finance Minister Mario Ribadeneira; Minister of the Economy and Finance of Uruguay Ignacio de Posadas, and the Czech Minister of Industry and Trade Vladimir Dlouhy.

TREASURY NEWS

Department of the Treasury   Washington, D.C.   Telephone 202-622-2960

STATEMENT OF LAWRENCE H. SUMMERS
UNITED STATES GOVERNOR
ANNUAL MEETINGS OF THE AFRICAN DEVELOPMENT BANK GROUP
ABIDJAN, COTE D'IVOIRE -- MAY 12-14, 1993

President Ndiaye, Governors of the African Development Bank, distinguished guests, it is an honor to be here representing President Clinton and Treasury Secretary Bentsen at these important meetings. I would like to thank our hosts for their hospitality; we are pleased to be back in the lovely city of Abidjan.

We come together today at a time of transition. The Cold War has ended. Political and economic reform are sweeping the globe. In Africa, the winds of change are blowing gale force as the torch passes to a new generation of leaders dedicated to the creation of a democratic and prosperous Africa for their children.

The United States has a new young President committed to economic renewal at home and abroad. President Clinton knows that we cannot speak of global prosperity until the African continent once again starts to catch up with the rest of the world. As he recognized during his campaign: "A revolution is underway in Africa. From South Africa to Ethiopia -- from Kenya to Zaire -- Africans are struggling to achieve political and economic freedoms... We have a strong interest in helping them translate those freedoms into a better life for themselves and their children."

We have come to Abidjan to renew and revitalize America's commitment to Africa and to Africans.

<u>THE RECORD</u>

Anyone attending these meetings in 1963, 1973, or 1983 who was told what the African economy would look like today would have been profoundly disturbed. Consider the record:

-- Sub-saharan Africa is poorer today than it was in 1965.

-- In large parts of the continent, a child born today is more likely to be hungry than to go to primary school and to die prematurely than to go to secondary school.

-- In the last 25 years, more than 7 million Africans have been killed in wars and the famines they have spawned.

-- Investment rates lag and the African continent today has fewer functioning roads and railroads than it did in 1960.

-- Physical and Human capital have fled Africa on a grand scale. And some estimates indicate that as many 1/3 of the Continent's college graduates fled the continent during the 1980s.

This poor economic and social performance has taken place despite a level of foreign aid from the rest of the world that has dwarfed support available to other continents. The average African has received four times as much foreign aid as the average Asian.

Nor was it an inevitable consequence of a difficult external environment. Two decades ago, Nigeria was richer, less dependent on commodity exports and had less debt than Indonesia. Ghana was richer and had less debt than Thailand. These examples can be multiplied.

<u>WINDS OF CHANGE</u>

With this record of economic difficulty, it is little wonder that an older generation of leaders is giving way to a newer generation dedicated to democracy, committed to economic reform, and determined to bring about better lives for their people:

-- We welcome developments toward sustaining participatory democracy in nations as diverse as Namibia, Mali, Zambia, and Lesotho. And we applaud the 13 African nations that have held multiparty elections since 1988.

-- We are glad to see that the process of national reconciliation between bitterly opposed factions -- often difficult and painful -- is underway in the war-torn lands of Angola and Mozambique.

-- We are heartened by the new spirit of dialogue between the Arab states of North Africa and Israel.

-- We admire the statesmanship of Nelson Mandela and F.W. deKlerk and the courage of the South African people in working to eliminate apartheid and create a non-racial democracy.

There are those who doubt that people living in poor countries in need of reform can afford the luxury of democracy. Let them consider this: History reveals that there has never been a war between democratic regimes. And history also suggests that there has never been a famine in a democratic nation with a free press.

These are some of the reasons why support for democratization is one of the cornerstones of the Clinton Administration's foreign policy.

The path to mature democracy is especially rocky during periods of major economic adjustment. That is why I am here to tell you that just as the United States supports a strong external assistance effort for formerly communist countries, we remain steadfast in our absolute determination to stand with reforming governments in Africa.

I want to use the remainder of my time here to talk about four areas where the nations of Africa, the African Development Bank and the United States can forge a partnership to support reform, promote democracy, and most important, make a better life for the children of Africa.

The challenge is great. But as President John F. Kennedy once said, "Man's problems are made by man. They can be solved by man."

Yes, the road is a long one. President Kennedy often told the story of the man who asked his gardener to plant a tree. The gardener responded, "but it will take one hundred years for it to grow." And so the wise man said, "then plant it this morning."

ECONOMIC REFORM

First, governments must reform their economic policies. The 1980s have been a decade of adjustment in Africa. Nearly 30 countries are now engaged in adjustment programs directed at the fundamental objective of macroeconomic stability, economic liberalization and restructuring the role of government. Adjusting governments have recognised that, to quote Keynes, it is not for governments to do what the market can do a little better or a little worse, but for governments to do what the market cannot do at all.

Adjustment has not brought the rapid progress that many hoped for. And I know that in some places adjustment fatigue has set in. But, the record is clear and is supported by numerous studies done at the World Bank, at the African Development Bank, and by private scholars inside and outside of Africa. Countries that adjust do better in terms of growth, better in terms of investment, better in terms of exports and bettdr in terms of helping the poor than those who do not. The greatest benefits go to the rural poor -- those worst off in almost every country -- who respond dramatically as their incentives to farm are greatly enhanced.

There is much that can be done to improve the quality of adjustment programs. We must not confuse austerity with adjustment! Local input must play more of a role in the design of adjustment programs. Barriers to private investment must be better targeted and removed. More effort must be devoted to protecting key social spending. And the consequences of adjustment for the natural world must be more carefully examined.

But the opposition of urban elites and entrenched bureaucrats must not be confused with the national interest of adjusting countries. The right question for most countries in Africa is not whether to adjust but how.

With the end of the Cold War, external supporters of development efforts will inevitably measure the extent of their support with the degree of progress in economic reform. I call on the African Development Bank to be more cautious in the future than it has been in the past about making loans in policy environments involving over-valued exchange rates, rapid inflation, or inadequate governance structures which prevents financial assistance from being used prudently. This has been an issue of concern for the United States for some time, and it will be of greater concern in the future.

For those countries with crushing debt burdens that are embarked on adjustment programs, there is no alternative to debt reduction if momentum of reform is to be maintained. I am pleased to announce that the Administration has requested from Congress new appropriations to enable the United States to participate in multilateral debt relief efforts along the lines of enhanced Toronto terms for many countries. We look forward to working with our partners to eliminate the debt overhang obstacle in low income countries over the next several years.

I'm also pleased to report that the United States will be an enthusiastic supporter of a new ESAF program that will enable the IMF to continue providing concessional support for stabilization in low income countries. It is critical that we maintain momentum in this effort, and given the stringency of donor budgets, all possible avenues of finance for this effort must be explored.

PRIVATE SECTOR INITIATIVE

Second, Africa's future lies with its entrepreneurs. The world cannot maintain forever the current level of aid. Even if it could, experience shows that those investments that meet market tests are essential to economic growth.

Private investment cannot succeed without the provision of basic infrastructure. The United States sees the provision of infrastructure, and not the funding of parastatals, as the appropriate objective of the African Development Bank in the years ahead.

We welcome the IFC's development of country funds to facilitate the investment in African equities, and call on more countries to open up their stock markets to eager foreign investors. We encourage the ADB's Private Sector Development Unit to make well-targeted quality investments. And we wish the new AFREXIM bank well, and express our fervent hope that it will be managed as efficiently as possible.

The success of the African private sector depends on the world market for African products. President Clinton's program of economic renewal with its emphasis on re-starting global growth and bringing down high interest rates through deficit reduction will make a major contribution.

And in recent days, President Clinton has made it clear both publicly and privately that the United States is prepared to walk a long mile to finish the Uruguay Round this year. With industrial country barriers costing the developing world more than it receives in aid each year, no other step is as important in promoting not just African development, but development around the world.

INVESTMENT IN PEOPLE

Third, in a world where capital, technology and ideas daily transform our existence, the most enduring investment any nation can make is in its most valuable resource: its people. Governments in Africa, the African Development Bank, and industrialized nations supporting Africa must reinvigorate their efforts to invest in people, especially in the children who will shape Africa's future.

The magnitude of the problem is dramatically demonstrated by statistics contained in the ADB's 1992 African Development Report. It cites UNESCO estimates that for low income Africa, expenditures per student rose from $57 in 1970 to $133 in 1980 but then declined to $89 by 1988. This despite the fact that primary education is perhaps the highest return investment available in the developing world, with a rate of return, according to the ADB report, of 26% per year in Africa.

It is estimated that there were 70 million more undernourished Africans in 1989 than in the mid 1970s, and that 40% of Africa's pre-school children suffered from acute energy deficiency, up from 25% in 1985.

This is a problem of spending priorities; African governments today spend more on the military than on health and education combined. Spending on health and education too often is directed at tertiary hospitals and universities in urban areas rather than primary health programs and schools that serve the poor. All too often health care is provided without medicines, or education without books because governments provide the buildings and civil servants without funding the recurrent costs.

Governments must change their spending priorities toward investment in people if they are to expect increased support. But as they do, in response to the pressures that inevitably come with democratization, we must do more to support investment in people. The United States welcomes the rededication of the African Development Bank to the central mission of combating poverty and looks forward to seeing greater emphasis on investments in the social sector in the future.

The IDA 10 Agreement represents a major international commitment to attack the underlying causes of poverty through investment in people and sustainable development. Almost half of the $22 billion program will flow to African countries.

We, in our bilateral efforts, will also be concentrating increasingly on investments in the next generation of Africans, because investments in people are the highest return investments of all.

POPULATION

Fourth, population: It is not possible to think about the problem of investing in children without thinking about their mothers. There is no development priority greater than empowering women by making sure that girls as well as boys are educated, and by enabling women to make fundamental life choices by controlling their own fertility.

-- It is a moral imperative, because it will allow more children to live. Educated mothers with few children are half as likely to see their sons and daughters die as uneducated women with many children.

-- It is an economic imperative because with population growing at 3% a year, most output growth goes just to maintain, not to increase, living standards.

-- And it is an environmental imperative. Women in Africa steward natural resources and more educated women do it better. Less population pressure means less deforestation, less desertification and less destitution.

The governments of Africa must do more to empower women. An increasing body of evidence suggests that female education and family planning measures offer the best defense against the scourge of AIDS. I agree with the findings of the ADB's African Development Report that family planning must be an integral part of the primary health care system in Africa. We welcome the commitment of the African Development Bank to become more involved in this area.

And I am pleased to report that the Clinton Administration has removed the ideological blinders of the last 12 years and has made the reinvigoration of family planning efforts a major foreign policy priority.

AFRICAN DEVELOPMENT BANK

Let me turn finally to a few observations on the African Development Bank.

President Ndiaye, I want to congratulate you on behalf of my government for building Africa's premier economic institution and for maintaining its Triple-A credit rating through these years under difficult circumstances. The United States looks forward to providing more support for the African Development Fund in the near term, and for replenishing the Bank over the longer term.

However, particularly in an environment of great budget stringency, our support for your institution will depend on its progress in renewing itself and adapting to emerging concerns. This means we will be looking for:

-- Strengthened lending and financial policies. In this context, I welcome President Ndiaye's comments this morning which seek strong Bank policies on arrears and provisioning, and alignment of lending with country risk in the region.

  This is consistent with the bold leadership which we have come to appreciate from President Ndiaye. I look forward to working with regional and non-regional governors to explore measures which would achieve these objectives.

-- Improved project quality supported by a serious and independent review of the existing portfolio, and by a reform of the bank's decision making procedures to emphasize development impact, and rigorous analysis of creditworthiness in evaluating projects.

-- Close controls on expenses of all kinds. In coming months we will be asking each of the international financial institutions to increase efficiency, cut frills and lower their costs.

  President Clinton has asked each agency in the U.S. government to do the same.

-- Increased environmental sensitivity and involvement of non-governmental organizations. We need to see more transparency in the development banks that ensures popular participation in project design and implementation. NGOs can make a valuable contribution and we encourage their involvement in the development process.

The world community can be proud of what its intervention in Somalia accomplished, but no one can be proud of the conditions that made it necessary. That is one reason why President Clinton is committed to working in partnership with Africa to ensure that at long last this great continent lives up to its tremendous potential.

I want to conclude by quoting the words of the African American poet Maya Angelou, speaking just after President Clinton took the oath of office 100 days ago. She was not just speaking of America, but perhaps of Africa as well when she said:

> (Quote) "Lift up your faces, you have a piercing need
> For this bright morning dawning for you.
> History, despite its wrenching pain,
> Cannot be unlived, but if faced
> With courage, need not be lived again.
>
> The horizon leans forward,
> Offering you space
> To place new steps of change
> Here, on the pulse of this fine day." (Unquote)

Thank you very much.

Capacity Building: The Missing Link in African Development**

by

Edward V.K. Jaycox
Vice President, Africa Region
The World Bank

I. Introduction

Mr. Chairman, ladies and gentlemen,

Thank you for your kind introduction.

I am delighted to have the opportunity to exchange views with you on capacity building in Africa.

First, I would like to congratulate the African American Institute on its 40th anniversary. Over the years, AAI has been instrumental in promoting the dialogue between Africans and Americans and has been a major facilitator in the education of thousands of Africans.

The Institute's current success is in large part due to the tireless efforts of its President, Vivian Lowery Derryck. She deserves special tribute. I would also like to thank her colleague, Steve McDonald, for organizing this conference.

II. The Importance of Capacity Building

There is no shortage of ideas about what lies at the root of Africa's development problems: **the paucity of trained and skilled manpower and weak institutions.**

The history of development demonstrates that to move from poverty to economic prosperity, countries need professionals who can identify problems, analyze them, formulate and decide on issues, and implement and manage decisions. They also need strong institutions that can allow their professionals to work efficiently and effectively at these tasks.

Human expertise and institutional effectiveness are not only important for designing and implementing policy, they are the key to the development of other fundamental qualities:

- they determine the ability to adapt development models effectively to local environments;
- they instil an important sense of ownership, enhancing commitment to development;
- they allow local control over economic events and promote confidence in responding to change;
- they promote responsibility for decision-making; and
- they provide for a more equitable dialogue with others.

**Address given to a conference sponsored by the African American Institute, Reston, Virginia, May 20, 1993.

ACROSS THE BOARD

The Conference Board Magazine Vol. XXX No. 4 May 1993

GLOBAL REACH

By Shlomo Maital

Kondratieff's Revenge

Poland's economic lessons offer food for thought for other former Soviet-bloc countries.

WARSAW—Who was Nikolai Dmietrievich Kondratieff? Why does his spirit haunt the plans of Poland? And what is he telling us? I learned the answers during a brief but intense stay here.

A little more than three years have passed since the then-Finance Minister, Leszek Balcerowicz, applied economic "shock therapy," in one stroke freeing all prices and allowing the forces of supply and demand to operate unhindered in markets.

Has it worked?

By all accounts, it has. Poland may well be the first of the ex-socialist countries to turn the corner. According to 38-year-old economist and banker Marek Mazur, board chairman of the People's Credit Bank and adviser to the finance minister, Gross Domestic Product (GDP) could grow by [illegible] percent to 2 percent this year, which is slow by Japanese standards but high compared to the expected 20 percent drop in Russia's GDP. Inflation in Poland is expected to slow from around 44 percent last year to 32 percent in 1993.

Over half of Poland's output and employment now comes from privately owned companies; some 600,000 new businesses have been started in the country since 1989. And according to a report by ex-Pole Jan Federowicz, even when overall GDP fell in 1989, GDP attributed to private companies rose. (Poland began moving toward free markets even before the "shock therapy," but that has speeded things up a lot.)

Though unemployment is high—12 percent to 14 percent—that actually may be a favorable sign in the long term, as inefficient state-owned plants release redundant workers to find jobs in more productive, privately owned companies. (Recently, 89,000 Poles applied for jobs at a new Radisson Hotel in Szezcin; there were only 600 openings available.)

Foreign investment is growing also. Italy's Fiat S.P.A. will sink $2 billion into producing its new Fiat *Cinquecento* ("500" in Italian) here. U.S.-based International Paper Co. bought a major Polish paper mill. The Coca-Cola Co., PepsiCo, Gerber Products Co., AT&T Co., Levi Strauss & Co., R.J. Reynolds Tobacco Co., Colgate-Palmolive Co., Procter & Gamble Co., Marriott Corp., and Gillette Co. all have made major investments in Poland.

True, problems remain, but solutions are in the works. Poland still has $45 billion in foreign debts, but up to half of it may be forgiven, through deals with the International Monetary Fund. After a fierce fight, Parliament passed a new budget limiting the budget deficit to $5 billion, or an acceptable 6.5 percent of GDP. And on the day I arrived here, Polish Prime Minister Hanna Suchocka fashioned a deal with eight big trade unions, trading agreement on privatization for a 10 percent workers' stake in privatized companies and other benefits.

A symbol of the new Poland is Robert Wasniewski, head of investment servicing at PAIZ, the state foreign-investment agency. I was impressed by his knowledge of new investment and tax laws, as well as his ability to explain them in good English. A recent economics graduate of Warsaw University, he is just 26 years old. In the old Poland, Wasniewski would have needed impeccable Communist credentials, and another 20 or 30 years, to get his job.

Another change: Shop windows are full of goods. Growing numbers of Poles are at last able to consummate their love affair with the automobile, once only a distant dream. ("The last love of my life," one woman described her little banged-up Fiat 126 to me, "before I met my husband.") The sour socialist frustration of having piles of zloty, the Polish currency, and nothing to buy is being replaced, for many, by the sweeter capitalist frustration of seeing heaps of new high-priced products and often not having the purchasing power to acquire them. A system that builds incentive to acquire more zlotys

SHLOMO MAITAL is a founder of TechnoStat, an Israeli consulting firm specializing in statistical and economic analysis, and a visiting professor at the Massachusetts Institute of Technology's Sloan School of Management.

99'

certainly beats a system that makes your existing zlotys essentially worthless.

Poland's fast transition to free markets was aided, Mazur reminded me, by the fact that Poles were relatively free to work abroad under socialism. Hence, they had some $2 billion to $3 billion in official foreign-exchange deposits held in banks, and perhaps an equal sum hidden under their mattresses, that they used for making purchases when goods flooded in after January 1990.

Another key to Poland's success, Mazur explained, is food. The Communists never succeeded in collectivizing Polish farms, unlike in Russia, Czechoslovakia, Hungary, and the Ukraine. They tried, I was told, but Polish farmers' attachment to their land is legendary and most of it stayed in private hands.

Food was scarce under socialism because for years, the Polish government purposely kept food prices low to provide cheap food for assembly-line workers in cities, and for export to the Soviets. This move led to shortages, as farmers understandably balked. But Poland's bountiful potential for food production remained intact. When the lid was lifted on food prices, making it profitable for farmers to expand output, food flooded into the shops in no time.

A sign of the times is the common scene of Polish farmers selling meat and potatoes from the backs of their vans at curbsides. The grocery stores and shops are full, and Poles, who have known hunger often, are renewing their French-like love of good food and wine. And Poland is now the world's second-largest producer of potatoes and rye.

"This is the most open nation in the whole ex-Soviet bloc," said Polish-born Mike Jaxa-Kwiatkowski, the marketing manager for Delta Air Lines Inc. in Poland. Jailed in the country for six months in 1982 and then expelled, he learned American management methods while working abroad for several U.S. carriers. His goal is to double Delta's business in Poland annually and so far, he has been able to achieve that.

"As the American ambassador here said, 'We [the United States and the rest of the free world] have a responsibility for Poland to succeed. If the

Polish farmers' attachment to their land is legendary and most of it stayed in private hands.

Poles don't succeed, with all their talents and their creative thinking, we are going to have a mess,' " Jaxa-Kwiatkowski told me during my recent visit.

What do the Poles really need? "Never give them money," he asserted. "The real shortage is technology and experienced managers." He explained that Poland will need thousands of CPAs, bookkeepers, and tax experts as businesses here shift to Western accounting and tax systems.

But what does this have to do with Nikolai Kondratieff, and why did I sense his spirit so strongly here?

Kondratieff was a brilliant young Russian economist who held a senior cabinet post in agriculture in Lenin's government. He is best known for his discovery of the "long waves" named after him, the economic theory that every 60 years or so, booms alternate with busts. Kondratieff is thought to have opposed Lenin's policy to collectivize farms. Later, that opposition won Kondratieff a one-way ticket, provided by Joseph Stalin, to the gulag prison camps in Siberia, where he apparently perished.

Socialism never did manage anywhere to persuade farmers on huge *kolkhozs* (collective farms), to convince them to slave from dawn to dark for the glory of the state, rather than for income and profit. The Ukraine, regarded as Europe's breadbasket during the last century, went hungry. So did Russia.

Kondratieff was right. The socialists should have left the farms alone.

In his pioneering work on economic development, the late Nobel laureate Sir W. Arthur Lewis, a longtime Princeton University professor, explained the key link between food and factories. Starve the farms of resources, he explained, and food becomes costly, causing wages to rise and choking off industrialization. Make food too cheap—say, by instituting price controls—and farmers won't produce enough of it, making it necessary to import food, waste precious foreign exchange, and hence hurt industry.

Poland's farmers were always able to feed more than twice the country's population. But since 1946, they lacked the incentive to do so, because food prices were kept so low. The rapid economic reforms of Balcerowicz restored those incentives, and farmers responded dramatically.

The contrast with Russia is stark. There, the enormous task of shifting land to private farms is only beginning. As a result, food is still relatively scarce and costly.

Americans, who gobble an average of 3,600 calories daily—probably 20 percent more than what's needed—take for granted the enormous productivity of American farmers and the cheap and plentiful goods that stock each U.S. supermarket with an average of 15,000 different products. It is food that provided the basis of industry. High farm productivity freed labor to work in the cities, while still feeding the population without the need of food imports.

With a few exceptions—Hong Kong and Singapore, perhaps— countries cannot built solid industry without solid farms. And the *kolkhoz* is a poor substitute for owning your own 40 acres.

The Poles, who knew wartime starvation, are eating well these days. Kondratieff is avenged. And as Poland becomes the first ex-Soviet-bloc country to emerge from the dark tunnel of shortages and move toward growth and stability, there is renewed hope that ultimately, others will, too. ■

160

III. Undermining Capacity in Africa

Human and institutional capacities are lacking in virtually all sectors and all countries in Sub-Saharan Africa. Why?

At independence most countries had only a handful of professional people, and institutions were weak. Post independence policies of state centralization, coupled with personalized systems of governance fed these weaknesses. Poor governance, political instability and the continued deterioration of African economies also forced many talented Africans to leave their countries.

We in the donor community must also take responsibility, and here I include the Bank. Let me first point out, however, that, contrary to some thinking, structural adjustment is **not** one of the factors that undermine capacity. Some people falsely assume that adjustment programs have hurt investments in human resources. The fact is, prior to economic reforms, African economies were in free fall -- there was no money to provide for books and chalk for the schools, also medicine for the dispensaries. This criticism about structural adjustment is a case of confusing the malady with the remedy.

External development agencies failed, in my view, to insist on full local participation in identification and design of projects. Having failed to ensure local involvement, it is not surprising that local commitment and sense of ownership was weak.

Donors also relied too heavily on foreign experts, even when qualified Africans were available. This did little to foster a receptive environment for the transfer of skills. In fact, it was often bitterly resented. Over reliance on technical assistance also brought many difficulties. Expatriates were frequently chosen for their technical skills rather than their ability to pass on those skills. This, coupled with operational difficulties pulled foreign consultants into operational support at the expense of capacity building.

After 30 years of technical assistance, and so much money spent, Africa's weak institutions, lack of expertise, and current need for more -- rather than less -- assistance tell us we have failed badly in our efforts.

But problems in making technical assistance effective were not all the fault of donors. The approach on the part of African officials to technical assistance has often been ambivalent. Many governments perceive it at best as a free good (because it is grant funded), and at worst as something imposed by donors, rather than an opportunity to be exploited. Local officials have often failed to provide local counterparts, or designated people who were frankly, not up to the jobs. They have also failed to provide appropriate environments for training.

In sum, the donors have done a disservice to Africa, and many African governments have participated blindly.

IV. Creating Capacity in Africa

The question is, **what can be done?** What specific policies and actions should be pursued by African governments and donors to enhance human and institutional capacities? It would be presumptuous for me to prescribe what others should do. But I shall venture to indicate what actions we in the World Bank consider will produce tangible results on the ground.

We are not in a very comfortable position in the Bank. We have been analyzing our portfolio and have concluded that at the root of the implementation problem is the absence of capacity. This is why, for example, the disbursement of IDA resources to Africa is extremely slow. The problem is not cumbersome disbursement procedures at the Bank. It is a question of having the capacity on the ground to effect the release of the commitments and ensure the efficient utilization of resources.

What are we doing to redress the situation and build capacity in Africa?

First, we are encouraging a sense of responsibility and ownership for projects and programs. We are asking governments to tell us what they want; to design projects and programs they feel are useful, and then to come to us. In effect, **we are creating demand.**

Second, we are actively working with a broad group of nationals to prepare country strategy and policy framework papers. We are insisting that the materials we use as the basis for our lending decisions be the product of Africans.

Third, we are focusing on hiring local African consultants for our projects wherever possible. In fact, this year we have instructed that no foreign expatriate consultants be used for Bank-funded projects unless task managers can prove to the Bank's loan committee that no qualified Africans are available to do the job.

Fourth, we are emphasizing training and retraining in the reform of the civil service.

Fifth, we are encouraging and supporting economic reform in order to promote an enabling environment for private sector development and the effective and efficient delivery of public services. The implementation of economic reform, along with the institution of better governance and emergence of pluralistic political systems, are prerequisites for economic development.

Finally, the Bank is making a long-term commitment to tackle the capacity building problem at its very heart: we are leading the effort with other donors to develop a critical mass of top-flight policy analysts and development managers who can help design and manage economic policy.

The focus on building these capacities represents a fundamental change in attitude about capacity building, a change which acknowledges that Africans must have the principal input into the design and implementation of investment projects and programs.

Our principal vehicle for implementing this change is the African Capacity Building Initiative (ACBI) and its operating arm, **the African Capacity Building Foundation (ACBF)**. Established in 1991, the Initiative is a partnership effort in which the World Bank, the United Nations Development Programme, the African Development Bank and 23 donor and African nations have contributed some $100 million in grant money to support a four year pilot phase of operations.

The Foundation's primary goals are: **first**, to promote capacity building programs in policy analysis and development management across the region; **second**, to make direct funding available to finance new and existing capacity building programs and to leverage substantially more funding from other sources; **third**, to provide high quality institutional basis for African policy analysts and managers

104

and thus help to reverse the drain of these valuable resources from Africa; **fourth**, to encourage the use of African researchers, analysts, and mangers in promoting the effective use of policy analysis by both the public and private sectors; and **fifth**, to create networks of highly trained professional policy analysts and economic managers in government, academia and the private sector.

The ACBF is a major initiative that is designed to play a catalytic role in capacity building, both by generating and coordinating donor resources for capacity building and by rationalizing capacity building efforts across Sub-Saharan Africa. The Foundation offers one of the strongest opportunities to directly respond to the challenges of capacity building in the region. To succeed, it must have strong and consistent support from the donor community.

V. Conclusion

Mr. Chairman:

Building African capacity is a cost effective strategy in the long run. Yet some donors do not yet appear to have grasped the fact that it is cheaper to build local skills for the future, than it is to boost their national consulting industries now.

Although we are aid institutions, we could take a leaf out of the book of the foreign private sector. Expatriate private sector managers have a much better record in training local employees, because they are rewarded for reducing local operating costs. In fact, they are considered to have failed if the local person or team they have trained is unable to operate independently and effectively.

Agencies need to refocus and strengthen their efforts. They need to rethink technical assistance. If donors put only half of their technical assistance budget into coordinated, quality training in critical skills they would provide a lasting contribution to sustainable development in Africa.

It is important we understand that capacity building is a long term process. It will require sustained commitment. Africa has already suffered too much from donors succumbing to the latest fad and dropping their interest in a program long before any results have had a chance to emerge. **Capacities cannot be created overnight -- the time frame is decades, not years.**

Capacity building is also an organic process -- to be successful it must come from within. Today, demand is growing from within. The profound economic and political changes sweeping much of Africa have unleashed an avalanche of people who are eager to take development into their own hands. We must encourage and support them.

Thank you.

Volume VI Number 4
APRIL 1993

THE NEWSLETTER

FROM THE INTERNATIONAL CENTER FOR ECONOMIC GROWTH

Policy to Rescue Africa

Policies for African Development, I. G. Patel, ed. International Monetary Fund, 1992, 293 pp.

To develop a consensus on the policies that are necessary to reverse Africa's poor economic performance in the 1980s, the Association of African Central Banks and the International Monetary Fund (IMF) called a symposium in Gaborone, Botswana. Meeting for three days in February 1991, governors of African central banks, IMF officials, and representatives of the development community took up the challenge in frank discussion, dealing with structural adjustment, external debt, financing growth, and trade and investment.

An important part of the consensus that was formed was the realization that for Africa to grow out of its crisis, it must achieve substantial progress on all of these fronts and receive major assistance from the international development community.

In his introduction to this compendium, I. G. Patel describes the problem at hand. Africa suffers from rapid population growth, inadequate infrastructure, corrupt governments, political instability, inadequate food production, erosion of the physical environment, and high external debt. In consequence, per capita GNP has been declining. If these problems are not dealt with, famines of Somalian proportions are likely to become commonplace.

Structural Adjustment

In order to make internal prices consistent with those in the rest of the world and manage the balance-of-payments problem, Africa has gone through a period of structural adjustment programs with the aid of the IMF. These programs have consisted of fiscal and monetary restraint accompanied by realistic devaluation of currencies. As these policies progressed, the need to address the human effect of austerity became apparent.

A. K. Mullei, director general of the African Centre for Monetary Studies, gives an overview of how seventeen countries fared under structural adjustment. During 1981-1987, as compared with the three preceding years, eight countries improved their economic performance, in terms of eight indicators. The economies of the other nine countries deteriorated. Structural adjustment generally increased domestic savings, exports and imports, and reduced inflation. However, growth rates, investment, debt-service ratios, and net resource transfers tended to deteriorate.

ICEG is delighted to welcome Dr. Andrew Mullei as African program coordinator. Dr. Mullei, a native of Kenya, was until recently director general of the African Centre for Monetary Studies, an ICEG correspondent institute, and secretary of the Association of African Central Banks.

Debt-Service Ratios and Additonal Debt-Service Reduction Requirements in 1997
(Values in millions of U.S. dollars; ratios in percent)

	Export Growth			
	5 percent		8 percent	
	Debt-service ratio	Additional debt-service reduction[1]	Debt-service ratio	Additional debt-service reduction[1]
Toronto terms	26.3	1,062	21.6	325
Trinidad terms	22.4	410	18.1	0
Dutch proposal	20.4	72	16.8	0

SOURCE: *Policies for African Development*, Table 1.
Data are drawn from 22 participants in the World Bank's Special Program of Assistance, excluding Zambia.
1. To attain a 20 percent debt-service ratio.

The argument is presented that a mix of financing and adjustment is necessary to achieve stabilization with growth, because balance-of-payments problems are frequently the result of external shocks and production bottlenecks rather than excess internal demand. Excess capacity results from the lack of foreign currency to purchase crucial intermediate inputs. Export diversification is difficult unless this problem of imported inputs is solved first.

Stabilization with growth also requires an enabling environment for structural reform. Improvements in governance and official accountability, institutional capacities, and human resources are called for.

Debt Crisis

At about $147 billion, sub-Saharan Africa's debt is equal to its GNP. The debt has grown sixfold over the past two decades, beyond the continent's capacity to service it. Payments to private creditors have been virtually suspended, devastating commercial creditworthiness. Attempts to service the debt led to deficit financing, which only worsened the problem. It has become clear that debt forgiveness, not just rescheduling, is required.

There is no clear relationship between investment, imports, and growth.

Francesco Abbate and Anh-Nga Tran-Nguyen analyze the three initiatives that have been suggested to resolve the debt issue. These are the "Toronto terms" (rescheduling), the "Trinidad terms" (rescheduling plus reduction of two-thirds of the debt), and the "Dutch proposal" (full forgiveness of official bilateral debt to the least developed). The authors consider that a country can only be expected to service debt at the level of 20 percent of exports. In two scenarios, assuming 5 and 8 percent export growth, respectively, they evaluate the three initiatives (see table on page 3). It is clear that only maximum debt forgiveness (the Dutch initiative) offers even a remote chance of success, considering that in the 1980s the value of Africa's exports actually fell by 3 percent. Furthermore, some countries, such as Guinea-Bissau, Mozambique, Sao Tome and Principe, and Somalia could not handle their debt overhang under any of these initiatives (because the terms do not cover commercial debt).

Development Finance and Trade

Tony Killick demonstrates that there is no clear relationship between investment, imports, and growth. The key, he maintains, is to assure that external financing results in productivity-improving investments in education, training, health, the financial sector, and institutional reforms, which was not often the case in the past. Multiparty democracy is viewed as a safeguard against predatory governments. Much of the debt is the result of financial aid given to ineffectual governments.

Africa's exports consist of a narrow range of commodities and raw materials that are likely to continue to face falling real prices. As the 1980s have demonstrated, this specialization makes African countries dangerously vulnerable to external shocks. Several approaches to dealing with this problem have been discussed. Some call for developed markets to remove tariff trade barriers against tropical products.

Trade within Africa represents only 5 percent of all African trade. The International Trade Center has estimated that the potential is ten times greater. The 1980 Lagos Plan of the Organization of African Unity, which called for three regional markets and pooling investment in heavy industry, transportation, and communication, was not broadly implemented, however.

Resolved: Joint Effort

IMF managing director Michel Camdessus notes that some countries have achieved major economic successes. By effectively addressing their problems, Botswana and Mauritius attained 12 and 3 percent GNP growth, respectively, during 1977–1987.

The symposium built a consensus that the international development community must work with the African countries on both structural and financial problems. Structural adjustment programs must be backed up with development efforts designed to counter any detrimental effects of these reforms on the poor. Development of infrastructure must be financed from external sources. An environment conducive to exports must be created by allowing prices that are consistent with those in world markets. If all of Africa can work effectively with the international development community toward these goals, then there will be more Botswanas. ❒

BILATERAL AND

MULTILATERAL ASSISTANCE

BILATERAL AND MULTILATERAL ASSISTANCE

Christopher, Warren. "Statement by the Secretary of State," U.S. Department of State Dispatch Supplement, U.S. Department of State, April 1993.

Remarks of The Honorable J. Brian Atwood, Administrator, U.S. Agency for International Development (USAID), before the Society for International Development, June 9, 1993.

Statement of Bradford Morse, Administrator, 1976-1986, United Nations Development Programme (UNDP), before the Committee on Banking, Finance and Urban Affairs/Subcommittee on International Development, Finance, Trade and Monetary Policy, U.S. House of Representatives, May 5, 1993.

Statement of Julia Taft, President/CEO, InterAction, before the Committee on Foreign Relations/Subcommittee on International Economic Policy, Trade, Oceans and Environment, U.S. Senate, May 19, 1993.

"FY 1994 International Affairs Budget: Promoting Peace, Prosperity, and Democracy," U.S. Department of State Dispatch Supplement, U.S. Department of State, April 1993.

Statement of Douglas Hellinger, Managing Director, The Development Group for Alternative Policies, before the Committee on Foreign Relations/Subcommittee on International Economic Policy, Trade, Oceans and Environment, U.S. Senate, May 27, 1993, The Development Gap, The Development Group for Alternative Policies, 1993.

Hellinger, Douglas, Stephen Hellinger and Fred O'Regan. "Aid for Just Development: Report on the Future of Foreign Assistance," The Development Gap, The Development Group for Alternative Policies, 1993.

Statement of Robert W. Kates, Director-Emeritus, World Hunger Program, Brown University, before the Committee on Agriculture/Subcommittee on Foreign Agriculture and Hunger, U.S. House of Representatives, April 29, 1993.

Fiske, Edward B. "A World Crisis in Basic Education," Basic Education: Building Block for Global Development, Academy for Educational Development, Inc. (AED), May 1993.

"Overview of U.S. Voluntary Agencies' Activies," *Voluntary Foreign Aid Programs*, U.S. Agency for International Development (USAID), 1993.

"Aid at the End of the Cold War," *Global Economic Prospects and the Developing Countries*, The World Bank, 1993.

"IDA and the Tenth Replenishment," *World Bank Information Briefs*, The World Bank, 1993.

DISPATCH
US DEPARTMENT OF STATE
BUREAU OF PUBLIC AFFAIRS
Volume 4, Supplement No. 1 April 1993

Statement by the Secretary of State

President Clinton has summoned us to national renewal with a call for innovation, investment, and a new partnership between the American people and their government. Our foreign policy must play a vital part in that renewal. It must reflect the realities of the post-Cold War era. It must be more closely integrated with our domestic priorities. And it must directly serve the prosperity, security, and values of all Americans.

The FY 1994 budget is a transitional budget. It marks a first but important step toward accepting the very new challenges we face abroad. It begins the process of redirecting our foreign policy, refocusing our foreign affairs budget, and reforming our foreign policy institutions. Each of these will promote the three overarching goals that President Clinton has set for American policy in the post-Cold War era.

First, we must revitalize the American economy. This hinges, above all, on prompt congressional passage of the President's economic program. As the world's most powerful economy, its largest market, and its leading exporter, we must use *all* the tools at our disposal to generate growth here at home and bring down barriers to our goods and services worldwide. This includes macroeconomic coordination among the industrial democracies, the negotiation of a new accord of the General Agreement on Tariffs and Trade, the speedy conclusion of the North American Free Trade Agreement with protection for workers and the environment, and vigorous export promotion.

Second, we must modernize our security structures to mirror post-Cold War realities. We must adapt our military forces to address enduring and emerging threats to our national security. With our partners, we must reshape old alliances, like NATO, to meet new missions. We need more robust international peace-keeping capabilities to face the challenges to international peace posed by ethnic and regional conflicts. We must work closely with our partners to confront the global threat of international crime. And we require stronger non-proliferation regimes if we are to stem the spread of dangerous weapons and technology.

Third, we must encourage the democratic revolution that has swept much of the world. By strengthening democracy, respect for human rights, and free markets, we do more than honor the universal values upon which our nation is founded. We help ensure our own security and prosperity. Democracies make more reliable partners in diplomacy, trade, arms agreements, and cooperation on global environmental protection. Democracy cannot be imposed from above; by its very nature, it must be built, often slowly, at the grassroots level. We should embrace and encourage this process by patient support for democratic institution-building around the world.

All three goals are vitally at stake in the former Soviet Union. If the forces of freedom prevail in Russia, Ukraine, and the other newly independent states, we will acquire partners in peace, open vast new markets for our goods and services, and see our national ideals flourish on once hostile soil. Americans have a real material and moral stake in the future of the former Soviet Union. Aid to the forces of freedom in Russia and elsewhere is not just a helping hand: It is an investment in American security, American prosperity, and American values.

Achieving our goals, in the former Soviet Union and around the world, will require more than a declaration of principles. Success will require a sustained diplomacy that looks beyond this week's or next month's crisis; a flexible diplomacy that uses the full range of bilateral, regional, and multilateral tools at our disposal; and an activist diplomacy that puts a premium on timely prevention, rather than costly cure.

We present the FY 1994 budget at a time of fiscal austerity. We see this austerity, not as a hardship to be endured, but as a challenge to innovate. In the months and years ahead, we will redouble our efforts to realign our priorities, reorient our budget, and restructure our institutions in ways that will promote the well-being of our citizens.

This budget presentation is not meant to foreclose options or preclude a full debate. We look forward to full partnership with the Congress as we fundamentally restructure our foreign affairs programs and institutions over the next years. But the Administration intends to do more: We will take foreign affairs to the American people, explaining our initiatives, justifying our expenditures, and seeking their support as we craft a new course through the end of this century and beyond.

In both foreign and domestic affairs, we must put people—the *American* people—first.

—WARREN CHRISTOPHER

REMARKS OF
THE HON. J. BRIAN ATWOOD
ADMINISTRATOR
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
TO THE SOCIETY FOR INTERNATIONAL DEVELOPMENT
JUNE 9, 1993

I want to extend my thanks to Larry Goldman and to the Washington Chapter of the Society for International Development for inviting me to share my thoughts with you this evening.

As you know, the U.S. Agency for International Development has entered a time of fundamental challenge. AID's mission, its methods, and even its existence are being scrutinized, and not simply because the Cold War has come to an end. Our multiple mandates, our operating style, our institutional culture have brought us to this pass.

We will survive. We will revitalize. That I can promise you tonight. The United States is not going to abandon the mission for which AID was created. But our situation is not a spectator sport. We -- all of us -- are the development community. AID's predicament affects you because it is not simply the story of an American bureaucracy at risk. It bespeaks a deeper problem: the crisis of international development -- a time of growing needs, and diminishing resources, and waning commitment.

We are in deep trouble. And we are part of the problem. Not just AID, but the entire development community. All of us. AID's troubles don't only affect Americans. They also touch the development agencies of other nations. They affect the international financial institutions that fund development, and the PVOs, and the NGOs. The technicians and consultants and activists who participate in this enormous cooperative enterprise. The vast contingent who see international development as a moral imperative. And more importantly, those in need -- the men, and women, and children -- a billion children -- who look to us with hope and expectation.

Tonight I want to analyze where we are, and why, and share my notion of where we must go.

***

From the end of World War II, international politics were framed by the struggle between East and West. Conflicts based on religious, ethnic, and economic tensions were often held in check by Washington and Moscow, or addressed exclusively in terms of their impact on the superpowers.

No more. The Cold War has ended. Problems like ethnic conflict and overpopulation now stand on their own perverse merits. In a sense, that represents a failure for the development community. Throughout the post-war era, we failed to define overpopulation and environmental degradation and social dislocation for what they are: strategic threats. Every bit as dangerous as armed conflict. The development community tried to communicate the dimensions of the threat. But in the political sphere, among the decision-makers, our message was lost in the worst-case scenarios of East-West conflict.

Read the morning paper. Some societies have already entered a death spiral, a Hobbesian, Malthusian, Spenglerian horror. Looking at Somalia and Liberia, Angola and Yugoslavia, we in the development community experience a kind of cognitive dissonance. The term "development" denotes progress, modernization. But by any meaningful standard, these nations are no longer "developing." Instead, their sovereignty is being dismantled piece by piece, like the water pipes in Mogadishu, like the villages in Bosnia. These nations are returning to the wild, to be ruled by the gunman and the scavenger. They are, in microcosm, the end of civilization as we know it.

We in the development community run the risk of offering solutions that are no longer relevant. Consider the event that recently focused the attention of the American people on the issue of migration: A ship smuggling Chinese immigrants ran aground in New York. But we cannot view this event in isolation. In their desperate swim to shore, the Chinese refugees symbolized the millions, desperate for opportunity, who want to come to the West. Who are coming to the West. And this is not even the worst part of the picture.

We in this room know the real face of migration: of Peru's urban slums, of Cairo's teeming City of the Dead, of Calcutta's baleful streets. We understand the rural poverty that drives it, the debt servitude, the powerlessness. Yet we also know that with poverty lending and microenterprise, with cooperatives and appropriate technology, we can mitigate the social ailments that make people flee their homes for the dream of a better life.

But will the development community get the chance?

Our problem is not that we face daunting development issues -- that is our business. Our community can find solutions, at least in part. Our problem is that the donor nations may lose the will to try.

At a time when the developing world has cause for fear, yet also for hope, the industrial nations may be giving up.

Throughout the industrialized world, support for development is in doubt. In February of this year, the Rockefeller Foundation released a poll on "Americans and Foreign Aid in the Nineties." They found the following:

The public does not have confidence that aid is improving conditions in other countries or reaching the people it is intended to reach.

The public increasingly believes that foreign aid is unaffordable.

Popular support for economic assistance is dropping; the majority of Americans now oppose it.

Opposition to economic assistance is strongest among the young.

Even among college graduates, only one person in six believes the United States is doing less than it should.

These attitudes are reflected in the resources that donors devote to foreign assistance. According to the OECD, official development assistance consumed .2 percent of America's GNP in 1991. Japan spent .3 percent of its GNP. The U.K., France, Japan, Sweden, and Germany increased the absolute amounts of their outlays, but on the whole the trend line was flat. At a time of burgeoning needs, spending on development lagged far behind demand.

How do we deal with our publics? This is an issue that I have already raised with my counterparts in other countries. They all agree: people misperceive development assistance. They are preoccupied with their own economic travails. They have donor fatigue, and a cynicism about the prospects for a more stable, more prosperous world.

Yet the situation is not entirely bleak. The Rockefeller Foundation found that Americans will support humanitarian aid, and the same appears to be true in other western democracies. People will support assistance that addresses environmental problems. They will fund programs that generate jobs.

Our immediate challenge, then, is to make a strategic case for foreign assistance. Deforestation and overpopulation, rural migration and endemic poverty threaten our air, our water, our economy, our society, and our future. The industrialized states cannot escape the threat by being passive, or worse, indifferent

Our publics are not yet wholly indifferent. Yet we detect a certain feeling of separation, perhaps because floods and famines and disorders stream too rapidly into our consciousness. And television plays a curious role here: On the one hand, the images of war come across with dreadful clarity: the clap of artillery, the devastated towns, the refugees. But the images of environmental disaster and societal breakdown only make an impact when they come to deadly fruition: the floods, the forests slashed and burned, the fleeing migrants, the starving children. And the underlying causes of those disasters -- the very things the development community is trying to fight -- barely make the news at all: Erosion, corruption, pollution -- they just aren't good television.

So we can add one more threat to the things that menace us: Indifference. The notion that caring won't change anything. The lack of any gut concern about the world. That truly is our ultimate development problem: the possibility that the donor nations might disconnect.

This is not some theoretical worry. We may already be seeing a glimpse of it in the former Yugoslavia, but not among the combatants. Yugoslavia is part of Western Europe, after all -- it is even feasible to mount weekend relief missions. People from nearby countries drive down to the war zone -- it's a couple of hours away -- and drop off food and blankets and medicine. By Monday, the donors are back at their jobs.

I recently heard an incredible variant. At least one tourist agency has been organizing "disaster tours." People drive down to the war zone, but only to watch. They stand on the hills above Sarajevo, and see the shells arc in. They drive up to besieged towns. They hear the snipers. And then they go home.

God help us if a neglected world becomes another Bosnia. The strategic threat we face will not allow us to be bystanders. The consequences of indifference and neglect will involve us and affect us. The western democracies won't have the luxury of being "disaster tourists." If we fail to act, we'll be more than spectators at the siege.

***

The United States Government will not accept the notion that our people will sit by while disaster overwhelms us. We believe the American people will understand that the costs of doing nothing are far greater. And we believe that our response can be encompassed by a new paradigm already endorsed by the international community in Rio. I refer, of course, to sustainable development.

We will base our sustainable development strategy on four missions:

-- Aiding the environment;

-- Addressing population and health;

-- Building democracy; and

-- Encouraging economic growth.

Our administration will follow an integrated development approach. We will address the larger economic and social process; and we will avoid operating within the narrow confines of the individual disciplines of development work.

There's the rub, and we all know it. The development community is a realm of city-states. Too often, we act like the seven blind people describing the elephant. In our operations, we are like the seven blind people assembling the elephant. I expect any time now to see a congressional earmark for a trunk!

But this is an indulgence we can't afford. We in this room are agricultural scientists, and urban specialists, and bankers and planners and politicians: it's inevitable that we would view development through our own particular prisms. But the time has passed when we can talk only of our remedies, as if they could work in isolation.

Consider, for instance, the commitments we undertake when we endeavor to save the life of one little girl. Let's say she lives in a village, and she's the beneficiary of a program that provides inoculations against childhood diseases. What does saving her life really entail?

If you inoculate her, so she doesn't die of whooping cough or rubella, then you have to provide childhood nutrition, so her mind and body can develop.

If you feed her, then you have to provide adequate schooling, so she is literate enough to understand her world.

If you educate her, then you have to provide proper housing and sanitation, so she can enter adulthood with youthful energy, and not exhausted from parasites and disease.

If you house her, then you have to provide some rural economic stability, which itself implies environmental planning and appropriate technology.

If she grows up in a stable rural environment, then you have to provide vocational training, so she can learn a skill that gives her an income and a sense of accomplishment.

If you help her acquire vocational training, then you have to address her role as a woman, including her reproductive rights, her economic rights, and her social status, so she is not isolated from the rest of society or rendered powerless.

And finally, if you do all these things, you have to help her nation build democracy, so she is not just a recipient of aid, but a participant in her own development.

If our goal is truly to save her life, all these things are needed

But will the development community get the chance?

An integrated approach, involving every element of the development community, is a matter of necessity. And for the development community, it is a matter of survival. We cannot hide out in our own little technical niches. If we are to rebuild our constituency, no one program will do it. If we are to summon a consensus to assist the developing world, then the overall benefits -- and costs -- have to be communicated to our publics.

Let us remember: Our work is Human Development, not just "development," and only human development is sustainable. The improvement of society cannot be divorced from the improvement of people. We have to embrace that notion, and all the complexities it implies.

I believe the Clinton administration understands this.

We will take an integrated approach to population and health. Family planning is a critical element in assuring healthy populations, but we need to build on it. At a time when AIDS is spreading rapidly in Asia and Africa, and targeting the very people who should be on the cutting edge of development, our concern must include family planning and go beyond. Maternal health, prenatal care, safe sex, and social education must be part of the total picture.

We will take an integrated approach to aiding the environment: Global warming is a transnational issue. So is the fate of the oceans and tropical forests; they require collective efforts that cut across national boundaries. Local environmental programs fit naturally into global ones; environmental damage does not stop at a line on the map. And solutions that work are applicable worldwide.

Our answers to environmental problems must themselves be interdisciplinary: For instance, sustainable agriculture implies appropriate crop planning, and integrated pest management, and soil conservation, forest management, crop storage, and transport. We want to support all of these endeavors, and more importantly, we will work to make them mutually reinforcing.

This administration has made a commitment to boost exports. Many agencies are gearing up their involvement: State, Treasury, the Commerce Department. AID will concentrate on private sector development. Our role is to develop markets, to create demand, and to promote free enterprise and equity.

And we will take an integrated approach to democracy-building. We have already read that several developing countries will come to Vienna and assert that democracy and development are mutually exclusive. They are not. It is a false choice. We will say it at Vienna, and our programs will embody that belief. No development process can be sustained if it does not include democratic development.

A lot of people thought that when I came to AID from the National Democratic Institute, I would equate democracy building with elections. I hope I am not guilty of viewing the development process through the same narrow prism of which I spoke earlier. I believe that at the grass-roots level, participatory development and democracy go hand in hand.

Group decision-making promotes representation, consensus, and accountability. It legitimates institutions, and encourages compromise and conflict resolution. Democracy is the antidote to zero-sum politics and beggar thy neighbor economics.

With each success, the ground is prepared for further democratic practice. Empowered individuals become the driving force for free labor unions, free enterprise, and civil discourse. The rise of a civil society promotes rational choosing and rational planning. Democracy is not an obstacle to development. It is a key to development.

This has particular relevance to the former Soviet Union, where AID is carrying out the President's commitment to provide assistance at a critical time. The greatest obstacle to development there is the lack of a civic society. Under the Tsars and the Communist party, the consent of the governed was an oxymoron. Law defined only a citizen's duties to the government. Attitudes and assumptions inimical to growth and civility did not die with Soviet rule. Free enterprise is still equated with gangsterism. Democracy is still equated with disorder. For local apparatchiks, public participation still means the loss of privilege.

The people of the Newly Independent States have almost none of the local institutions of democracy that we take for granted: a rational tax system. Responsive local governments. The schools and clubs and volunteer organizations that teach democratic values -- liberty, peace, justice, and belief in the future -- simply by their everyday workings. That has to change.

Because we in the development field sometimes have had to carry out our work in nations where corruption is endemic, every development agency has suffered at one time or another simply by association. Yet in a sense, I am gratified by all the international public attention on corruption. It does bespeak disorder, but also the expectation that public thievery should <u>not</u> be the norm.

This is a step forward, in every land where corruption now elicits outrage and not just acceptance. It reflects a desire for transparency and accountability. Whatever your view of the relationship between democracy and economic development, let us at least agree that transparency and accountability are indispensable in our work.

Our challenge now is to analyze the process of political development, establish criteria for success, and set goals for ourselves as we do in economic matters. Economic and political development reinforce each other. AID's programs will embody that fact

***

But will we get the chance? What is AID now prepared to do?

First, to meet the challenges of development in a struggling world, the Agency will need to get smaller to prepare itself to grow. Of necessity, we will reduce the number of country programs, and missions, and projects on which we work. We have no choice. Budget cuts and reductions in our operating expenses budget impel us to cut back, but we should do it anyway because we now are spread too thin.

We will use development criteria to determine how we're going to reduce the number of nations in which we operate. We certainly will use the criterion that if a government does not participate with us in the development effort as a partner by allowing us access to the people in the country, then we cannot make development sustainable. We will also take into account whether a government puts its own resources into development. We are not going to be in the business of setting political conditions, but we must be in the business of establishing development conditions.

Second, AID will improve its ability to mount a rapid response. Too often we seem to be institutionally incapable of moving quickly. That has to change. An increasing number of countries are losing their sovereignty to anarchy and chaos, and we need to have the capacity to help countries put themselves back together. We need to do more than provide disaster relief and food. We have to be able to stabilize institutions, and help rebuild them.

Third, AID will work with you. As an institution, and as a development endeavor, we require the trust of Congress and the American people. To do that, we need your help. You are the implementors of development, and we need your guidance. We will not and cannot develop a strategy in isolation. We want you to help us with our plans, but to do this, each of you must look beyond your own immediate concerns. With that tradeoff, we will listen, that I promise.

We will be more responsive. The time when AID made its grantees jump through hoops for reasons that had nothing to do with development is over. We are partners, and we must treat each other with respect.

We will be more willing to take risks, knowing that the nature of development is to try new methods and be open to ideas, even if they sometimes don't turn out as expected. AID needs to be on the cutting edge; progress is achieved, after all, by trial and error, not trial and success. With our limited resources, we will not always be able to lead with dollars, but we will always lead with our ideas and well-developed plans. And to get the most from the risks we take, we will share the lessons of success and failure with you, and with other development agencies, and with international financial institutions.

This is the ultimate integrated approach to development: a synergy of all our skills. At a time of diminishing resources, all of us have to concentrate our efforts and coordinate our programs. As a community, we need better means of evaluating what we accomplish and how we fall short. AID intends to be a leader in evaluating its projects, and sharing its knowledge, and insights, and skills.

Will we get the chance? We <u>want</u> the chance to make a difference.

What ultimately motivates us to be in this work? We may not be always be able to save nations, but we can save individuals, and villages, and sometimes societies. Some people would write off the nations we seek to help, write off whole classes within those societies. Yet the poor of those countries -- the very people who would be written off -- reject that hopelessness. We know that. We've seen it -- in successes like the Grameen Bank of Bangladesh, and FINCA's poverty lending in Central America, in appropriate agriculture in Africa and a worldwide democratic revolution that refuses to wither.

We will fight the notion that most people will participate in the 20th century only as statistics. That I promise you. We will not stand idly by. We will not be uninvolved. We will not be tourists at the disaster, but builders of humanity, and architects of hope.

Statement of

Bradford Morse

Administrator
United Nations Development Program
1976 - 1986

Subcommittee on International Development,
Finance, Trade and Monetary Policy

Committee on Banking, Finance
and Urban Affairs

May 5, 1993

I am grateful to you, Mr. Chairman, and to your distinguished subcommittee, for the privilege of appearing before you as you consider funding for the commitment of the United States for the 10th Replenishment of the International Development Association. While I certainly don't qualify as an expert witness, I have followed IDA since my days as a member of the House Foreign Affairs Committee a quarter century ago, and in my tenure as Administrator of the United Nations Development Program. During that period, I had considerable exposure to the work of IDA.

In 1991-1992, I chaired an independent review (the first in the World Bank's history) of two carefully delineated aspects of the Sardar Sarovar Projects on the Narmada River in India, which were supported by IBRD and IDA funds: (1) the implementation of measures for the resettlement and rehabilitation of the people displaced or affected by the projects; and (2) the implementation of measures taken to ameliorate the environmental impact of all aspects of the projects.

The Narmada projects had become, before our review was undertaken, a major focus of criticism by environmental and human rights organizations in many parts of the world. They had also inspired widespread opposition among the people who would be affected by the projects.

Our findings were, in my opinion, both serious and substantial. Some environmental groups have cited them as a basis for the reduction -- or even elimination -- of U.S. funding for the 10th replenishment of IDA.

I have tremendously high regard for the work of environmental groups in the United States, not least those who have testified recently regarding IDA. They have made an enormous contribution to consciousness-raising about the dangers to the global environment and have contributed sizeable resources, financial and otherwise, to the worldwide goal of sustainable development. In considerable measure, environmental NGOs were responsible for focussing world-wide attention on the Narmada dam.

Since we presented our report to the President of the World Bank and the Bank's Executive Board on 18 June 1992, my colleagues and I have not engaged in any amplification of the Report; rather, we have let the Report speak for itself.

I stand by the findings and recommendations of the report of the Independent Review in every particular. I want to emphasize, however, that I asked to testify on the value and effectiveness of IDA and the importance of U.S. support for it -- not the work of the Independent Review, which as I pointed out, had a carefully defined, limited mandate.

* * * * *

With the end of the Cold War we have entered a world characterized by a completely new set of international economic and political relationships. The dangers in this new world are apparent to us all -- we have only to read the daily headlines or catch CNN. At the same time, however, new opportunities for international cooperation have arisen. The end of the East-West confrontation with its crushing burden of military expenditures permits greater concentration on the shared goals of reducing poverty, satisfying basic human needs, enlarging human opportunities, and protecting our fragile environment.

We will be unable to meet the challenge of fashioning a new world in the aftermath of the Cold War if we ignore the fact that by far the major part of mankind lives neither in the industrial countries of the West nor in the nations of the former Soviet bloc. They -- more than four billion people -- live in the world's developing countries in Africa, Asia, Latin America, and the Middle East. What happens in the developing world in the years to come will have an increasingly profound effect on the economies and societies of the industrial countries, our own included. The deep-rooted problems of developing countries are increasingly spilling over to the industrial world, whether in the form of migration and refugees, environmental degradation, or narcotics trafficking. A stable world cannot be constructed if it ignores the challenges, opportunities, needs, and potential of the developing world. And that is where IDA comes in.

* * * * *

I am convinced that IDA and other development institutions take on added importance as we approach the twenty-first century. The collapse of the former Soviet Union has demonstrated plainly to the developing countries that centrally planned economies simply don't work: they produce disastrous economic results, and they generally bring about political repression as well. Throughout the developing world, scores of countries have opted for market-oriented economic systems and more democratic political systems.

IDA is playing a crucial role in this transition. This is apparent in its support for broad-based economic reform programs over the past decade. It is apparent in its increasing support for private sector development in many countries. And it is apparent in its support for human resources development, which will give people in developing countries undertaking reforms greater capacity to take advantage of the economic opportunities presented by market-oriented growth.

The support of IDA and other development organizations for market-oriented solutions to the problems of development will contribute to the advancement of good governance and human rights in developing countries. Liberalization is contagious. Unshackling an economy inevitably leads to pressures for a free, participatory and responsive political system.

* * * * *

Suffocating poverty and the daily misery and hopelessness that accompany it are at the heart of the problems of the poorest developing countries. It has been reliably estimated that 1.1 billion people live in absolute poverty in the developing world. If sustained efforts are not made, their ranks will continue to increase.

The fundamental responsibility for tackling poverty remains with the developing countries themselves: it is they who must adopt and implement the appropriate policies and mobilize the bulk of the financial resources required to reduce poverty. But external resources have an essential supplementary role to play in the process. Low-income countries cannot do everything. Already low consumption levels in the poorest countries cannot be squeezed further to generate additional domestic savings and investment.

IDA has a crucial financial role in these poorest countries of the world. It lends the vast bulk of its resources to them. The overwhelming proportion of IDA lending is devoted to low-income countries with per capita GNP under $610. This distinguishes IDA from many bilateral donors, including our own Agency for International Development, that provide relatively little support to the poorest countries.

In recent years about half of IDA's new lending commitments have gone to countries in Sub-Saharan Africa. In contrast, estimates of the proportion of American bilateral assistance flowing to Sub-Saharan Africa in recent years range between 8 and 19 percent. IDA has also made substantial investments in the development of a number of poor non-African countries that receive small amounts from our bilateral aid program.

The country allocation of IDA assistance reveals a key point: IDA is an effective complement to our own bilateral aid. Much of our bilateral assistance is understandably targeted on nations of particular political and strategic importance to our country, not only the obvious cases of Egypt and Israel but others as well. IDA picks up much of the slack elsewhere in countries whose long-term economic development is important to our own welfare in an increasingly interdependent global economy.

Within poor countries, substantial IDA resources are directly devoted to the reduction of poverty. In recent years, for example, IDA has significantly stepped up its lending for human resources development. Direct lending for education, health, nutrition and demographic planning now amounts to about 30 percent of IDA lending. Many of IDA's agricultural projects, which account for another 30 percent of its total lending, help the small farmer. IDA has also significantly increased its support for enhancing the role of women in development. About 50 percent of new IDA projects approved in the last two fiscal years have included specific actions to help women -- up from 18 percent in 1988.

• • • • •

I'd like to say a word about Sub-Saharan Africa, in which I've had a special interest for many years. The region receives about half of current IDA assistance. The images of Africa in our popular press and on television are certainly not happy ones; Somalia and Sudan are only the latest chapters in a long history of human misery and suffering.

The record of economic management in many countries of the continent is all too obvious. Domestic failures, however, are not the whole story over the past decade. The international environment within which Africa has attempted to develop has been less than supportive. Africa's terms of trade have deteriorated. Commodity prices, crucial because commodities form the bulk of Africa's exports, have deteriorated to their lowest levels in real terms since the great depression. When real international interest rates rose dramatically in the 1980s, they contributed to mounting levels of external debt.

In the face of these and other adverse factors, it is really remarkable that many countries in the region -- vigorously supported by the World Bank and IDA -- have adopted and implemented wide-ranging economic reform programs. Since 1986, no fewer than 30 Sub-Saharan African countries have adopted structural adjustment programs -- taking steps to liberalize their trade regimes, privatize state enterprises, improve management in the public sector, correct distorted macroeconomic policies, implement social safety nets for the poor, and the like.

These reforms have been strongly supported by Bank and IDA lending. IDA pioneered the Special Program of Assistance (SPA) for severely-indebted low-income countries undertaking economic reforms in the region. The SPA is a consortium of eighteen bilateral and multilateral donors to support structural reform. And the reforms are starting to bear fruit: Bank data show convincingly that economic performance in the African countries which have embarked on reform has been significantly better in recent years than performance in non-reforming countries of the region. I don't think it's the time to back away from a commitment to African development, and IDA is a vital part of that commitment.

• • • • •

My focus on the continuing challenge of world poverty and on the development difficulties in Africa in particular should not cause us to forget that much of the developing world has made substantial progress over the past three decades, roughly since the time of IDA's creation. Economic growth rates in many developing countries--a number of East Asian and Latin American countries are cases in point--actually exceeded such rates at a comparable period in the evolution of the currently industrialized countries. Progress is even more readily apparent when looking at a key indicator of social progress -- infant mortality rates. Overall, infant mortality in low-income countries fell from 124 per 1,000 live births

in 1965 to 70 in 1989, and in middle-income countries it fell from 97 to 51. Significant progress was made in education as well over this same period of time.

Some former recipients of IDA resources have achieved broad-based economic expansion resulting in dramatic improvements in the quality of life. Their sustained rates of economic growth have enabled them to pass the per capita GNP ceiling for IDA eligibility and they have graduated from the status of recipients. They made effective use of external resources, including the resources received on concessional terms from IDA. They include Indonesia, the Republic of Korea, and Thailand, among others.

In short, much has been accomplished in the developing world over the past three decades, and concessional assistance from abroad -- from IDA and others -- has played no small part in these accomplishments. Substantial challenges remain, however -- especially in Sub-Saharan Africa but also in other IDA recipients throughout the developing world. The task ahead is to replicate, to the maximum extent possible, the favorable development experiences that have occurred in the former recipients of IDA resources.

• • • • •

I'd like to turn to the current criticisms of IDA. The findings of the Independent Review of the Sardar Sarovar projects in India -- and, as I said earlier, they were serious and they were substantial -- have been cited to justify the condemnation of IDA's overall development effectiveness.

I have to disagree. I believe that in spite of IDA's failures -- and like other development institutions it has had its share -- to deny it U.S. support would simply be wrong.

In the past year, the Bank has been unusually self-critical -- far more so than any other aid agency of which I am aware. A thorough and candid assessment under the general direction of a senior Bank official pointed to a number of major problems with the implementation of many Bank-supported projects. The report, however, also reached a fundamental conclusion that has frequently been overlooked: about 75 percent of Bank/IDA projects demonstrate acceptable or more than acceptable performance. A 75 percent performance acceptability record in the development business is far better than we would find in many programs, including our own domestic programs, if we were to apply the same rigorous appraisal criteria.

I've been told that the Bank and IDA are taking a series of actions to improve the implementation of projects. Of particular importance in the environmental area is a strengthened capacity to assess potential environmental impacts from Bank- and IDA-financed projects by screening them more closely during the preparation phase, as the Independent Review recommended. Stringent environmental assessment is a valuable tool for identifying problem projects as well as a means to turn them around. It identifies ways of making projects more environmentally sustainable by preventing, minimizing, mitigating, or compensating for adverse impacts. It should help the Bank avoid the kind of deficiencies that the Independent Review identified.

I ought to mention other IDA initiatives that should improve its development effectiveness, especially in reducing poverty. For example, IDA has significantly increased its work with nongovernmental organizations, whose activities on the ground in developing countries are valuable -- indeed critical -- in helping to reduce poverty. At the same time, IDA has taken numerous steps to involve the poor more directly in the design and implementation of the programs and projects it supports. And it has devoted considerably more effort to working with its borrowers in building their human and institutional capacities, since these, in my view, are often more important than physical infrastructure in achieving sustainable development.

* * * * *

It has been suggested to the Congress that, instead of meeting our commitments to IDA, we redirect the funds to other American organizations, both official and nonofficial. I conscientiously believe that we need strong support for <u>both</u> IDA <u>and</u> the full range of American organizations involved in helping developing countries to develop. It is not an either-or proposition. The emphasis should be on complementarity -- on drawing on the best of both IDA and other agencies to improve the overall development assistance effort. Starving IDA of funds would, in my view, place an unfair burden on, and constitute an unjustifiable disservice to, the poorest people in the poorest countries of the world.

* * * * *

There are those who are unpersuaded by arguments about the importance of development assistance in general and IDA in particular in the post-Cold War world. They ask, quite honestly, What's in it for the United States? Why should the United States authorize and appropriate funds for IDA? I have tried to give my perspective on the question earlier, but, as I conclude, I'd like to address it more directly.

What the United States gets out of its support for the World Bank and IDA should not be measured in a narrow way. One should not, in my view, make a simplistic comparison of the amount of money the United States has subscribed to the World Bank's capital or contributed to the various IDA replenishments over the years and the amount that directly comes back to American suppliers of goods and services in procurement under Bank- and IDA-financed projects.

Rather, the more important points concern the contributions that concessional resources make that do not easily fit into such a narrow calculus, including the imports of American goods and services by countries in the developing world that have sustained robust rates of economic expansion owing in part to the receipt of external financial resources.

Developing countries continue to be the fastest growing foreign markets for American goods and services.

Consider also the people who have not had to flee their countries because they have been able to escape from poverty and become productive citizens in their own lands, or those who have not been obliged to degrade their natural environments because growth has rescued them from the shackles of subsistence. It is not easy to put a precise number on the contribution these factors make to global welfare or indeed on the benefit to our own country. There is no doubt in my mind, however, that the payoffs from economic growth, poverty reduction, and environmental protection in developing countries are substantial--and they have been obtained by a fruitful combination of domestic efforts and external assistance.

There is another point I'd like to make in this connection. The substantial payoff I have referred to is one which results from a relatively modest contribution of our own resources. I know that, in the current climate in the Congress, the $3.7 billion that represents the U.S. obligation to the negotiated three-year Tenth Replenishment of IDA seems like a considerable sum of money. And it certainly is.

But let's look at a few basic facts. In the most recent year for which I could locate the data (1991), U.S. appropriations for concessional assistance to developing countries as a proportion of our total national budget amounted, roughly, to 0.8 percent. Moreover, the United States devotes only 0.20 percent of its GNP to official development assistance in the aggregate. Among industrialized countries, only Ireland ranks below the United States on this measure of support for international development cooperation.

We Americans spend nearly five times as much on alcoholic beverages and three times as much on tobacco products as we spend on foreign economic and security assistance. I don't suggest that Americans should give up beer, wine and liquor for the sake of development in poor countries, but these numbers certainly help to put in perspective the amounts we are being asked to contribute to development.

* * * * *

In my view, the conclusion is inescapable -- given the relatively small amount of money we put into foreign aid, we get a very large payoff. Indeed, examined in this way, foreign assistance may begin to look like one of the more cost-effective of all our governmental programs.

IDA is especially cost-effective. As a multilateral development institution, it leverages each dollar provided by the United States with four dollars provided by IDA's other donors and produces a developmental output and impact that no nation acting alone could produce. Domestically and internationally, we have an urgent need to seek effective programs that yield high-value returns. I truly believe that the International Development Association is one such program. I hope you will give the Tenth Replenishment of IDA your strong support.

STATEMENT OF JULIA TAFT,
PRESIDENT AND CEO OF INTERACTION,
BEFORE THE
SENATE SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY,
TRADE, OCEANS, AND ENVIRONMENT

May 19, 1993

Chairman Sarbanes, members of the subcommittee, I am Julia Taft, President and CEO of InterAction. This is my first opportunity to testify on behalf of InterAction, which I joined three weeks ago.

InterAction exists to help promote and enhance the effectiveness of private humanitarian efforts. Our membership includes 152 US-based private humanitarian organizations that work in 180 countries. The central focus of our members' work is to alleviate human suffering and work at the grassroots level to promote local participation in designing and managing programs to assist the poor. Our agencies handle over $600 million of government funding (about half of which is in the form of commodities.)

However, most of our resources come from the American people. Private donations of more than 1.5 billion dollars annually is testimony to the fact that our humanitarian work is enthusiastically supported by US citizens. InterAction represents the diversity of the American people – and their commitment to working hand in hand with people throughout the world.

InterAction members are involved in disaster relief, refugee protection, assistance and resettlement, long-term sustainable development, development education, public policy and advocacy. There are organizations that concentrate on agricultural outreach programs, rural development, health care reform, and environmental advocacy. There are organizations with vast experience in delivering relief supplies and promoting development through the use of US PL 480 food resources.

We are called Private Voluntary Organizations or PVO's. Whenever possible, we work with local non-governmental organizations (NGO's) in developing countries to provide a sustainable means for long term development.

AID and Sustainable Development

InterAction shares this committee's concerns over the state of US foreign assistance efforts. It is widely recognized that the United States Agency for International Development (AID) is saddled with conflicting and competitive mandates that must be streamlined if AID is to be an effective development agency.

As AID partners, the PVO community welcomes attempts by the Clinton team to repair AID. Strong measures need to be taken so that AID can focus its mission and become the leader that the United States long term development agency should be.

It is our belief that AID should have as its central focus the promotion of sustainable development. InterAction has outlined an integrated strategy to accomplish this which is included in our issues paper entitled, *Steps to Revitalize US Foreign Aid.* I would like to submit this issue paper for the record.

For several months, InterAction has been working with Bread for the World, numerous other environmental and development groups, and leading members of Congress to advocate that the US take a leading role in promoting sustainable development. We call this effort the Many Neighbors, One Earth campaign. A Many Neighbors, One Earth Congressional resolution was introduced in the House last week and will be introduced in the Senate today by Senators Simon and Jeffords.

A model for AID's new approach for getting to the grassroots is the Development Fund for Africa. If implemented according to the letter and spirit of the law, the DFA could represent a dynamic aid program that could involve the poor themselves in the design and implementation of development programs in sub-Saharan Africa. The DFA requires AID to consult and participate with local NGO's, women's groups, peasant associations, and other grassroots groups in the initial stages of program design so as to develop programs which are most responsive to the needs of the poor. Unfortunately, AID has failed to meet the requirements of the DFA statute. InterAction has monitored AID's performance and we stand ready to assist the Agency in improving its record. Let me add that we strongly support the current $800 million funding level for the DFA, and while we support additional aid to Russia, we do not think it should come at the expense of the world's poorest nations.

Over the years, PVO's and non-governmental organizations (NGO's) have struggled to find ways to alleviate poverty in many different cultural contexts. What we have found is that in order to attack poverty, one must grapple with environmental degradation, access to credit, family size, health, women's empowerment, even international trade and investment policies. The PVO community has experienced at the local level the link between human development issues and global issues such as population and environment. These problems cannot be solved separately. We are involved in promoting the integration of these issues at the program and policy levels.

PVO Participation

PVO's and local NGO's function in partnership to promote community development in host countries, and help to build civil society that will endure. By their very nature, NGO's and PVO's are people-to-people oriented organizations and provide a tangible alternative to centralized government decision-making in a wide range of fields. NGO's are used to working at the grassroots to solve local problems and to meet local needs.

Moreover, because the PVO community represents a US-based constituency for development and humanitarian relief numbering in the millions, there should be no controversy about our work. We welcome the opportunity to broaden our participation with the United States government, where it is appropriate, in implementing programs that promote sustainable development.

AID intends to focus some of its efforts on assisting countries to build social and economic environments that will nurture emerging democracies. Democracy is more than "voting," it is enabling true participation in decisions about values and programs that affect the individual, the community, and the nation.

Here, the experience of PVO's is particularly relevant. We have found that direct interventions to alleviate human suffering, while still necessary, are not as effective as initiatives that empower people — working to strengthen local nongovernmental organizations. We increasingly concentrate on working with local organizations to help them meet the goals they set for themselves. This is a simple, powerful recipe for achieving sustainability and building civil society, and it is as true in the Newly Independent States as it is in developing countries.

Problems and Solutions

The US Office of Foreign Disaster Assistance (OFDA) stands as an example of excellent PVO/AID relations. Working with OFDA, the PVO community implements humanitarian relief operations in a most efficient and effective manner. The massive relief operation in Somalia is the most timely example of how PVO's, supported by donations from the American public, OFDA and other donor nations were able to move tens of thousands of metric tons of food and medicines to save millions of lives.

The partnership between AID and PVO's has been greatly enhanced by the Matching Grants program of AID. Administered through the Office of Private Voluntary Cooperation, the matching grants program supports some of the most cost-effective and innovative development programs of PVO's throughout the world. These matching grants complement and strengthen official development assistance programs because the value of the grants is increased one to three times over by matching funds from PVO private and public contributions, thus stretching limited aid dollars.

Because of the high costs of AID overseas staff and the burden of overseeing many relatively small PVO activities, AID missions are often inhibited from more fully supporting US PVO's. This program, therefore, is particularly important to the PVO community. In FY 1991, we estimate that the total PVC funds released to InterAction members equaled $207.4 million, including new and ongoing grants. Since most of these were matches, think of the resources that were used for development that year!

AID has provided World Wildlife Fund with $1.75 million to strengthen and support its Wildlands and Human Needs Program that promotes the conservation and management of natural resources and improves the quality of life of people in wildland areas. With an $8 million matching grant that was leveraged with $25 million in private resources, CARE has been able to implement more than 100 agriculture and natural resource projects in 33 countries, working with thousands of farmers, many of them women, to conserve their natural resources and to increase agricultural yields.

Recommendation: Any reduction in funding for PVO's will affect programs that address the health and well-being of children, environmental, agricultural and natural resource management and water and sanitation, and programs that address small business development. We urge this committee and the administration to preserve the PVC office at full funding of $60 million.

AID has not always been user friendly, however. Despite the best intentions of Congress, the PVO's, and those inside AID, bureaucratic tangles have delayed or even defeated many a PVO program.

The recent history of microenterprise credit promotion, which is designed to provide small loans to poor people who have no other access to credit, demonstrates how AID's own policies and bureaucratic problems have sometimes interfered with the original intent of its programs. AID's own microenterprise program has been criticized for its slow progress in reaching poor people. In 1991, AID's own worldwide program made 67,000 loans and mobilized $1,307,127 in savings. By comparison, a program implemented by InterAction member FINCA in one country alone generated 63,000 loans and mobilized $1,228,361 in savings after 19 months of operations. Yet, despite PVO success in reaching target populations, PVO's have had difficulty accessing AID funds because the bureaucratic AID structure has not encouraged AID missions to fund microenterprise. In this case, the PVC office has provided the majority of funds for PVO microenterprise programs.

Recommendation: Twenty three PVO's that implement microenterprise programming have recently made a proposal to the administration and Congress for a centrally managed AID fund for microenterprise. InterAction would like to work with your subcommittee and the administration to address other similar problems in the AID/PVO relationship as they arise.

Women represent a disproportionately high number of the world's poor. They produce as much as 70 percent of the developing world's food, manage the majority of the world's natural resources, and have primary responsibility for ensuring the well-being of future generations. Successful sustainable development policies and projects must incorporate the critical role played by women in the developing world. Experience has shown that whole communities benefit from projects that improve the health, educational, and socioeconomic status of women and girls.

Recommendation: AID should make the economic and social empowerment of women a major focus of US foreign assistance programs. PVO's, with their network of grassroots organizations that can reach women, should be included in this effort.

The legitimate need for government accountability has created a serious problem for PVO's that wish to work with the government. Current contracting and auditing procedures are suffocating the PVO's. Several InterAction members have reported that the A-133 is inappropriate for conditions in which PVO's work and sometimes, when applied to indigenous NGO's, costs more than the grants themselves! Reporting requirements are needlessly cumbersome and enormously time-consuming. Match requirements for PVO's range from 0% to 100% or greater with no consistent rationale behind the differing levels.

Recommendation: New mechanisms must be developed which provide both adequate flexibility and program experimentation in the field as well as adequate accountability to Congress and the US taxpayer. Reporting and match requirements for US PVO's should be examined and revised.

While US based PVO's are highly qualified, cost effective actors in promoting grassroots development, we are private, independent actors that work where we believe we will be most effective. We do not view ourselves as agents of US foreign policy, but rather as partners when there are common goals to be achieved. Previous administrations too often saw us as mere implementors of their programs. The diversity of approach, flexibility, and innovation that characterize the PVO sector is an asset that should not be submerged in a contractual mindset.

Recommendation: We look forward to a process of regular interaction with officials working on sustainable development and humanitarian relief, and we hope that current structures for coordination will be revised. New ways of incorporating NGO/PVO points of view into AID's programs and projects should be developed.

The growing numbers of civil conflicts in the world are sure to cause increased humanitarian crises that will require rapid response. This is a traditional area of expertise of our agencies.

Disasters have a direct, negative impact on development goals, affecting a country's economic performance for years after the occurrence of the disaster. For instance, the US government spent some $736 million on drought relief in southern Africa in 1992. By contrast, the 1992 budget for the Development Fund for Africa was $800 million for all of Africa. Because disasters can slow or even erase development progress, it is important and cost effective for development practitioners, including AID and PVO's, to concentrate more resources on preventing or mitigating potential disasters. Otherwise, we will continue to trade short term band aids for longer-term impacts. In addition, traditionally, within AID and OFDA the linkage among relief, rehabilitation and development has been weak. This leads to limited opportunities for coordination and collaborative program development.

Recommendations: Joint planning by relevant development and relief offices in AID should be required when a country is experiencing or expected to experience recurring or long term disasters; flexible funding and management mechanisms should be established for implementing agencies to allow them to engage in prevention, emergency relief and rehabilitation; AID missions should develop analyses of natural vulnerabilities and potential civil conflict as part of their mission country strategies. Since disasters frequently occur where development has failed, more flexible funding mechanisms must be integrated into OFDA and development accounts so that regional bureaus and OFDA can jointly address the continuum of disaster recovery, reconstruction and mitigation. Other recommendations are included in InterAction's issue paper, "The Relief-Development Continuum." I would like to request that this issue paper be included in the record.

Many InterAction members work both in the United States and overseas, and find that insights from years of work internationally can often be applied to programs in the US The most timely example of this cross fertilization is microenterprise. In a front page article on May 6, *The Washington Post* cited the emergence of microenterprise as an innovative and popular method to combat domestic poverty. *The Post* said, "Microenterprise, a tried-and-true Third World development technique for more than three decades, is perhaps the hottest anti-poverty strategy in the United States today." I have a copy of this article and request that it be included in the record.

InterAction's members are leaders in the microenterprise field. One InterAction member, Accion International, is implementing credit programs in Arizona, California and Brooklyn with more planned elsewhere. Although the methodology must be adapted to serve American needs, the overall concepts of providing access to credit to poor people while simultaneously building sustainable credit institutions are the same as those introduced by the Grameen Bank in Bangladesh 15 years ago.

Another InterAction member, Save the Children, is implementing lessons learned from its child survival programs overseas in its "Mothers Too!" program that is serving hundreds of young mothers in rural US communities. The program combines community-based outreach, training and education with professional or paraprofessional health care to improve health behaviors of adolescents and birth outcomes of young mothers. These are but two of the many examples of the programs which underscore the interrelatedness of the interests of the US and our neighbors in other countries.

. .losing, Mr. Chairman, we recognize that development is a long term process. We hope that the new AID — and the PVO's — will be given the support over the long haul that will be required to achieve results. We hope that American citizens will also increase their understanding that problems in the remote villages and crowded urban areas overseas are inextricably linked to problems here at home, and solutions will benefit us all.

We look forward to working with your subcommittee and the administration to make AID an e ctive leader in transforming global challenges into opportunities.

DISPATCH
US DEPARTMENT OF STATE
BUREAU OF PUBLIC AFFAIRS
Volume 4, Supplement No. 1 April 1993

FY 1994 International Affairs Budget: Promoting Peace, Prosperity, and Democracy

Summary

The President's FY 1994 International Affairs Budget* signals important new directions and re-orients resources toward meeting new challenges in the post-Cold War environment. At the same time, funds will be redirected toward programs that yield more direct benefits to the American people.

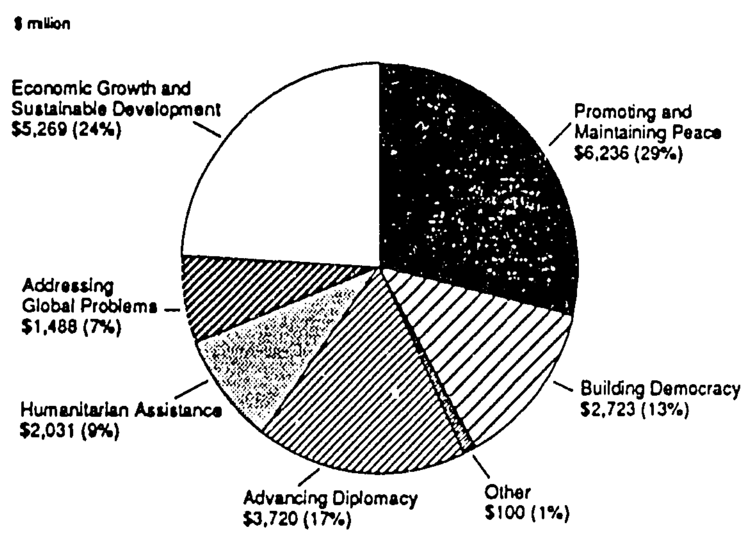
US economic prosperity remains directly tied to world economic growth and international peace and stability. By investing scarce international affairs resources in a few priority areas, the United States will be investing in its own long-term economic and security interests and will avoid far greater costs in the future. For example, modest investments in promoting democratic reforms in Russia; preventing regional, religious, and ethnic conflicts; and attacking the problems of environmental degradation, unchecked population growth, and the proliferation of weapons will reap immeasurable benefits and contain federal spending over the long-run.

The FY 1994 budget is based on five overarching, mutually reinforcing objectives that reflect vital US interests and fundamental values. They are:

- Building democracy;
- Promoting and maintaining peace;
- Promoting economic growth and sustainable development;
- Addressing global problems; and
- Providing humanitarian assistance.

*Some funding categories within the total *FY 1994 International Affairs Budget Request* contain preliminary estimates. Estimates may change once final foreign assistance allocations are determined. ❑

FY 1994 International Affairs Budget
$21.6 Billion in Budget Authority



"To renew America, we must meet challenges abroad as well as at home. There is no longer a clear division between what is foreign and what is domestic. The world economy, the world environment, the world AIDS crisis, the world arms race—they affect us all."

—President Clinton
Inaugural Address
January 20, 1993

A sixth theme, "advancing diplomacy," refers to one of the most important means to achieve progress in the above five areas. The effective use of diplomacy and international organizations is a critical and cost-effective ingredient to success in these areas.

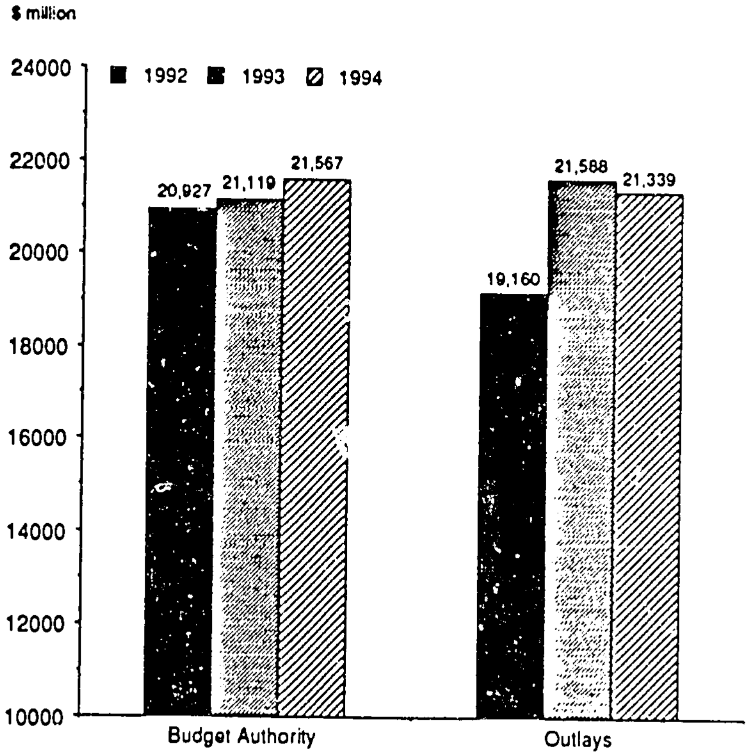
The President's FY 1994 budget requests about $21.6 billion in budget authority (the authority to commit funds) and $21.3 billion in outlays (actual spending) for FY 1994. This is about $450 million more in budget authority and $250 million less in outlays than FY 1993 enacted levels. Compared to the FY 1993 budget, the Administration has redirected more than $700 million from existing international affairs programs toward higher priorities. In real terms, the budget is about $200 million in budget authority and $100 million in outlays below the current services baseline (the current level of spending adjusted for inflation). Over 4 years, the budget reflects the importance of containing federal spending by saving nearly $3 billion in outlays from the current services (no real growth) level.

Significant changes in the FY 1994 budget from FY 1993 levels are:

- An increase of more than $300 million in assistance to the former Soviet Union;
- A net increase of nearly $170 million to support multilateral and bilateral peace-keeping efforts (this is in addition to increases for peace-keeping in the Department of Defense (DOD) budget);
- About $100 million more for programs addressing the problems of population growth;
- $50 million for a new non-proliferation fund to stem the flow of weapons;
- $35 million more for environmental programs aimed at tackling global environmental degradation;
- $20 million more for the Trade and Development Agency and nearly $1 billion more in Export-Import Bank guarantees to increase opportunities for US business overseas and expand exports;
- $190 million more for increased commitment to the International Development Association for assistance to the poorest and least creditworthy countries, in addition to increases for other multilateral development banks.

To offset much of these increases, the FY 1994 budget reduces a number of existing programs, the largest being a reduction of more than $400 million in security assistance programs, including phasing out the Special Defense Acquisition Fund. Other programs have been cut by more than $250 million, including a $50 million reduction in development assistance by the US Agency for International Development (USAID).

FY 1994 International Affairs Budget Authority and Outlays



Note: Excludes International Monetary Fund quota increase in FY 1992

New Budget Presentation

Table 1 (see following page) presents the funds requested under each of the six new categories and highlights the changes proposed in the FY 1994 budget. This new presentation clarifies the link between budget decisions and policy objectives. While actual appropriations continue to be requested within the existing account structure (See Tables 2 and 3 and Appendices A and B at end of document), the FY 1994 budget represents a first step in working with Congress to undertake a more fundamental restructuring of international programs. The objectives listed are preliminary pending a more comprehensive review. While reflecting general Administration priorities, the functional categories are intended to reflect foreign policy objectives, not programs.

The six categories are mutually reinforcing and interdependent. For example, maintaining peace and addressing global problems are integrally linked to economic growth and sustainable development.

THE DEVELOPMENT GAP

STATEMENT OF DOUGLAS HELLINGER, MANAGING DIRECTOR, THE DEVELOPMENT GROUP FOR ALTERNATIVE POLICIES (THE DEVELOPMENT GAP) BEFORE THE SENATE COMMITTEE ON FOREIGN RELATIONS, SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY, TRADE, OCEANS AND ENVIRONMENT

27 MAY 1993

Mr. Chairman, Members of the Committee, thank you for the opportunity to appear before you today. This year's hearings on U.S. economic policy in the Third World, or the South, are particularly significant because they are being held parallel to the new Administration's review of our economic assistance programs. Although the State Department's Task Force report has not yet been released, it is clear that it will signal a sharp departure, not only from the programs of the past dozen years, but from the orientation of our foreign assistance program going back to its inception following the Second World War.

For the past 17 years, our organization, The Development GAP, has been advocating a very different approach to foreign aid from that which both the liberal and conservative schools have promoted. We believe that the solution to the problems of the South lies with the people themselves and that there exists in most countries a rich array of local institutions and activities on which to build. During the 1970s and early '80s we worked extensively within the World Bank and AID, demonstrating in the field how to do this work. We have assisted the Congress in reorienting our aid programs in Africa and the Caribbean and, in the latter case, organized forums for the House Foreign Affairs Committee in the region so that Members could hear the views from representatives of a broad range of sectors. And, having written extensively on aid-reform issues (see attachment), we led a coalition of 30 PVOs which presented an alternative aid-reform plan to the House Foreign Affairs Committee in 1989. Presently, we are advising the Administration on this issue.

Much that was in our 1988-89 proposals is now common wisdom: the need for greater independence for the Agency or a successor institution; a reduction in, and a consistency among, the institution's objectives and functions; a decentralization of its operations; an internal reward system that encourages responsiveness to local reality and populations in determining programmatic initiatives; greater reliance on local expertise; a reorientation of the policy framework to support rather than undermine the activities of the majority of local populations; doing more efficient and relevant work with less money; and supporting a development approach that is more participatory, equitable, self-reliant and sustainable.

927 Fifteenth Street, NW • 4th Floor • Washington, DC 20005 • USA
at Three McPherson Square
TEL: 202 898-1566 • FAX: 202 898-1612 • E-MAIL: dgap @ igc.apc.org

Problems with Our Aid Programs

By contrast, those who have run our aid programs have historically insisted on telling the people of the South how they should develop, glowing rhetoric about public participation and democracy notwithstanding. Some have called for more aid money without a clear demonstration that what we are already providing is being used effectively. They spent the 1970s telling local populations overseas what their "basic needs" were, creating new sectors of research and work in the North in the process, and sending ever-increasing numbers of "sectoral experts" to the field to help meet those needs. These experts and their organizations became the new constituency and lobby for foreign assistance in the 1970s at a time when the American public was rightfully questioning the effectiveness of our overseas aid.

More recently, our aid experts have taken to prescribing -- without prior, local consultation needed to understand local realities -- an overly simplistic set of "market oriented" policies across the Third World and, lately, Eastern Europe. The World Bank, in conjunction with the International Monetary Fund, has taken the lead in imposing structural adjustment programs in some 75 countries over the past decade. Both institutions claim that it is not their responsibility how the supposed benefits of these trickle-down adjustment programs are distributed, but both deny the state (and local organizations) a role in "leveling the playing field" so as to ensure equitable and sustainable outcomes.

The tragic result of the billions of dollars in adjustment lending -- **close to US$150 billion from the World Bank and the IMF alone since 1980** -- has been a deepening and expanding poverty around the globe, as well as exacerbated environmental problems due to this growing poverty, the rapid extraction of natural resources for export markets, and a lack of public oversight. Economic growth, where it has taken place, is unsustainable under these conditions.

Failures of Adjustment and the International Financial Institutions (IFIs)

In a report released last month, the British charity, Oxfam, concludes that adjustment programs have not worked in Africa, that they "...have had the effect of forcing the region to struggle up a downward escalator." Following the advice of the IMF and the World Bank, countries have experienced "...not export-led growth but export-led collapse," as experts have pressed them to expand production of commodities, such as coffee and cocoa, where international demand is already saturated. According to Oxfam, whatever limited economic growth that has taken place has been based on aid rather than investment and that even the so-called success stories of Ghana and Uganda have not come to grips with growing poverty. European Community officials have also expressed their doubts about the effectiveness of Bank and Fund adjustment policies in Africa, while UNICEF has attributed "the chronic rise in poverty" in Latin America and the Caribbean in good part to the high social cost of economic adjustment. An Inter-American Development Bank/UNDP report also concludes that adjustment programs in those regions have exacerbated an expanding and deepening poverty and have failed to address the underlying historical and structural causes of the problem.

The same picture is being painted by the architects, promoters and defenders of adjustment. According to Lawrence Summers, Undersecretary for International Affairs at the U.S. Treasury and former Chief Economist at the World Bank, the number of people living in poverty around the world increased over the past decade. There was a particularly sharp increase in Africa, where the number of poor people is expected to continue to grow through the 1990s. Furthermore, Mr. Summers reported to the House Subcommittee on International Development, Finance, Trade and Monetary Policy earlier this month that the poor in both Latin America and Africa actually became poorer during the 1980s. Also of significance is the fact that during the previous two decades, before adjustment programs were introduced around the globe, the poorest countries had experienced the fastest increase in their social indicators, but, according to Summers, there was a "complete reversal" of that trend in the '80s.

These trends are not surprising news to those who work on the ground in the South. They have been reporting on the disastrous impact of Northern-imposed adjustment programs for the better part of a decade – the impact on wages, income distribution, social services, small farmers, food production, health conditions, nutritional and educational levels among children, the increasing work load of women, and the environment.

In Ghana, illiteracy and school drop-out rates have risen, malnutrition and illness among the poor have increased, food production has declined, and the country's remaining forest resources have been rapidly depleted during a decade of adjustment, while domestic investment has fallen and the nation's external debt has tripled. In Mexico, real wages have fallen sharply and small grain producers have been undercut by the new economic policies. Unable to participate in new, non-traditional export programs, they either have become agricultural workers on large plantations or have migrated to overcrowded cities, the border industries or the United States. Bank staff acknowledge that, as in Ghana, the concentration of income and wealth has sharply increased in Mexico over the past decade. Similarly, in Costa Rica, wages have fallen, small farmers cannot get credit, land ownership has become increasingly concentrated, food production has declined, and there have been major health and environmental problems due to an increased use of agrochemicals on new export crops. All three programs have been held up by the World Bank as model adjustment cases.

During just the past couple of months, the international media has reported numerous other adjustment failures. In Kenya, 80,000 primary-school students cannot afford to attend secondary school after passing their exams because Bank- and IMF-imposed spending cuts have pushed minimum school fees to the level of the country's average annual per capita income. In Nigeria, the health system has been collapsing since an adjustment program was adopted in 1986. In Zimbabwe, local industries, facing heavy international competition as a result of the new trade liberalization program and unable to replace aging equipment due to a steep currency devaluation and high interest rates, have begun to retrench and/or collapse. In Zambia, traditional farmers, who account for 65 percent of national food production, are now at great risk due to the economic reforms that favor cash-crop production and cheap food imports.

Press reports from Latin America are no more encouraging. Three years after the initiation of Peru's adjustment program, hundreds of private firms have declared bankruptcy, un- and underemployment now encompass 80 percent of the population, a new class of formerly middle-class "new poor" has been created, tuberculosis and cholera are rampant in slum areas, and high inflation persists. Yesterday, in Ecuador, workers, indigenous organizations and students launched an indefinite general strike to protest the government's adjustment policies, while protests against such policies in Guatemala, according to first reports, contributed to the suspension of constitutional government in that country.

Threat to Democracy

The widespread discontent and mounting social unrest in response to the IFI-promoted economic reforms in Ecuador is reflective of a growing problem around the world that should be of great concern both to this Congress and to the Clinton Administration: the threat to democracy and human rights that these programs represent. The Ecuadoran government, answerable first and foremost to the Bank and the Fund rather than to its people, has ruled out any change in economic policy and has dismissed the popular demonstrations as "absurd". According to the country's vice-president, "The government will act with the full weight of the law against those who oppose progress and modernization." The government in Guatemala, where the percentage of the population living in poverty has increased from 63 to 84 percent under adjustment, actually went beyond the law this week with its declaration of emergency rule and its banning of human-rights and other civic organizations. Eighteen months ago in neighboring Honduras, the government violently cracked down on members of the National Electrical Company Union when they struck in protest against a program of privatization, massive lay-offs and large rate increases; shortly afterward, the World Bank, the IDB and the IMF resumed funding for the energy sector.

Halfway across the world in the Philippines, the Catholic church and consumer and labor groups have vigorously opposed a power-rate increase pushed by the World Bank. Although this measure was subsequently frozen by a temporary restraining order from the country's Supreme Court, the Bank has warned the government that all loans to the power sector would be halted until this matter was resolved in accordance with the adjustment program.

In effect, we are supporting international bureaucracies that are unaccountable to the hundreds of millions of people over whom they have tremendous power. Caught between the rock of citizen demands and the hard place of being effectively cut off from all international lending, most governments have chosen to ignore their people and risk creating situations of heightened political tension and potential repression. Do we want to continue to put our faith in international institutions that prescribe programs and policies that have not been informed by citizen input and that compromise the democratic processes that we have committed ourselves to promoting?

Tackling Poverty

Until recently, most of our major institutions, including Executive Branch agencies, the Congress and the media, have chosen to ignore the devastating impact of adjustment programs when discussing our economic assistance programs and their role in reducing poverty and environmental problems. This is comparable to ignoring the elephant that has slipped quietly into the room.

The multilateral institutions, as well as AID, have in fact succeeded to date in closing off adjustment policies from serious public scrutiny when a full re-evaluation, from the grassroots up, is needed. To deflect this examination, our aid organizations and other adjustment promoters have recommended that ever-increasing amounts of money be thrown at the margins of the problem to hold off growing poverty and desperation. First, these monies financed small, short-term "compensatory" programs, then somewhat larger "social investment" programs, and, most recently, large-scale "poverty reduction" and "social reform" programs.

None of these have worked, nor will they work in the future, to reverse the trend of growing poverty, because the economic reforms themselves are exacerbating the very structural inequities that both the adjustment and poverty programs fail to address.

So, as we overhaul our aid programs, as Secretary Christopher has committed the Administration to doing, we must be particularly careful not to fall into the trap of supporting two parallel and conflicting processes of change. The new leadership at AID is dedicated to supporting a community-based approach to development, one that invests in and builds upon the capabilities, activities and organizations of the people themselves and takes direction from their knowledge and perspectives gained through local experience. If AID is to be effective in this endeavor, these perspectives and local-level reality must inform all the development processes supported by the Agency, including the formulation and implementation of investment programs, sectoral- and regional-planning exercises, and the determination of economic-policy frameworks.

There are those who would reserve these latter responsibilities for the multilateral institutions. This would be a major and fatal mistake based on a false and unnecessary division of labor. The IFIs, far from having built on the local social infrastructure of the South, have helped to erode this infrastructure by promulgating – without any local involvement – large-scale projects and economic policies that have forcibly displaced hundreds of thousands of people, destroyed their natural environment, undercut the production of small farmers and dramatically increased the concentration of both wealth and income.

Reforming the System

We must move away from this two-track approach. A new bilateral aid program, if sufficiently decentralized, independent and free from outside interference, could attack the interrelated problems of poverty and environmental degradation by addressing their root causes in conjunction with local populations and institutions. The alternative is to continue to throw good money after bad based on economic theories developed in Washington or at Northern universities.

A reconstituted AID must be bold but respectful, responding to a different, more grounded set of actors and institutions in the field and bringing new ideas into the mix. A more inclusive and democratic process of decisionmaking related to the allocation of economic resources would yield a very different set of programs and economic policies – ones which most probably would put greater emphasis on basic food production, more sustainable agricultural practices, selective protection of the small-farm sector, greater integration of the agricultural and industrial sectors, increasing the purchasing power of the many instead of that of the few, distributing land and other wealth more equitably, and ensuring the general health and education of the population. These have been neither the goals nor the effects of the economic programs and policies of the IFIs.

To achieve new goals and objectives we need a different type of bilateral program, as well as multilateral programs with a consistency of purpose. We need to free up and reward staff in order to get them out in the field to learn about and build upon the dynamics and institutions already operating at the local level. Such staff could not only direct support to larger initiatives growing out of community-based efforts, but could encourage and support

local non-governmental input into, and cooperation with, municipal, provincial and national government programs. And, as mentioned earlier, we should support the participation of a wide range of popular constituencies in the South in both program and policy planning in order to ensure the quality and relevance of the output of those processes. As long as AID is not buffered from interference from above, however, it will not be able to respond first and foremost to grassroots pressures from below. As a result, Congress would be forced to continue to micro-manage the Agency, and staff would continue to spend all its time processing papers in the field.

At the same time, major changes need to take place within the multilateral development banks. The reforms at these institutions, pushed principally by environmental organizations, have not changed their culture of secrecy, made them more participatory and accountable vis-a-vis local populations, nor improved the quality or relevance of their projects and policies. In fact, what the current debate over the tenth IDA replenishment has done is made abundantly clear that the wrong institution is managing – or mismanaging – IDA resources. It is unfortunate that Africa's desperate need for foreign exchange has focused the discussion on exactly how much of our taxpayers' money should be allocated to the IDA program in each of the next three years, although the public dialogue has been successful in establishing a growing consensus that IDA funds should be authorized on an annual basis in order to promote improved performance and fundamental reform within the World Bank. The real issue, however, is the disastrous record of the Bank in utilizing past IDA funds to finance environmentally and socially destructive projects and failed adjustment programs insensitive to local realities.

The Bank's record in this area and its resistance to significant reform raise the immediate need to explore removing IDA from Bank management and establish a new mechanism of international cooperation which could manage these funds in a more open, democratic and socially and ecologically sensitive manner. In any event, there is no good reason why a bank directed by finance ministers should be in charge of managing soft-loan funds designed to help the poor. We strongly recommend that such action be part of our current aid-reform effort.

Conclusion

We are at one of those rare moments when profound and far-reaching change is both desirable and possible. To hear our new AID Administrator speak of the need for his Agency to directly empower people to engage economically and politically in their own development is to believe that this actually can be done. If our bilateral program indeed puts people first, builds on what they have already established in their communities and through their work, and is results oriented, it can thrust this country into a leadership role among our Northern partners and win the admiration and appreciation of hundreds of millions of people across the South.

I thank you.

THE DEVELOPMENT GAP

Aid for Just Development:
Report on the Future of Foreign Assistance

by Stephen Hellinger, Douglas Hellinger and Fred M. O'Regan
Lynne Rienner Publishers, Boulder, Colorado, 1988

Summary

Need for Fundamental Departure in Aid Policy and Organization

- U.S. bilateral and multilateral aid has been generally ineffective in fostering development, whether its focus has been basic human needs or the private sector.
- Aid has been used to promote short-term political, security and economic interests that are not necessarily consistent with long-term development objectives.
- Attempting to achieve both sets of objectives through the same aid program has done justice to neither.
- Most of our aid has been channeled through public and private organizations in the South that do not represent the poor or their interests and has thus fostered economic dualism, alienation and instability.
- Far more can be done with less aid if that aid is channeled appropriately.
- The local realities of aid and development in the South have been obscured by the well entrenched aid lobby that promotes special interests in the North.
- The economic crisis among the Third World poor is reaching tragic proportions and is being exacerbated by structural adjustment policies and programs promoted by aid agencies.
- Adherence to inappropriate development models has Third World countries forever looking outward for resources, markets and solutions to their development problems rather than building upon local resources and creativity.
- The Third World poor have the knowledge and capabilities to define their own development, but they have seldom been consulted by policymakers and the aid community.

927 Fifteenth Street, NW • 4th Floor • Washington, DC 20005 • USA
at Three McPherson Square
TEL: 202 898-1566 • FAX: 202 898-1612 • E-MAIL: dgap@igc.apc.org

- The image of the United States across much of the Third World has suffered from the imposition by our aid institutions of development approaches that further marginalize, alienate and anger local populations.
- The full integration of local populations in the development process can yield equitable development and achieve the long-term objective of social and political stability.

Framework for a New Aid Approach

The following principles should guide a restructuring of the U.S. foreign aid program:

- **Participation** of the poor through their own organizations and those that work closely with them: aid organizations should underwrite development activities undertaken and/or supported by Third World people rather than programs that ignore or undermine these efforts.
- **Responsiveness** to ongoing development activity and to the evolution of effective development institutions: to be effective, the U.S. development assistance program must be restructured to respond to the evolving capacity and needs of local populations and of those local institutions that promote equitable development.
- **Autonomy** of development assistance institutions from the pursuit of short-term U.S. political, security and economic objectives: to be able to respond to Third World needs and efforts, these institutions must be structurally and operationally independent.
- **Decentralization** of decisionmaking responsibility: structural autonomy enables internal restructuring and decentralization of aid institutions that places responsibility predominately at the field level, where decisionmaking can be informed by local realities.
- **Consultation** with local populations to ensure that local knowledge and realities are reflected prominently in aid and development plans and policies: structured consultation with representative Third World organizations would help make badly needed micro-macro linkages by ensuring that local perspectives are incorporated in development programming and policy planning, as well as in project financing.
- **Accountability** to the Third World poor and to U.S. taxpayers: sufficient oversight by representatives of both these parties is required to ensure that development assistance is utilized for the purposes for which it is promoted.

Statement by Robert W. Kates to the U.S. House of Representatives, Committee on Agriculture, Subcommittee on Foreign Agriculture & Hunger April 29, 1993

My name is Robert W. Kates. I am University Professor and Director-emeritus of the Alan Shawn Feinstein World Hunger Program at Brown University, Providence, Rhode Island. The World Hunger Program is the unique research center that combines basic research on the causes and prevention of hunger with efforts to bring together and to communicate what is known about world hunger and the policies required to end it. Currently I serve as Co-chair of an international nongovernmental advisory group of scientists, advocates, and practitioners under the title of Overcoming Hunger in the 1990s. I am a geographer by training and a member of the National Academy of Sciences. In 1991, I received from President Bush the National Medal of Science, for among other research, "studies on the prevalence and the prevention of world hunger"

Before beginning my testimony I would make a personal observation. In our lifetimes, most of us encounter few heroes, and it is probably the same in Congress as elsewhere. Yet I have been fortunate in the last five years to meet two such heroes, both of them Congressmen. One is with us today in spirit, Mickey Leland, the other is Tony Hall. Brown University is proud to have honored the House Select Committee on Hunger with the Alan Shawn Feinstein World Hunger Award for Public Service in 1988. The Select Committee's torch has been passed to you. Grasp it proudly!

I have been asked to give you an overview on international hunger and what might be done to overcome it. Thus I will try to do three things: to bring you up to date on trends in the prevalence of world hunger, to describe the international consensus that has produced a common hunger agenda for the 1990s, and to outline the opportunities for U. S. leadership in implementing that agenda.

Trends in the Prevalence of World Hunger

International hunger has many faces. For most people hunger is synonymous with famine. Famine is the only form of hunger that you are likely to see on television. Famine is frequently associated with large and persistent food shortages, although we now know that people can suffer famine because of their inability to have access to food even when food is available. Indeed, all current famines stem primarily from the use of hunger as a weapon in war.

Despite our sense that famine is rampant, the numbers affected by famine as compared to other, less acute forms of hunger, are relatively small—15-35 million at risk at anytime in recent years—and are declining. The trend in famines since the end of World War II is clearly downward, reflecting a lessening of famine and a major shift in famine incidence from populous Asia to less-populated Africa. Indeed, even as we focus on the horrors of famine in Somalia, the numbers at risk to famine continue to decline. Indeed, Somalia can mark a turning point in the age-old struggle against famine (I have appended my recent analysis of the famine situation from the April 8th issue of the *New England Journal of Medicine*).

If we define as hungry individuals whose dietary intake is inadequate for growth, activity, and good health, then the faces of the hungry are many. According to the latest estimates by the United Nations Subcommittee on Nutrition as of 1990, more than a billion people people worldwide suffered one or more nutritional deficiencies. Such deficiencies included the 786 million who lived in households too poor to obtain the food they need for health and modest levels of activity, the 400 million underweight women, and the 184 million wasted and stunted children under the age of five. Hundreds of millions more suffer anemia, goiter, or impaired sight; or die from diets with too little iron, iodine, or Vitamin A (see Table 1).

The trends show good news and bad news. Over the last 25 years the proportion of malnourished individuals in developing countries has decreased from 33% to 20% and of children from 42% to 34%, yet the number of of hungry children has actually increased from 168 million to 184 million because of rapid population growth. Regionally, hunger has increased in Africa, decreased slowly in South Asia and Latin America, and rapidly in East and Southeast Asia.

Table 1 . Malnutrition in Developing Countries, 1975-1990

	Percent affected		*Number (millions)*	
	1974-76	*1988-90*	*1974-76*	*1988-90*
GENERAL MALNUTRITION				
1. Population (all ages) with energy intake (kcals/caput/day) on average below 1.54 BMR over one year	33%	20%	976	786
	1975	*1990*	*1975*	*1990*
2. Children (under five years) with weight below -2 S.D. of reference	42%	34%	168	184
	1980s		*1980s*	
3. Women (15-49 years old) with weight below 45 kg.	45%		400	
MICRONUTRIENT MALNUTRITION				
4. Anaemia: women (15-49 years old) haemoglobin < 12 g/dl (non pregnant) or < 11 g/dl (pregnant)	42%		370	
5. Iodine deficiency disorders (IDD) Goiter (all ages)	5.6%		211	
6. Vitamin A deficiency: children (under five years) with xerophthalmia	2.8%		13.8	

Notes:

1. Data on population with low energy intake (underfed) were calculated by FAO. The estimates are averages for 1974 to 1976 and 1988 to 1990.
2. Underweight children results are estimated by ACC/SCN, for children aged 0 through 60 months, using a cut-off of -2 S.D. of the median NCHS reference.
3. The estimate of underweight adult women is calculated from ACC/SCN's database on women's nutrition. The 45 kg cut-off is used as a basis for comparison, as that commonly reported. The prevalence estimates exclude pregnant and lactating women but these are included in the calculation of numbers.
4. Anaemia estimates are based on ACC/SCN's database on women's nutrition. The cut-off points for anaemia use the WHO reference for pregnant and non-pregnant women. See
5. IDD estimates are based on WHO and ICCIDD data.
6. Vitamin A deficiency estimates are based on WHO data.

Finally, as this is a committee concerned with agriculture, a word on global food sufficiency. Considering the world as a single region, global food sufficiency depends on the standard of food sufficiency adopted and the assumed purchasing power of the population. For example, it is widely believed that there is actually plenty of food in the world and that hunger results mainly from its maldistribution. This is certainly true for a world universally content with a basic vegetarian diet. Distributed equally according to need, the vegetarian food supply plus the naturally grazed animals, could feed about 120% of the world's current population. But for a world whose diet contains a modest amount of animals fed with cereal grains, there is only enough food produced at present for three-quarters of the world's population. And to feed people with a healthy but animal-rich industrialized nation diet, there would only be enough food for 50% of the world's population. These figures do not necessarily imply that people cause hunger by eating cereal-fed animals or that there is or will be a global food shortage.

Economists rightly point out that if poor countries and peoples had greater purchasing power there could easily be greater production of food, as the world has much unused capacity for raising food.

The Hunger Agenda for the 1990s

In November 1989, a major nongovernmental initiative, the *Bellagio Declaration: Overcoming Hunger in the 1990s* proposed four achievable goals for the 1990s: (1) to eliminate deaths from famine; (2) to end hunger in half of the poorest households; (3) to cut malnutrition in half for mothers and small children; and (4) to eradicate iodine and Vitamin A deficiencies. Together, these comprised a comprehensive yet practical program to end half of world hunger in the 1990s by building on the better and best of programs and policies for overcoming hunger. The most promising programs, the Declaration found, were those that empower people to assess their own condition and to act in their own behalf, that provided short-term hunger relief while addressing deeply rooted causes, and that could be sustained over the long term.

In the 42 months since its production, the Declaration has been widely disseminated—even emulated—the individual goals have been adopted in many fora, and major efforts at implementation are under way. At the same time, renewed conflict, slowed economies, and population growth increase the numbers at risk of hunger and make the halving of hunger more difficult to achieve.

The Declaration itself has been endorsed, to date, by over 360 technical experts, advocates, practitioners, and opinion leaders in 65 countries. The goals of the Declaration have been adopted in various fora and in somewhat differing formats. Even preceding Bellagio, the World Food Council had adopted in its Cairo Declaration a statement supporting goals of "...the elimination of starvation and death caused by famine; a substantial reduction of malnutrition and mortality among young children; a tangible reduction in chronic hunger, and the elimination of major nutritional diseases." Through this more general formulation, the goals have been included in the UN Development Decade Strategy for the 1990s. The Bellagio goals relating to children and to micronutrient deficiencies were adopted by the extraordinary gathering of heads of state in the World Summit for Children held in New York in 1990. Finally, the intergovernmental International Conference on Nutrition, attended by 162 nations in December of 1992, affirmed the human rights to food and nutrition and adopted the goals of the World Summit for Children (including cutting child undernutrition in half) and declared, as well, that an end to famine deaths and elimination of Vitamin A and iodine deficiencies are achievable goals by the end of the decade. In short, these goals in various formats have emerged as the international hunger agenda for the 1990s.

Major efforts are under way to implement each of the four goals:

- Ending famine deaths crucially depends on being able to provide humanitarian assistance in zones of armed conflict. U.S. leadership in Somalia (and one hopes as well in Bosnia) has provided new precedents for delivering such assistance through the United Nations, the International Committee of the Red Cross and other nongovernmental agencies. In turn, the United Nations has sought to improve upon the delivery of humanitarian assistance in zones of armed conflict by creating a special fund and coordinating the diffuse responsibilities within agencies under a new deputy secretary-general. The ready availability of U.S. food aid is a basic requirement for such emergency food aid.
- The World Bank, following on the "personal commitment" of its new President, has renewed its efforts to address poverty, exemplified by efforts to increase funding for nutrition, to provide food security in Africa, to introduce poverty considerations in all Bank activities, and to include "poverty conditionality" in bank lending.
- Under the leadership of the World Health Organization and UNICEF, national plans to halve hunger among mothers and children and to implement the World Summit for Children's goals are being prepared in 72 countries. Integrated efforts to encourage breastfeeding, to monitor growth and supplement feeding, and to break the nexus between illness and undernutrition by

immunization and oral rehydration are having measurable effects in reducing childhood wasting and stunting. U.S. support for such child survival activities has been steadfast.

- Following a series of major international gatherings, international and national agencies, the technical community, and international voluntary groups are vigorously attacking the "hidden hunger" of micronutrient deficiencies. Efforts are under way to supplement iron, iodine, and Vitamin A intake, to fortify commonly available foods with appropriate micronutrients, and to encourage the use of foods naturally rich in these nutrients. Creative new approaches are being sought for implementing such interventions and linking efforts addressed to individual nutrients. U.S. leadership on Vitamin A in particular has been outstanding.

These encouraging actions, are however, primarily "top-down" initiatives that address only individual goals of the Declaration. What is still missing is a focal point for pursuing a comprehensive program for overcoming hunger rather than particular goals; a reliable process for assessing progress; an independent forum for resolving tensions; and most important, a bringing together of the grassroots and the summit at scales sufficient to make halving hunger a reality. This last point is most important. When we met at Bellagio 42 months ago, we were encouraged by the enormous and spontaneous growth of local, indigenous grassroots organizations throughout the developing countries. We thought then, and still believe, that if their energy, local initiative, and insight could be effectively linked to the international hunger agenda, then there is real opportunity to take a giant step forward in cutting hunger in half

Finally, a word about costs. Based on yearly per capita costs of large scale programs already in existence, $25 can stave off famine, $20-25 can eliminate hunger in poorest households, $15 can address malnourishment among small children, and a bargain 50¢ can provide Vitamin A or 7¢ can provide iodine to those in need.

A bill to each of the 1.2 billion citizens of the developed countries for halving hunger would appear thus

INVOICE

To: Developed Country Citizen
From: Overcoming Hunger in the 1990s
For: Annual services to be rendered to the hungry of the world

To eliminate deaths from famine	$0.55 billion
To reduce hunger among poorest households	$6.41 billion
To cut malnutrition among women and children	$1.61 billion
To eradicate Iodine and Vitamin A deficiencies	$0.17 billion
Total	**$8.74 billion**
Your share: 1/1,206,600,000	**$7.24**

Payable Annually 1991-2000

☐ Government ☐ Private Voluntary Org. ☐ Both
☐ Taxes ☐ Credit Card ☐ Check ☐ Cash

Thus a realistic program to combat hunger in the 1990s would cost less than $10 billion a year and might require only $4-5 billion more in new resources because an amount equal to that is already being spent, albeit not necessarily well. Thus more important than money, halving hunger in the 1990s requires renewed social energy and political will, the creative employment of local institutions and underutilized resources, and increases in the level of public support.

U.S. Leadership

In 1990, I testified before the House Select Committee on Hunger as follows:

"Yet for the first time in human history, the end of famine is achievable. Endemic goiter and Vitamin A blindness can be eliminated. The wasting and stunting of small children and the starvation of their mothers can be halted. Most nations, even very poor ones, could meet their minimal overall nutritional needs, even if distributing food adequately proves more difficult. The worst forms of urban food poverty and rural food insecurity can be halved.

The United States can contribute in a major way to such an effort if we build on our skills and experience. A U.S. initiative could include the following:

• *To eliminate deaths from famine:* Maintain the moral high ground in addressing hunger as a weapon of war by leading in the provision of humanitarian aid and seeking safe passage in zones of armed conflict.

• *To end hunger in half the poorest households:* Make sure that our generosity in providing food aid is matched by the neediness of its recipients. Use our experience in targeting food aid, at home and abroad, to make such aid more effective. Find ways to make our assistance of microenterprises work for truly poor people. Make sure that our external assistance and that of other donors does not undermine hungry farmers' production incentives and access to resources. Use short-term support for hungry people in Africa to help build a rural infrastructure for internal markets.

• *To cut malnutrition in half for mothers and small children:* Build upon the current efforts on child survival with activities and support rising to double the current level. Assist mothers with support for child spacing.

• *To eradicate iodine and Vitamin A deficiencies:* Build upon the experience in both research and practice in addressing Vitamin A, with a clear U.S. commitment to seek eradication within the decade.

• *Overall:* Provide a global challenge to match 1:3, a U.S. commitment of a billion dollars per annum in new resources."

Three years later, this list of possible U.S. initiatives is still relevant. Overcoming hunger remains a unique, low-cost opportunity to make a better post-cold war world. Although not all of us can hope to be heroes, this Subcommittee can carry forward the inspiration of Mickey Leland and Tony Hall and be heroes on behalf of hungry people everywhere.

A World Crisis in Basic Education

Edward B. Fiske

Academy for Educational Development. 1993.

Two out of three adults in the poorest developing countries lack basic literacy and numeracy skills — and thus the skills to become productive workers, learn about good health and family planning, protect the environment and support democratic forms of government.

Basic Education Can Yield Big Results

This publication makes the case for a renewed commitment by the United States to invest in basic education. It brings together data that show the powerful and positive relationship between investments in basic education and outcomes in economic productivity, health and social well-being, the growth of democracy and conservation of the environment. In newly developing societies, each additional year of schooling beyond grade three or four can lead to:

- up to 20 percent higher wages
- up to 10 percent fewer births
- up to 10 percent fewer child deaths

Education has a profound impact on economic development. For example, research has shown that in modernizing societies, farmers with just four years of education are 9 percent more productive than farmers with no education, and literacy gains of 20 to 30 percent can boost a country's gross domestic product by 8 to 16 percent.

The yield from investments in basic education extends well beyond economics. Research shows that when citizens of developing countries receive basic education:

- A foundation is laid for the development of democratic institutions.
- Families have fewer children.
- Infants and children eat more nutritious foods, are treated more effectively for childhood diseases and therefore survive at higher rates
- Citizens understand and support programs to protect the environment.

Why Invest in Basic Education?

Basic education must be a vital element in the partnership for sustainable development and the growth of democracy throughout the world. The alternative is unthinkable. A world *without* widespread basic education is a world in which:

. . . the cost of welfare and disaster relief will continue to soar. Somalia today is as devastated as Germany in 1945. Yet rebuilding Somalia will be slower and more costly because it lacks an educated citizenry able to use foreign assistance to develop agriculture and to build industry, social institutions and a democratic government.

. . . the world's population count will explode. Making birth control devices available to people in developing countries is only half the battle. They need the knowledge and will to use them. As education increases, particularly the education of girls, family size decreases. As little as four years of basic education makes a measurable difference.

. . . the growth of democracy will be threatened. Basic education opens new sources of information to people now dependent on word-of-mouth or mass media. Education fosters public debate and promotes the free exchange of ideas so critical to a democratic society. Lack of education makes these developments impossible.

. . . the human and economic burden of health care will increase. Lacking knowledge and skills, the people of developing nations cannot take the relatively simple steps that prevent childhood diseases like diarrhea and measles. This creates a spiral of soaring public health costs, a greater number of infant deaths and parents having even more children to replace the ones they fear losing.

. . . women will continue to be excluded from full participation in society. Women with a basic education are empowered and contribute more to the economy than their uneducated peers. Educated women wait longer to marry and, when they do, bear fewer children. The health and social benefits of their knowledge are magnified as they are passed on to future generations.

. . . the environment will be further endangered. Unaware of the long-term consequences, rural farmers will continue to slash and burn forests. Fragile water systems will become increasingly polluted by unaware urban families, and an ill-informed public will fail to challenge industrial pollution.

Post-Cold War Foreign Policy

The defeat of communism and the breakup of the Soviet Union mean the assumptions that have guided American foreign policy for nearly half a century — assumptions organized around the primacy of military containment — are no longer adequate. The current reassessment of our foreign policy must include the rethinking of U.S. assistance to developing countries.

A new foreign aid program can and should grow out of new domestic policies. The Clinton Administration's domestic agenda emphasizes investment in America's social and economic infrastructure — with special attention to the development of human resources. These are precisely the themes that should dominate a new policy toward countries in the Third World. As in this country, basic education plays a central role in strengthening the abilities of developing countries to help themselves.

A New Vision: Seven Policy Recommendations

Following are seven policy recommendations for strengthening U.S. bilateral support for basic education in a comprehensive plan to promote sustainable development and the spread of democracy in Third World countries:

1. As with domestic policy, make investment in human capital a major priority of U.S. foreign assistance.
2. In recognition of its strategic importance, dramatically increase the amount of development assistance devoted to basic education. This should be coordinated with strengthened efforts in health, population and the environment.
3. Emphasize basic education for girls and women.
4. Include in new basic education programs training for education leaders from developing countries at U.S. colleges and universities.
5. Create an information and policy planning center that collects and disseminates successful practices in international basic education to help countries address policy reform, teacher training, curriculum improvement, materials development and assessment.
6. Pay special attention to the development and deployment of new instructional and broadcast technologies to enhance basic education in developing countries.
7. Increase linkages with multilateral development and regional development banks so that successful education programs initiated by countries with the support of U.S. bilateral assistance are better able to be sustained and extended to additional countries.

Report of American Voluntary Agencies
Engaged in Overseas Relief and
Development Registered With the
Agency for International Development

Bureau for
Food and Humanitarian
Assistance

Office of Private and
Voluntary Cooperation

Agency for International Development
Washington, DC 20523

Overview of U.S. Voluntary Agencies' Activities

The Agency for International Development (A.I.D.) recognizes the significant role that private and voluntary organizations (PVOs) play in providing humanitarian and development assistance to the developing world. Although the PVOs registered with A.I.D. vary markedly in size, scope, and capability, they share a strong commitment to improving the quality of life of people in developing countries.

PVOs' humanitarian activities originated more than a century ago in response to natural disasters. As a result of their ability to respond quickly and effectively, PVOs emerged as leaders in disaster relief. Gradually, their efforts broadened from emergency relief and food distribution to programs aimed at addressing the root causes of poverty and vulnerability to disasters.

This shift in emphasis from short-term relief to planning and implementing long-term development projects marked the beginning of the process of cooperation between A.I.D. and the PVO community that has firmly taken root over the past 22 years. While continuing to be responsive to immediate human needs, particularly in emergency situations, PVOs are increasingly contributing their valuable resources to long-term development activities that A.I.D. considers crucial to improving conditions in the developing world: promoting economic growth that is broad-based and sustainable and also ensures a safe environment; fostering human capacity development, particularly the attainment of health and educational levels required for all citizens to contribute to, and benefit from, economic development; and encouraging pluralism and democratic institutions.

These principles guide a variety of PVO activities in areas such as microenterprise development, environmental preservation, child survival, and democratic institution building. They are the foundation upon which A.I.D.'s development assistance program is based and upon which A.I.D.'s partnership with PVOs is focused.

In its work overseas, the PVO community demonstrates the traditional American values of pluralism, voluntary action, and concern for others. PVOs foster sustainable self-help efforts at the community level and provide a direct channel for people-to-people projects that broaden the participation of the poorest citizens in the social and economic decisions that affect their daily lives and ultimately influence the well-being of the nation as a whole. In recent years, the hallmark of PVO efforts has been their commitment to building the capacities of their indigenous partners in the field. More and more U.S. PVOs are offering training, technical assistance, and support to local affiliates and community organizations at the grass roots to strengthen the organizations' ability to carry out their own technically sound, effective development projects. This emphasis must continue during the 1990s if development is to be sustainable.

As we move further into this decade, A.I.D. will be giving high priority to programs that address the following: the role of the informal sector, and microenterprises in particular, in building strong, free-market economies; the need to preserve the environment for future generations, while at the same time bringing about economic development and an equitable sharing of resources here and now; and the challenge to respond to fledgling democracies around the world and to ensure that the trend toward democratization is sustained.

PVOs have the skills and experience to contribute to each of these priorities in significant ways. Some specific opportunities for PVO programming in areas of interest to A.I.D. in the future include microenterprise credit and training projects; the use of debt for development exchanges; new initiatives to promote democratic pluralism, particularly in Eastern Europe and the former Soviet Union; and the use of new program design techniques to ensure project sustainability.

A.I.D.'s support for PVOs has two major dimensions. First, PVOs act as independent agents, conducting their own programs, with A.I.D.'s financial and technical support to meet mutual goals. In other cases, PVOs act as intermediaries for A.I.D., specifically in countries where A.I.D. strategies and PVO project objectives coincide precisely. In some areas of the world where A.I.D. does not have resident staff, PVOs may be the sole implementors of A.I.D. projects. While each type of partnership is different, all joint A.I.D./PVO projects recognize the independent, voluntary nature of PVOs. In line with Congressional legislation, all PVOs must be registered with A.I.D. in order to be eligible for grants funded from development assistance funds, and all must obtain at least 20 percent of their annual financial resources of their international programs from non-U.S. Government sources.

By maintaining a central point of contact for PVO information, coordination, and dissemination through the Office of Private and Voluntary Cooperation (PVC) of the Bureau for Food and Humanitarian Assistance, A.I.D. reinforces its relationship with PVOs. In coordination with the regional and other bureaus within A.I.D., PVC carries out programs aimed at enhancing the impact of A.I.D./PVO cooperative efforts by strengthening PVOs' planning and management capabilities, allowing for more effective and sustainable programming at the local level.

Whatever the terms of the relationship, PVOs make an important contribution to the foreign assistance programs conducted by A.I.D. As this report illustrates, the private resources devoted to international development by the private voluntary community far exceed their U.S. Government support. The private revenue PVOs are able to generate affords A.I.D. a means of leveraging its own limited resources for development. By joining forces and complementing each other's capabilities and scope, A.I.D. and PVOs can accomplish more together than either could alone.

The following pages present a current picture of the work being carried out by the PVOs that are registered with A.I.D. Included is information on the geographic and sectorial focus of each PVO, as well as summaries of support, revenue, and expenditures. As of September 30, 1992, there were 347 PVOs registered with A.I.D. PVOs required to submit support and revenue data received $2,435,237,482 in private contributions, and the U.S. Government provided them with an additional $1,203,788,914 in the form of grants, contracts, U.S. Government-owned excess property, ocean freight subsidies, and P.L. 480 donated food.

Global Economic Prospects and the Developing Countries

5 Aid at the end of the Cold War

Aid—or to give its proper name, official development assistance (ODA),[1] comprising grants and concessional loans—accounted for a third of net resource flows to all developing countries in 1992 and for nearly twice that share to the low-income countries. The number of country claimants on aid has been growing fast, however, and donor objectives have been changing. The issues have arisen, therefore, as to whether the underlying slow growth in real aid flows can be augmented to meet special needs and what can be done to improve the quality of aid in respect to distribution and tying to donor procurement. This chapter argues that the aid "pie" at the end of the Cold War is limited at a time when new claimants and the exceptional needs of the reforming socialist economies have appeared. Donors are faced with the problem of how to raise additional resources if they are to meet environmental challenges and avoid shortchanging the needy in poor countries.

There are two forces impelling change: first, the imbalance between slow growth in donor aid budgets and fast growth in the list of claimants recognized as eligible for aid and, second, the change in donor objectives, resulting largely from the demise of communism in Eastern Europe and the former Soviet Union (FSU).

The slowly expanding supply of aid

Donor aid flows in real terms have grown at a respectable but not especially fast rate over the past decade (table 5-1). During 1981–91, aid from OECD, Arab, and CMEA donors averaged 4 percent growth (including significant amounts of debt forgiveness in 1990 and 1991), deflating with a developing country import price index. In terms of donor GNP, however, the position appears less favorable. For example, OECD-DAC figures show that aid as a percentage of GNP in countries that are members of the OECD Development Assistance Committee (DAC) averaged 0.32 percent in 1978–82, 0.33 percent in 1983–87, and 0.33 percent for 1991.[2] The main bright spot has been an increase in the degree of concessionality for the poorest countries, with grants often replacing loans.

Donors vary widely from the 1991 average of 0.33 percent of GNP devoted to aid, from 0.20 percent for the United States to around 1 percent each for Denmark, Norway, and Sweden.

While some countries, such as Finland, France, Japan, and Switzerland, have sought to raise their ODA-GNP ratios, others, such as the United States, have reduced their aid in real terms. In the United Kingdom, aid has been growing, following cuts earlier in the 1980s. A recent example of unexpected budget stringency occurred in Sweden, which in the autumn of 1992 was buffeted by the currency crisis in the European Exchange Rate Mechanism (ERM) and was forced to cut its aid budget. A second example is found in the situation of Italy, whose aid budget rose strongly in 1979–89 but declined subsequently. Globally, aid from private voluntary organizations, although small in relation to official aid, has grown more rapidly.

Arab aid has shown major fluctuations, falling throughout the 1980s from its very high levels (in relation to donor GNP) in the 1970s. In its peak years between 1975 and 1981, aid from Arab donors reached higher than US$ 8 billion per year and accounted for a substantial portion of total net ODA. More recently, in 1990 Arab donors offered strong support to countries later affected by the Gulf crisis, notably Bangladesh, Egypt, Jordan, Pakistan, and Turkey. For 1991 it appears that the amount of such support dropped sharply.

Aid from the FSU and Eastern European donors has fallen since 1986. Although comprehensive data are not available on such aid, it appears that there was a further fall in 1991 and that aid is now confined largely to technical assistance. Previous major recipients were Cuba, Mongolia, and Viet Nam.

One bright spot in aid flows is nongovernmental organizations (NGOs), which form a distinct and growing aid channel. In 1991, NGOs provided about

Table 5-1 Official concessional flows to developing countries by types of flows, 1981–91
(billions of U.S. dollars)

	1981	1986	1991
Official development assistance	24.2	27.4	42.9
Bilateral loans	9.4	7.4	6.5
Multilateral loans	3.4	4.5	6.6
Official grants[a]	11.5	15.6	29.8
Real net ODA (1991 US$ billions)[b]	28.6	34.6	42.9
Bilateral loans	11.1	9.3	6.5
Multilateral loans	3.9	5.7	6.6
Official grants	13.6	19.7	29.8

a. Excludes technical cooperation grants, which amounted to US$ 6.4 billion in 1981, US$ 8.7 billion in 1986, and US$ 10.5 billion in 1991.
b. Real flows are nominal flows deflated by an import price index for developing countries.
Source: OECD, World Bank.

US$ 5 billion in grants to developing countries, equivalent to 4 percent of total net resource flows. Nevertheless, since roughly one-third of that amount was funding derived from bilateral government sources, some of the NGO-mediated flow may represent a reallocation of rather than an addition to traditional aid sources.

The prospect in the 1990s, therefore, is for a limited aid pie in real terms.

And new claimants knocking at the door

Meanwhile, the number of claimants recognized as eligible or potentially eligible for aid has grown. The principal criterion for aid eligibility is per capita income, with low-income countries (those with a 1991 per capita income of US$ 635 or less) recognized as the most deserving. Other criteria include economic performance, the lack of access to private market financing, and the need for food or relief aid.

Three categories of countries appear as new claimants: first, countries that appear now able to support only concessional borrowing (for example, Angola and Mongolia); second, countries that are potentially reactivated aid recipients, following poor economic performance and exceptional factors such as war (for example, Afghanistan, Cambodia, Iran, Jordan, and Viet Nam);[3] and third, the republics of the FSU and the formerly socialist economies of Eastern Europe. Some of these countries have been receiving substantial financial support from a single donor and now hope to attract broader creditor support. Viet Nam, for example, has recently (November 1992) become eligible for Japanese ODA.

Additionally, there is a group of countries that have been receiving bilateral aid and are now deemed eligible for multilateral concessional funds through IDA, the World Bank Group's concessional lending arm. These countries (for example, Côte d'Ivoire, Egypt, and Honduras) have suffered a regression in per capita income, and even if they can support some nonconcessional borrowing, their weak creditworthiness position makes a softening of borrowing terms desirable.

Concerns have been voiced that official concessional support for the republics of the FSU and Eastern Europe could divert aid from other developing countries. (The concerns apply primarily to concessional flows because nonconcessional flows—for example, multilateral lending—are much less constrained.) ODA flows are indeed susceptible to diversion, to the extent that national aid budgets are not increased to cover grants and concessional loans to the FSU republics and Eastern Europe.[4] Therefore, donors need to take steps to ensure that resources allocated to the reforming socialist economies are additional, or diversion will become a valid concern for the future. Grants from OECD countries to the FSU totaled US$ 600 million in 1990 and US$ 2.6 billion in 1991 (while concessional loans were zero). Although comparable figures for earlier years are not available, the amounts for 1990–91 would appear to represent a big increase.

In December 1992 all five Central Asian republics (Kazakhstan, Kyrghyzstan, Tadjikistan, Turkmenistan, and Uzbekistan) were deemed eligible for OECD and DAC aid (recognized by donors as additional legitimate claimants on ODA), and three Caucasian republics (Armenia, Azerbaijan, and Georgia) and Moldova are also prospective recipients.

Official aid from OECD countries to Eastern Europe was US$ 1.5 billion of concessional disbursements in 1990, and commitments (particularly to Hungary and Poland) are high. It is understood that ODA disbursements to Eastern Europe and the FSU taken together were in the region of US$ 7.5 billion in 1991, including US$ 2 billion of debt relief for Poland from the United States. Much of this assistance has been coordinated by the Group of 24 (G-24) countries, established by the EC under 1991 guidelines that provided for balance of payments financing in support of reform.[5] So far, G-24 financial support has been aimed at Bulgaria, the former Czechoslovakia, Hungary, Poland, Romania, and the former Yugoslavia and was extended in July 1992 to the Baltic countries and Albania.

In assessing the impact of new claimants on aid requirements, it is worth distinguishing those countries whose per capita income lies in the upper-middle-income range (that is, above US$ 2,555 in 1991). From the FSU, these countries are Belarus, Russia, and the three Baltic republics (Estonia, Latvia, and Lithuania) and from Eastern Europe, the countries are Hungary and the former Yugoslav Republic. Arguably, the requirements for concessional assistance from these countries are exceptional and temporary (in the form of, for example, technical assistance and temporary food and other emergency assistance).

A rough order of magnitude for the potential additional requirements for ODA from all new low- and lower-middle-income claimants can be found by assigning ODA on the basis of population and per capita income and comparing each claimant to countries of similar per capita income level. On that basis, the potential call on ODA by new claimants would be roughly US$ 5.5 billion per year, equivalent to 13 percent of 1991 net ODA to all developing countries. For the reforming socialists economies the best measure of their exceptional requirements may be recent actual receipts, indicating balance of payments needs. Including the upper-middle-income countries of the FSU and Eastern Europe on that basis would add a further US$ 4.5 billion, bringing extra requirements to US$ 10 billion per year, or 23 percent of 1991 net ODA.[6]

What these figures suggest is that the call of new claimants on aid funds is a major, but potentially not insuperable, challenge to donor countries.

Distribution and quality of aid

No less than one-third of aid continues to go to middle-income countries. By income group, low-income countries (those with 1991 per capita income below US$ 636) account for 66 percent of ODA to all developing countries, 25 percent of GNP, and 70 percent of population. Middle-income countries account for 34 percent of ODA, 75 percent of GNP, and 30 percent of population. Within middle-income countries, lower-middle-income countries (those with 1991 per capita income between US$ 636 and US$ 2,555) take 27 percent of ODA and have a 22 percent GNP share and a 14 percent population share; for upper-middle-income countries the shares are 7 percent ODA, 53 percent GNP, and 16 percent population. Moreover, the numbers exclude US$ 2 billion of concessional flows that went to high-income countries in 1991.

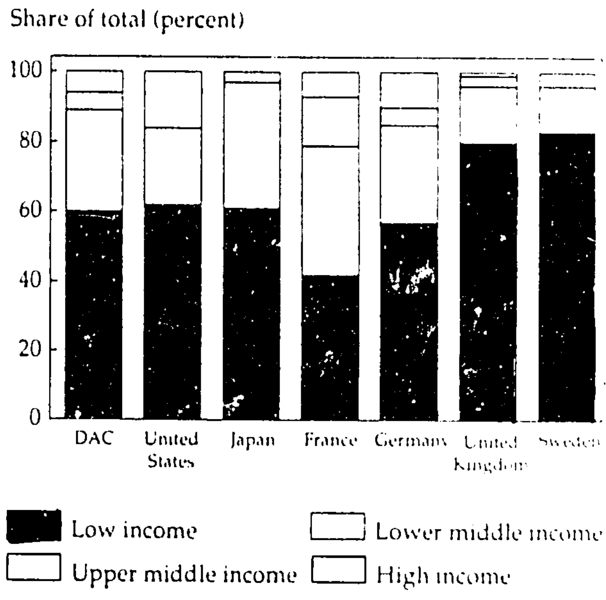
Multilateral aid is substantially more concentrated on the poorest countries than is bilateral aid. In 1991 the share of multilateral aid going to low-income countries was about 90 percent. By contrast, the corresponding share of bilateral aid to low-income countries was around 60 percent. By individual donor, the share of net bilateral aid going to low-income countries varies widely (figure 5-1).

A recent evaluation of the alleged middle-income bias in bilateral aid flows (Clark 1992) concluded that ODA flows from multilateral agencies showed a much smaller bias than did bilateral disbursements (as confirmed by the figures quoted above on distribution by income band). This finding suggests that one way donors could ensure that aid distribution is concentrated on the poorest countries would be to accord higher priority to multilateral channels.

The degree to which bilateral aid is concentrated on a small number of recipients also varies widely among donors. For the period 1986–90, the share going to the top five recipients, for example, is 59 percent for the United States, 50 percent for Sweden, 48 percent for Japan, 33 percent for the United Kingdom, 32 percent for France, and 24 percent for Germany. In 1990, the top five recipients of aid from the United States were (in descending order) Israel, Egypt, El Salvador, the Philippines, and Pakistan; from Japan, they were Indonesia, China, the Philippines, Thailand, and Bangladesh; and from Sweden, they were Tanzania, Mozambique, India, Viet Nam, and Ethiopia. Concentration by recipient is in itself neither good nor bad, but it can be an indicator of donor priorities.

The distribution of overall aid flows also reveals a tendency for smaller countries to receive more aid per capita than larger countries. For example, ODA per capita in 1991 was US $1.6 for the biggest (India

Figure 5-1 Share of bilateral net ODA to developing countries by recipient income, 1991



Note: Excludes flows not allocated by donors to specific countries.
Source: OECD.

and China combined), US$ 6.6 for seven other countries with populations greater than 75 million, US$ 16.7 for the thirty-nine countries with populations between 10 and 75 million, and nearly US$ 50 for sixty-seven countries with populations of 10 million or less. In part, this reflects absorptive capacity in the biggest countries and their ability to access nonconcessional sources of funds.

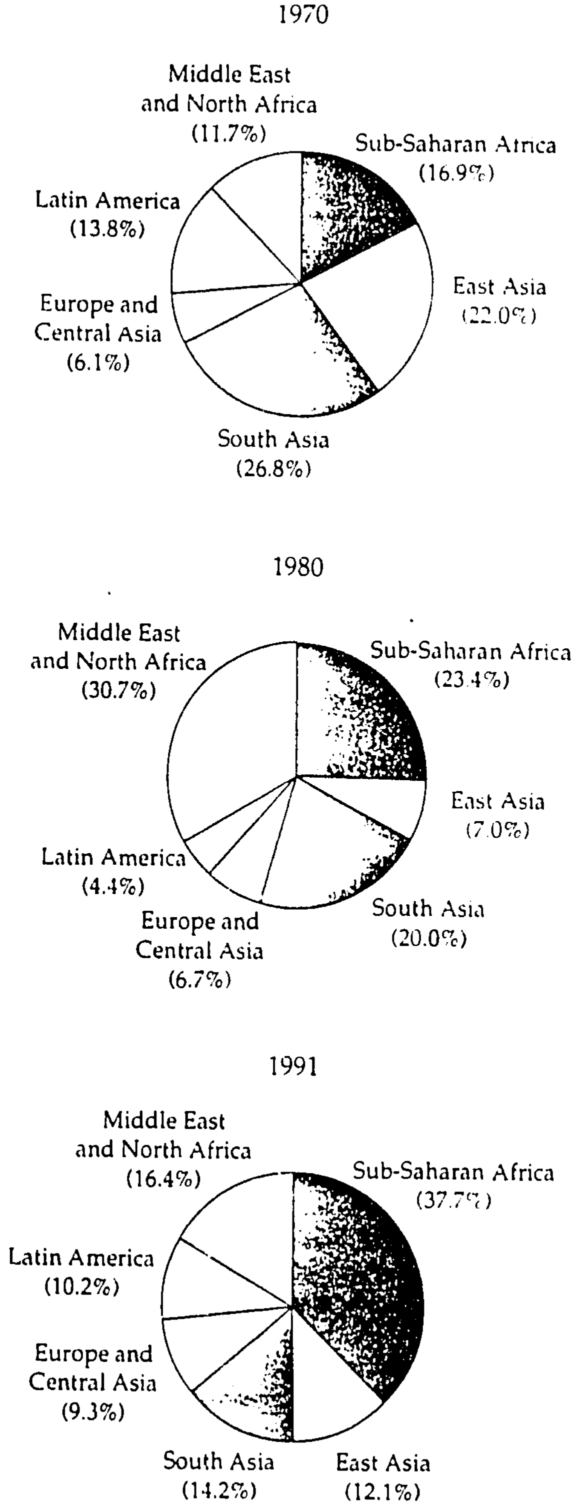
The geographical allocation of ODA (figure 5-2) has shown a strong rise in the proportion going to Sub-Saharan Africa in the past decade; a rise and then a fall in the share going to the Middle East and North Africa over the past two decades; a general decline in the share going to South Asia; and a recent significant increase in the share going to Europe and Central Asia. The rising share for Sub-Saharan Africa reflects donor perceptions of a growing need for concessional assistance to that region. The fluctuations in the Middle East and North Africa share reflect those of Arab donors' contributions. At its peak in 1980 these contributions amounted to more than US$ 8 billion, concentrated in Jordan, Morocco, Syria, and Yemen. More recently, following the Gulf crisis, the largest recipient was Egypt. The declining South Asia share is perhaps explained by India's growing capacity to access external finance on commercial terms and by a fall-off in Arab donor aid, particularly to Pakistan. In consequence, aid to South Asia grew modestly in nominal terms over the 1980s, below the ODA average. Finally, the recent increase of aid to Europe and Central Asia is accounted for by the FSU.

A key measure of the quality of aid is the extent to which it is tied to procurement in the donor country. Although there has been a trend toward less tying of bilateral aid in the past decade, the extent of tying remains high. In 1989, the OECD-DAC country average was 44 percent for tied and 7 percent for partially untied aid, compared to 48 percent and 12 percent, respectively, in 1977–79. There is evidence, however, that tying declined significantly in 1991.

One area of recent modest progress has been in mixed credits, which constitute an especially beguiling form of tying. Mixed credits (and so-called associated financing), which originated in the 1970s, are a financing package that combines ODA, officially supported export credits, and nonconcessional loans. In practice, the ODA component of mixed credits is effectively tied and represents a domestic subsidy available as a protectionist device.

Attempts to minimize misuse met with success in February 1992 when OECD export credit agencies agreed to amend the guidelines on tied aid credits (the "OECD consensus") to restrict the use of mixed credits. The agreement, if implemented effectively, would virtually eliminate the use of mixed credits

Figure 5-2 Regional allocation of net ODA to developing countries



Note: Based on 115 DRS reporting countries. ODA is the sum of net flows on official concessional debt and official grants, excluding technical assistance.
Source: World Bank, OECD.

for upper-middle-income recipients. OECD-DAC continues to examine policy options to extend untying.

Donors appear to tie aid in order to improve domestic employment and the balance of payments or as a protectionist reaction to other donors' tying. The overall impact of tying on any single donor country's exports is, however, likely to be very small because aid is only a fraction of donor exports. This suggests that the lobbying of individual sectors or business firms in the donor country for directed subsidies is a more rational if less laudable explanation for tying. Coordinated action among donors would be necessary to offer realistic prospects of a substantial reduction in the degree of tying. Multilateral aid, in contrast to bilateral, is untied.

The cost to recipient countries of tying aid is hard to estimate, but one study (Jepma 1991) suggests that the direct cost may range upwards from 15 percent of aid provided and that circumstantial evidence produces individual cases of much higher excess cost margins. By direct cost is meant the excess in prices of aid-financed deliveries compared to prices of comparable goods and services not based on an explicit aid policy. On this basis, untying all aid flows would generate economic benefits to developing countries of as much as US$ 4 billion per year, which equals one-fifth of the nominal increase in aid flows over the past decade. In addition, the indirect costs—such as administrative overheads, misallocation of skilled labor, and a distorting preference for capital-intensive, import-oriented projects—are substantial. To be sure, costs are reduced to the extent that the recipient country is able and willing to substitute flexibly between alternative sources of donor funds (Bhagwati 1985); substitutability is, however, hard to estimate, and, hence, estimates of costs should only be considered as orders of magnitude.

Multilateral aid, in addition to being concentrated on the poorest countries, is untied and plays a key role in improving the effectiveness of all aid through the efforts of multilateral agencies to promote sound policies in recipient countries and in coordinating donors. In this context, the recent successful conclusion to the IDA Tenth replenishment ("IDA 10") negotiations is to be welcomed. Donors committed SDR13 billion (Special Drawing Rights, of the IMF) over a three-year period, representing a maintenance of IDA in real terms. Also noteworthy is the growing share of aid channeled through the EC.

Aid and trade

Protectionism in OECD markets is particularly vexing for aid-receiving countries that are, through their own export efforts, attempting to generate additional financial resources for industrialization.

The importance of trade barriers, both tariff and non-tariff, is illustrated by the position of fourteen aid-receiving countries (table 5-2).[7] First, the average levels of tariffs that several of these developing countries face are relatively high.[8] Bangladesh, Dominican Republic, Korea, and Sri Lanka face OECD tariffs that average 7 to 10 percent (the average level of OECD tariffs on all imports is now 4 percent), while Haiti—because of the high share of textiles and clothing in total exports—encounters average tariffs over 11 percent. Second, nontariff barriers (NTBs) are also of major importance as over 50 percent of the exports of Hungary, Pakistan, Poland, Thailand, and Sri Lanka encounter these measures, while 80 percent of Bangladesh's exports face NTBs.[9]

What value of additional export earnings might occur if the tariff and NTB restrictions reported in table 5-2 were removed?[10] Total exports from China, Jamaica, Pakistan, Philippines, and Thailand would increase by at least 40 percent if OECD trade barriers were removed. Other countries would gain even more: Bangladesh, Dominican Republic, Haiti, Jamaica, and Sri Lanka—countries whose total exports contain a high share of textiles and clothing—could double their exports (table 5-3). Even in the case of a "least developed" country such as Haiti (which has major clothing exports to the United States market), the projected trade gains are more than double ODA assistance. These gains would also expand the demand by these countries for OECD exports in a mutually beneficial expansion of trade.

In short, the old phrase "trade not aid" would certainly be the most advantageous prescription for this set of countries.

Changing donor objectives

Bilateral (as distinct from multilateral) ODA has generally pursued a variety of objectives besides economic development—for instance, commercial, political, humanitarian, and cultural interests. These objectives have influenced the allocation of aid, the degree to which it has been tied, the conditionality attached to it, and hence its effectiveness. The end of the Cold War, by altering foreign policy objectives, has brought major changes also in aid objectives (OECD 1990). Accordingly, donors now find it less expedient to overlook economic mismanagement and poor governance by recipient countries.

Although it is difficult unambiguously to identify donor objectives (not least because of the multiplicity of ministries responsible for individual donor programs),[11] among the most prominent publicly stated ones are the following: reduced poverty; human development; environmental protection; reduced military spending; efficient economic management;

Table 5-2 Average tariffs and nontariff barriers for aid-receiving countries in all OECD markets

Exporting country	*1988–89 value of OECD imports (billions of U.S. dollars)*[a]	*Average OECD tariff (percent)*[b]	*Share of imports covered by nontariff measures (percent)*[c]
Bangladesh	1.0	6.9	80.5
China	31.8	5.4	43.4
Dominican Republic	1.8	9.9	38.3
Haiti[d]	0.4	11.2	16.7
Hungary	3.3	2.9	57.4
India	9.4	2.3	49.2
Jamaica	0.9	6.2	43.7
Korea, Republic of	43.4	7.1	37.1
Malaysia	12.9	2.2	40.8
Pakistan	2.7	3.5	65.6
Philippines	6.6	5.7	35.9
Poland	4.8	2.5	50.8
Sri Lanka	1.0	8.3	63.9
Thailand	11.4	3.3	51.4

a. Imports of all OECD countries except Turkey.
b. The trade-weighted average of the MFN, GSP, Lomé Convention, or other preferential tariff actually applied to imports.
c. Some products are covered by multiple forms of NTBS.
d. Designated by the United Nations as one of the "least developed" countries.
Source: World Bank, UNCTAD, and SMART database.

private enterprise development; enhancement of the role of women; good governance and democratic government; and the observance of human rights and the rule of law.

A recent example is the 1992 White Paper on Japanese ODA released by Japan's Ministry of Foreign Affairs in October 1992. The report states that Japan's post-Cold War ODA should play a more active role in "promoting democracy, human rights, and world peace" as well as in addressing "global environmental issues." The White Paper listed examples of the application of the ODA guidelines adopted in April 1991 by the government. These guidelines necessitated full consideration of trends in military expenditure and the democratization process in the recipient countries. Kenya and Malawi were cited as examples where the Japanese government refrained from pledging new aid at international donor meetings; Indonesia and Thailand were cases where Japan, together with other nations, expressed concern over antidemocratic incidents. In August 1991 Germany similarly announced that its 1992 foreign aid budget would reflect a new policy of linking foreign aid to recipient military expenditures.

Many donors now recognize the importance of support for environmental protection to promote sustainable development. Increasingly, they are viewing these needs as a legitimate call on aid budgets. Additionally, the role of aid in supporting economic reforms and stabilization has been complemented by official nonconcessional finance, both multilateral and bilateral.

A recent study (Hewitt and Killick 1992) of major donors indicated that aid objectives had proliferated and grown more diffuse in recent years. Of the ten most commonly articulated donor aid objectives, more than half are considered non-high priority by more than half the major donors whereas three—efficient economic management, environmental protection, and observance of human rights and the rule of law—command widespread support. The common consistency and feasibility of these objectives will be an important determinant of the effectiveness of aid in coming years.

Policy implications

Aid at the end of the Cold War needs rethinking as to its rationale and needs reworking as to its adequacy and quality. Donor countries should explore new ways to augment the slow growth in aid flows of recent years, should ensure that available aid is concentrated on the poorest countries and on exceptional needs in support of reform, and should reduce tying, which is a form of protectionism. For some recipient countries a better alternative to more aid is more trade. For recipient developing countries the stark message is: show a capacity to use aid effectively—through both sound economic policy and effective governance—or risk losing it.

141

Table 5-3 Estimated effects of trade barrier liberalization in major OECD markets on selected aid-receiving countries' exports

	Estimated effects of removal of trade barriers value (millions of U.S. dollars)		*Projected increase in exports as a percent of*	
Aid-receiving country	*Total*	*Percentage increase*	*1991 debt service*	*1991 ODA assistance*
Bangladesh	985	104	168	46
China	12,313	41	146	568
Dominican Republic	1,712	95	632	--
Haiti[a]	421	100	—	214
Hungary	581	22	14	—
India	3,123	35	42	188
Jamaica	555	62	79	282
Korea, Republic of	18,006	44	298	—
Malaysia	1,943	16	59	423
Pakistan	1,492	58	75	126
Philippines	2,820	44	82	229
Poland	1,725	37	172	—
Sri Lanka	1,016	105	236	430
Thailand	4,613	43	93	623

— Not available.

a. The projected export expansion is more than ten times the 1991 value of debt service of ODA assistance.

Sources: Debt service statistics drawn from the World Bank 1992c; net ODA assistance from OECD 1992a, table 37. Figures include assistance from multilateral organizations and Arab countries.

Notes

1. Official Development Assistance consists of flows to developing countries and multilateral institutions undertaken by the official sector, with the main objective of promoting economic development and welfare and with a concessional grant element of at least 25 percent.

2. These figures exclude technical cooperation grants and apply to all donor aid, including ODA to high-income countries. Source: OECD/DAC.

3. Additional exceptional demands have also arisen because of the drought in Africa: for instance, in December 1992 Zimbabwe received a US$ 1.4 billion package, from donors coordinated by the World Bank, of largely concessional assistance.

4. Grants and concessional loans to some of the reforming socialist economies are not classified as ODA. Nevertheless, the concern remains that they may be funded out of diverted ODA.

5. Included under this umbrella are nonconcessional bilateral loans disbursed in conjunction with IMF programs and untied cofinancing with World Bank structural adjustment loans.

6. For net ODA excluding technical cooperation grants. Including those grants, the extra requirement would be 19 percent of 1991 net ODA.

7. Fourteen exporters were chosen to reflect the experience of countries at different stages of development; they include least developed countries such as Bangladesh and Haiti as well as more industrialized exporters such as Korea and Malaysia. Two Eastern European countries (Hungary and Poland) were added to assess the importance of OECD trade barriers that these (former) socialist countries face.

8. Due to major departures from the MFN principle, developing countries may have conflicting objectives relating to further Uruguay Round tariff reductions. For example, countries benefiting from the GSP or receiving Caribbean Basin Initiative or Lomé Convention preferences may have a strong incentive to ensure that MFN duties are not cut further since this would reduce current tariffs preferences and result in export earnings losses.

9. Numerous studies that estimated nominal equivalents for NTBs indicate that the protective effect is often many times that of current MFN tariffs.

10. Although estimates are subject to some margin of error, the World Bank-UNCTAD "Software for Market Analysis and Restrictions to Trade" (SMART) model was developed to permit order-of-magnitude projections of trade barrier effects (see World Bank 1992a, Appendix C for a description of SMART). The SMART projections incorporate the effects of tariffs as well as NTBs for which reliable ad valorem equivalents exist. For the present exercise, NTB nominal equivalents were drawn (primarily from Laird and Yeats 1990) for OECD imports of textiles, clothing, footwear, iron and steel, sugar, vegetable oils and fats, fish, and several agricultural products.

11. For instance, ministries for foreign affairs, finance, trade and industry, and economic planning.

WORLD BANK INFORMATION BRIEFS

IDA and the Tenth Replenishment

Some 3 billion people, or 60 percent of the world's population, live in the poorest countries. Yet many of these countries cannot afford to borrow at commercial rates to meet their minimum needs for foreign exchange in order to develop. The International Development Association (IDA), funded by donations by the governments of the world's richer countries, is the leading source of aid for these nations. IDA is an affiliate of the World Bank.

In December, 1992, 34 donor countries agreed to provide IDA with $18 billion to fund its aid operations for the three years beginning July 1, 1993. This funding is called the Tenth Replenishment (IDA10) because it is the tenth time donors have agreed to replenish IDA. Those funds, along with another $4 billion that is expected from repayments of earlier IDA credits to its borrowers, will make possible total new aid from IDA of $22 billion over the three years July 1, 1993-1996. This is about the same real amount as the Ninth Replenishment (IDA9), which covers the years July 1, 1990-1993.

IDA's Program

The donors agreed that during IDA10's life IDA should build on its emphases of poverty reduction, economic reform and sound management, and environmentally sustainable development.

Poverty Reduction: Sustainable poverty reduction is the central goal of IDA's assistance to recipient countries. IDA's approach to poverty reduction is twofold: 1) to support a pattern of economic growth which will provide efficient employment and income opportunities for the poor, avoiding subsidies for capital-intensive industry or damaging exploitation of natural resources; 2) to support investment in people -- in primary health, education, and nutrition -- to enable the poor to participate in economic growth. Investments in family planning and in increasing women's access to education are especially important .

IDA will strengthen this approach during IDA10. It will deepen its poverty analysis by completing poverty assessments (PAs) for all recipient countries -- with active government involvement in their preparation -- and it will expand the monitoring of progress in poverty reduction. Economic reform programs supported by IDA will include more specific poverty reduction measures. The share of lending to social sectors and for projects specifically targeted to reach poor people, which rose from 29 percent in IDA8 to nearly 40 percent in IDA9, will rise.

Recognizing the central role of women in development and their contribution to poverty reduction, more than half of new IDA operations include actions to assist women. This focus will sharpen, and support will increase for family planning and social services for women, in particular the education of girls. IDA lending for programs in population, health and nutrition tripled during IDA9, and will grow further during IDA10.

Economic Reform: A key prerequisite for sustained poverty reduction is sound economic management and growth. IDA's approach to helping countries restore sound growth combines policy reforms with strengthening institutions. About 30 IDA recipient countries are pursuing reform programs agreed with and supported by IDA. The reforms cover policies such as pricing, tariffs and trade, and interest rates and credit. Institutional strengthening includes raising the quality of public sector management, improving the civil service, and reforming banking systems and regulation.

This broad approach has been complemented by increasingly incorporating social safety nets into reform programs to protect the poor. Many reform programs supported by IDA include measures to raise spending on health and education for the poor.

IDA10 will stress other aspects of reform. Development funds are scarce, and an important part of IDA's support for economic reform is reviewing public expenditures. These reviews help governments focus on priority public investments and expenditures. When budgets are being cut it is especially important to protect essential social services, while delivering services to the poor more efficiently. Reform programs also need to be compatible with encouraging productive investment, and the bulk of IDA's lending will continue to be for investment. The IDA10 donors indicated as well that they expect that countries would ensure that public expenditures reflect development priorities and that non-development expenditures, including military expenditures, are reduced to the maximum extent feasible.

Sound growth will require a healthy private sector. Despite widespread policy reforms, investment remains low in many IDA countries. IDA lending for infrastructure will continue to be a key way to stimulate private investment, along with reforms of economic incentives and legal and regulatory systems. IDA is also conducting, and will report on, assessments of the private sector in IDA countries.

Good governance is also critical to implementing reform. Reform programs will stress more developing the accountability of public institutions, open economic policies and decision-making (which reduce corruption and waste), and a stable and predictable legal framework.

Environmental Sustainability: Poor countries already suffer from acute environmental problems, and rapid population growth is adding to the pressures. IDA's basic strategy for encouraging environmentally sustainable development was set out in the World Bank's *World Development Report 1992*. The first element--policies and programs for reducing poverty and improving economic efficiency--is at the core of IDA's work. The second element--environmentally-targeted policies, institutional change, and investments--is of growing importance. The principles of sustainable development are being incorporated into all aspects of IDA's assistance.

In the projects it supports, IDA began during IDA9 to require that recipient countries carry out Environmental Assessments (EAs) at an early stage of project design to ensure that alternative approaches are considered and that any potentially harmful impact is eliminated or adequately addressed. All projects are reviewed and classified according to the nature and extent of their potential environmental impact, and EAs are required where the potential impact is significant.

Prospective borrowers must make EAs available to groups in the country that may be affected by the project as well as to local non-governmental organizations (NGOs), and they must carry out consultations with these groups before projects are discussed by IDA's Board. This process will be refined during IDA10.

More broadly, IDA began during IDA9 to work with IDA countries to develop national Environmental Action Plans (EAPs). The plans identify a country's major environmental problems and a strategy and program for addressing them. In drawing up these plans, countries are encouraged to consult with NGOs to help build consensus on the content and implementation of the plans.

The countries that have already completed their EAPs are using them to help guide investments, raise funding for environmental projects, and improve national policies that affect the environment. IDA10 will continue the process and support the implementation of these plans.

IDA will give particular importance during IDA10 to sectors with a key impact on the environment. There is much potential for improving energy efficiency. There should be more use of environmentally sustainable energy strategies that minimize costs, looking at demand (especially energy conservation) and alternative supply sources (such as solar, biomass, and small hydro). IDA will similarly promote environmentally sustainable policies in other sectors, such as transportation, industry, urban rehabilitation, rural development, small enterprises, and water supply and conservation.

Recipients

During IDA10, IDA's assistance will continue to be restricted to countries which are poor, which cannot meet their foreign exchange needs from commercial sources, and which demonstrate that they can use the funds effectively. In allocating funds among countries which meet these criteria, IDA will continue to consider a country's size, economic performance, and efforts to reduce poverty.

IDA's funds will be stretched because nine extra countries became recipients during IAD9. The IDA10 donors therefore agreed that the more creditworthy recipients that were also able to borrow from the World Bank ("blend countries") should rely more on the Bank. IDA funds for these countries will be directed primarily to reducing poverty or promoting environmental sustainability. While funding from the Bank and IDA taken together will be more expensive for these countries, the agreement will conserve IDA resources. This will accomodate new recipients without seriously jeopardizing funding for countries without alternative financing. The share of IDA funding for blend countries is being reduced, therefore, from 40% in IDA9 to 30-35% in IDA10. The regional pattern of IDA10 lending is expected to be broadly similar to IDA-9. (Apr.1993)

The World Bank • 1818 H Street, N.W. • Washington, D.C. 20433 • (202) 473-1793 • Fax (202) 676-0578

DEVELOPMENT STRATEGIES

DEVELOPMENT STRATEGIES

"Hunger Issues and Possible Solutions: A New U.S. Program for International Development and Cooperation," Statement of Charles Sykes, Vice President of CARE, before the Committee on Agriculture/Subcommittee on Foreign Agriculture and Hunger, U.S. House of Representatives, April 29, 1993.

Kingsley, Thomas G., George E. Peterson and Jeffrey P. Telgarsky. "Urban Economies and National Development," Abstracts, Office of Housing and Urban Programs, U.S. Agency for International Development (USAID), January 1993.

Statement of Robert S. Gelbard, Principal Deputy Assistant of State for Inter-American Affairs, before the Committee of Foreign Affairs/Subcommittee on Western Hemisphere Affairs, U.S. House of Representatives, April 28, 1993.

Human Development Report 1993 (Overview), United Nations Development Programme (UNDP), 1993.

"Balance Sheet of Human Development--Developing Countries/Industrial Countries," Human Development Report 1993, United Nations Development Programme (UNDP), 1993.

"Highlights of Interventions at Meeting for 1994 International Conference on Population and Development," Population Headliners, Economic and Social Commission for Asia and the Pacific, United Nations Population Fund (UNFPA), June 4, 1993.

"Population and Development in Latin America and the Caribean," CEPAL News, United Nations Economic Commission for Latin America and the Caribbean (ECLAC), May 1993.

"IDB Expands Support for Women in Development," Inter-American Development Bank (IDB), March 8, 1993.

William, Paula. "Women and Forestry in Africa," Ecoforum, Environment Liaison Centre International, Global Coalition for Environment and Development, December 1992.

"Government Policies Rob Africans of Precious Drylands," World Bank News, The World Bank, May 27, 1993.

Falkenmark, Malin. "Regional Water Scarcity - A Widely Neglected Challenge," People & the Planet, Planet 21, United Nations Population Fund (UNFPA), the World Conservation Union and the International Planned Parenthood Federation, 1993.

"Nicaragua Requests OAS Assistance for Program to Strengthen Democratic Institutions," Organization of American States (OAS), March 30, 1993.

"Strengthening the Roots of Economic Reform," The IDB, Inter-American Development Bank (IDB), April 1993.

Icamina, Paul. "Threads of Common Knowledge," IDRC Reports, International Development Research Center (IDRC), April 1993.

Pace, William R. "The CSD - No Backpeddling Yet," The Network, The Centre for Our Common Future, February 1993.

"The Impact of AIDS on Sustainable Development," Monday Developments, InterAction, May 31, 1993.

Grant, James P. "Jumpstarting Development," Foreign Policy, Summer 1993.

Morrison, David C. "Whose Rights?" National Journal, June 26, 1993.

Statement of Robert S. Gelbard
Principal Deputy Assistant Secretary of State
for Inter-American Affairs
before the
Subcommittee on Western Hemisphere Affairs
House Committee on Foreign Affairs

April 28, 1993

Mr. Chairman, members of the Subcommittee, thank you for this opportunity to discuss our proposed foreign assistance budget for Latin America and the Caribbean.

If there is one message I hope you take from my statement and our budget proposals, it is this: Very often we have engaged in this hemisphere in periods of crisis, when the good options are few and the costs to us are high. Today we have a rare opportunity to engage in this hemisphere, using modest resources to help consolidate the progress that has been made in developing democratic government, sound economic policies and a more open trade and investment regime. Both we and our neighbors will benefit.

This year's request for Security Assistance is a transitional budget which reflects the exigencies of a changing world and our country's commitments to our allies and friends in the hemisphere. We have cut the overall levels of assistance substantially, while preserving our vital interests. And we are able to do all this while shifting resources to the critical areas of the former Soviet Union and Eastern Europe. For example, the total amount of Foreign

Military Financing in our hemisphere has gone from $61 million in FY 93 down to $53.9 million in FY 94. Economic Support Funds have dropped from $332.7 million in FY 93 to $256 million in FY 94. And International Military Education and Training has moved from $12.19 million spent in FY 93 down to a FY 94 request of $11.822 million.

Secretary Christopher has outlined three overarching goals that President Clinton set for U.S. foreign policy: revitalizing the American economy, modernizing our security structures, and encouraging democratic development. Our assistance budget fits these priorities. The budget's functional categories for FMF and ESF include regional security and defense cooperation, economic development, counternarcotics, democratic development, peacekeeping, and demining. IMET programs are designated under promotion of democracy and human rights, counternarcotics, regional stability and defense cooperation, and promoting professional military relationships.

History has shown that when Latin America and the Caribbean are troubled or impoverished, we suffer. When they are prosperous and stable, we benefit. When we invest time, money and effort to help neighboring democracies with their difficult problems, we invest in ourselves as well. When we ignore problems to our south, we also ignore our own needs and interests.

ABSTRACTS

PUBLICATIONS OF THE

OFFICE OF HOUSING AND URBAN PROGRAMS

JANUARY 1993

Urban Economies and National Development

George E. Peterson, Thomas G. Kingsley, and Jeffrey P. Telgarsky
The Urban Institute
Policy and Research Series, 80 pages
PN-ABI-305(English)OS3.00/PS10.40/MS1.75

This is a report about "urban economic development." The term invites many interpretations. It is perhaps most commonly used in the local sense. When city leaders speak of formulating an urban economic development strategy, their goal is to achieve faster economic growth and generation of jobs for their own community. At the national level, urban economic development policies are often understood to mean those that will produce more growth for the urban sector, or those that will favor urban activities at the expense of rural activities.

From the perspective of a Chamber of Commerce, mayor, or League of Cities, this focus is understandable. To them, in the short run, it may not matter greatly how urban growth is generated, or whether is inefficiently diverted from other locations through public policy.

That is not the perspective of this report. Our concern lies with the contribution urban areas can make to national economic growth. If this goal is best achieved by having major urban areas grow more slowly or assume more of the burden of their own financing against the wishes of local tax payers and businesses, we argue that the resulting strategy is still desirable national policy and desirable urban development policy. There should be no presumption that urban policy must be pro-urban in the narrow sense of trying to make cities better off relative to the rest of the nation.

One of the most important lessons from the experience reviewed here is the futility of talking about rural and urban development as if they were opposing alternatives. Rapid urbanization does go hand in hand with economic growth, at least in the intermediate stages of economic development. Attempts to prevent urbanization, by prohibiting internal migration or freezing the number of business establishments in cities, will almost always inflict high economic costs. But this in no way implies abandoning fruitful rural development themes in favor of a pro-urban stance. Rather, governments and international donors should strive for policies that enhance market efficiency across all locations, without trying to construct a specifically "rural" or "urban" policy program.

This report attempts to bridge the gap between "urban policy" and "national economic policy," and between urban development specialists and those making or advising on macroeconomic decisions.

The report will be useful, first of all, to those who design urban housing programs, on infrastructure projects, and local small business policies and programs. Too often, these programs are designed as if they stood alone, without reference to a national economy, and as if their success could be judged on project terms and not by their ability to contribute to national economic development. Local government officials, of course, should be myopic to some degree; their effectiveness rests on their ability to think first and most vigorously about the local community. However, external advisors, whether in state or national government or international aid agencies, have the obligation to assess the impacts of local action on the entire country. And even local officials must take into account the national market realities that constrain their choices. The report serves as introductory guide to the best strategies to use in moving from a local perspective on urban programs to a national market perspective.

The report will also be useful to those who design or recommend national economic policies. Because cities contain such a high concentration of economic activity and politically influential households, the policies adopted toward them have great potential for generating gains or losses in national economic efficiency. Not every national growth strategy needs to have a parallel "urban development strategy." But many of the policy prescriptions contained in the structural adjustment programs, are played out in cities. Those who design and try to implement these programs need an appreciation of the specifically urban institutions and urban markets in which abstract plans get translated into reality. It is one thing for a central government official (or international advisor) to conclude that, because central government budgets are unbalanced, more responsibility for revenue raising ought to be delegated to local government; or that housing and local infrastructure investments should pay for themselves through higher fees, charges and interest rates. It is quite another thing for a local official to implement this policy change. Besides the political opposition to be encountered, the new policies are likely to disrupt local markets in ways that central government officials, with their macroeconomic perspective, have not anticipated. Many national economic reform programs have failed, not because they did not make sense at the national scale, but because they were incompatible with the way institutions and markets operate at the local level. This report should help convince national policymakers of the relevance to national development objectives of such "nuts and bolts" matters as urban land use regulations, housing mortgage finance systems, and local tax incentives to attract industry.

HUNGER ISSUES AND POSSIBLE SOLUTIONS:
A NEW U.S. PROGRAM FOR INTERNATIONAL
DEVELOPMENT AND COOPERATION

before the

SUBCOMMITTEE ON FOREIGN AGRICULTURE AND HUNGER

of the

HOUSE AGRICULTURE COMMITTEE

APRIL 29, 1993

BY

CHARLES SYKES, VICE-PRESIDENT OF CARE

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, THANK YOU FOR CALLING THIS TIMELY HEARING AND THANK YOU FOR INVITING NON-GOVERNMENTAL ORGANIZATIONS LIKE CARE TO SHARE THEIR EXPERIENCE AND RECOMMENDATIONS WITH THOSE OF YOU WHO BEAR RESPONSIBILITY, WITH THE EXECUTIVE BRANCH, FOR CRAFTING EFFECTIVE U.S. POLICY ON OVERSEAS DEVELOPMENT AND HUMANITARIAN ASSISTANCE.

TWENTY OF MY THIRTY-TWO YEARS WITH CARE INCLUDED OVERSEAS SERVICE, ADMINISTERING BOTH DEVELOPMENT AND RELIEF PROGRAMS IN THE FIELD, INCLUDING FOOD AID PROGRAMS, IN INDIA, PAKISTAN, EGYPT, POLAND AND THE DOMINICAN REPUBLIC.

HISTORICALLY, THE UNITED STATES HAS PLAYED A SIGNIFICANT ROLE IN MEETING THE FOOD NEEDS OF VULNERABLE GROUPS IN POOR FOOD INSECURE DEVELOPING COUNTRIES THAT WERE NOT ABLE TO GROW OR COMMERICIALLY PURCHASE OR IMPORT ADEQUATE FOOD TO MEET THE BASIC FOOD NEEDS OF THEIR PEOPLE TO LIVE HEALTHY AND PRODUCTIVE LIVES.

FOOD AID FROM DONOR COUNTRIES LIKE THE U.S. WAS REGARDED AS A SHORT TERM PALLIATIVE AND NOT A LONG TERM RESPONSE TO THE CHALLENGE OF HOW WE ENGAGE THE POOR IN THE PROCESS OF SUSTAINABLE ECONOMIC DEVELOPMENT. TO THE EXTENT THAT FOOD AID CAN BECOME A POWERFUL INSTRUMENT AND FORCE FOR IMPROVING THE HEALTH AND PRODUCTIVE CAPACITIES OF POOR PEOPLE, IT HAS A VALUABLE ROLE TO PLAY IN INTERNATIONAL DEVELOPMENT, PARTICULARLY GLOBAL AGRICULTURAL DEVELOPMENT. FOR EXAMPLE, THE POTENTIAL FOR EXPANDING U.S. AGRICULTURAL EXPORTS WILL LARGELY DEPEND ON INCREASED DEMAND FROM DEVELOPING COUNTRIES WHICH IN TURN DEPENDS NOT ON INCREASED DEMAND OF ELITES, BUT STEADY IMPROVEMENT OF THE ECONOMIC STATUS OF THE POOR.

THE ECONOMIC BENEFITS OF THIS PROGRAM ARE INDEED QUITE SIGNIFICANT TO THE UNITED STATES. 75% OF U.S. FOOD AID MUST BE DELIVERED ON U.S.FLAG VESSELS. OTHER SUBSTANTIAL ECONOMIC ACTIVITY GENERATED BY THIS PROGRAM IN THE UNITED STATES ACCRUE TO U.S. FOOD PROCESSORS, RAIL AND BARGE TRANSPORTERS, BAG MANUFACTURERS AND STEVEDORE UNIONS.

THE NON-GOVERNMENTAL ORGANIZATIONS [NGOS], LIKE CARE, CATHOLIC RELIEF SERVICES, THE NATIONAL COOPERATIVE BUSINESS ASSOCIATION AND THE WORLD FOOD PROGRAM OF THE UNITED NATIONS OBTAIN FOOD COMMODITIES TO CARRY OUT PROGRAMS UNDER TITLE II-THE EMERGENCY AND PRIVATE ASSISTANCE PROGRAMS. IT IS THE EXPERIENCE OF THE NON-GOVERNMENTAL ORGANIZATIONS OR NGOS WHICH I WOULD LIKE TO SHARE WITH YOU TODAY.

WHAT DO WE KNOW AND WHAT HAVE WE LEARNED ABOUT THE ROLE OF FOOD AID IN PROMOTING SUSTAINABLE DEVELOPMENT, WHAT ARE ITS SHORTCOMINGS AND FINALLY WHAT ARE THE CRITICAL POLICY CONCERNS WHICH SHOULD BE ADDRESSED BY THIS COMMITTEE IN THE DECADE OF THE 1990S?

WHAT DO WE KNOW AND WHAT HAVE WE LEARNED ABOUT FOOD AID SINCE ITS INCEPTION?:

IN THE LATE 1970S SOME POLEMICISTS RAISED SERIOUS DOUBTS ABOUT THE USEFULNESS OF FOOD AID AS AN EFFECTIVE RESOURCE EXCEPT IN THE CASE OF EMERGENCIES AND LIFE THREATENING SITUATIONS. THE PAUCITY OF WELL DOCUMENTED FIELD EVALUATIONS ON FOOD AID SUPPORTED PROGRAMS AND PROJECTS RAISED DOUBTS IN THE MINDS OF THE PUBLIC AND POLICY MAKERS ALIKE. WHAT HAVE WE LEARNED ABOUT FOOD AID OVER THE LAST DECADE WITH RESPECT TO ITS UTILITY AS A DEVELOPMENT RESOURCE?

*WE'VE LEARNED THAT A VERY MODEST DAILY RATION PER STUDENT OF 100 GRAMS OF FOOD SERVED AT POOR RURAL AND URBAN PRIMARY SCHOOLS IN DEVELOPING COUNTRIES HAS A SIGNIFICANT POSITIVE IMPACT ON ENROLLMENT, ATTENDANCE AND RETENTION, PARTICULARLY AMONGST GIRLS AND THAT FEMALE LITERACY HAS A DIRECT LONG TERM POSITIVE RELATIONSHIP WITH IMPROVED FAMILY NUTRITION AND HEALTH, AGRICULTURAL PRODUCTION AND FERTILITY.

WE'VE LEARNED THAT A MODEST 90 GRAM DAILY SUPPLEMENT OF FOOD FOR PRE-SCHOOL CHILDREN IN INDIA, WHEN COMBINED WITH IMMUNIZATION AND ANTENATAL CARE, CAN HAVE A DRAMATIC EFFECT IN REDUCING CHILD MORTALITY. IN SUCH PROGRAMS, THERE IS EVIDENCE OF SIGNIFICANT DECLINE IN SEVERE AND MODERATE MALNUTRITION. FOR EXAMPLE, IN INDIA SEVERE MALNUTRITION DROPPED FROM 20.5 PER CENT TO 6.6 PER CENT FROM 1976 TO 1990 IN INDIA'S INTEGRATED CHILD DEVELOPMENT SERVICES PROGRAM.

*WE'VE LEARNED THAT WELL DESIGNED FOOD-FOR-WORK PROJECTS HAVE A DIRECT POSITIVE IMPACT ON RURAL EMPLOYMENT, INCOME AND FOOD CONSUMPTION LEVELS WHILE THE PROJECTS THEMSELVES, SUCH AS THE CONSTRUCTION AND MAINTENANCE OF VILLAGE-TO-MARKET ROADS, IRRIGATION CANALS AND GRAIN STORAGE FACILITIES CREATE NEW AND LASTING JOBS WHICH STRENGTHEN RURAL AGRICULTURAL ECONOMIES.

*WE'VE LEARNED THAT SLUM IMPROVEMENT FOOD-FOR-WORK PROJECTS HAVE NOT ONLY HELPED PROTECT LOW INCOME URBAN DWELLERS FROM BASIC COMMODITY PRICE INCREASES DURING PERIODS OF RAPID INFLATION AND STRUCTURAL ADJUSTMENT. MORE IMPORTANTLY, SUCH PROJECTS HAVE IMPROVED THE LIVING AND HEALTH CONDITIONS IN THESE BLIGHTED COMMUNITIES AND STIMULATED COMMUNITY DEVELOPMENT ACTIONS WHICH WENT FAR BEYOND THE ORIGINAL OBJECTIVES OF THE PROJECTS.

*WE'VE LEARNED THAT WOMEN PLAY A CRITICAL ROLE IN THE SUCCESS OF FOOD AID SUPPORTED PROJECTS-SUCH ROLES AS ORGANIZERS, FOOD PREPARERS, TEACHERS, HEALTH PROMOTERS AND WORKERS AND AS FOOD PRODUCERS.

*WE'VE LEARNED THAT FOOD AID CAN HELP PROMOTE BOTH FOOD AND NUTRITION SECURITY AND THAT FOR MOST OF THE WORLD'S POPULATION, FOOD AND NUTRITION SECURITY [INCLUDING SAFE DRINKING WATER] ARE THE MOST IMPORTANT AND FUNDAMENTAL ASPECTS OF NATIONAL AND GLOBAL SECURITY.

*WE'VE LEARNED IN INDIA THAT FOOD AID CAN CONTRIBUTE POSITIVELY TO MACRO-FOOD SECURITY AND BASIC COMMODITY PRICE STABILITY WITHOUT HAVING ANY DISINCENTIVE EFFECTS ON LOCAL PRODUCTION.

*WE'VE LEARNED THAT THE MORE CAREFULLY DESIGNED, WELL MANAGED AND PURPOSEFUL PROJECTS OF NGOS AND THE WORLD FOOD PROGRAM ARE MUCH MORE LIKELY TO REACH VULNERABLE GROUPS IN DEVELOPING COUNTRIES THAN ANY OTHER TYPES OF FOOD AID PROGRAMS.

*WE'VE LEARNED THAT NON-EMERGENCY FOOD AID IS FAR MORE EFFECTIVE WHEN FULLY INTEGRATED INTO PROJECTS WHICH HAVE SIGNIFICANT CAPITAL BUDGETS AND WELL DEFINED OBJECTIVES-NOT IN ISOLATION FROM OTHER INPUTS.

*WITH RESPECT TO EMERGENCY PROGRAMS, THE NGOS HAVE LEARNED THAT FOOD AID IS OFTEN THE ONLY RESOURCE WHICH CAN EFFECTIVELY RESPOND TO HUMAN NEEDS IN CASES OF DROUGHT AND FAMINE. IN SUCH PROGRAMS, THE FOOD AID RATIONS ARE SUBSTANTIALLY LARGER BECAUSE IT IS FREQUENTLY THE ONLY FOOD AVAILABLE TO PEOPLE. FOR EXAMPLE IN SOMALIA, THE DAILY RATION PER ADULT IS 400 GRAMS OF GRAIN WHILE CHILDREN RECEIVE SPECIAL HIGH PROTEIN, CEREAL-BASED PROCESSED OF FOODS.

THE NEWEST FOOD AID MODALITY, AUTHORIZED BY THIS COMMITTEE IN 1990, FOR USE BY NGOS IS MONETIZATION [SALE FOR LOCAL CURRENCY], WITH THE LOCAL CURRENCY BEING USED TO MEET THE FOOD SECURITY OBJECTIVES OF PUBLIC LAW 480. THE CURRENCY GENERATED BY MONETIZATION IS USED FOR TWO PURPOSES, [1] TO COVER INTERNAL TRANSPORT, STORAGE AND TRANSPORT COSTS OTHERWISE NOT COVERED BY RECIPIENT COUNTRIES AND [2] TO IMPLEMENT INCOME GENERATING, NUTRITION AND HEALTH, COMMUNITY AND COOPERATIVE DEVELOPMENT AND OTHER DEVELOPMENT PROJECTS AND ACTIVITIES WITHIN RECIPIENT COUNTRIES.

THE SHORTCOMINGS AND DANGERS OF FOOD AID:

*FOOD AID SUPPORTED PROGRAMS AND PROJECTS ARE MANAGEMENT INTENSIVE; THE SHIPPING, TIMING, PORT CLEARANCE AND IN -COUNTRY ACCOUNTING RESPONSIBILITIES AND REQUIREMENTS ARE MUCH MORE DEMANDING THAN OTHER FORMS OF INTERNATIONAL ASSISTANCE.

*FOOD AID CAN BE A DANGEROUS RESOURCE TO MANAGE IN THAT IT IS FUNGIBLE AND HAS THE POTENTIAL FOR SPOILAGE AND DAMAGE.

*FOOD AID IS REGARDED BY MANY DEVELOPMENT PROFESSIONALS AS A RESOURCE OF SECOND CHOICE AND MANY ARE FRIGHTENED AWAY FROM USING IT BECAUSE OF THE STRINGENT AUDIT REQUIREMENTS ASSOCIATED WITH FOOD AID AND THE DANGERS ALLUDED TO ABOVE.

*THE GENERALLY NEGATIVE ATTITUDE AND VIEW OF FOOD AID EFFECTS DECISION MAKING IN THE AGENCIES RESPONSIBLE FOR ITS OVERSIGHT AND MANAGEMENT.

*FOOD AID CAN HAVE A DISINCENTIVE EFFECT ON LOCAL AGRICULTURE BY DEPRESSING THE PRICES OF LOCALLY PRODUCED FOODS, PARTICULARLY THE ARRIVAL AND DISTRIBUTION OF LARGE FOOD AID SHIPMENTS AT THE TIME OF CEREAL HARVEST IN DEVELOPING COUNTRIES AND DURING THE TRANSITION FROM EMERGENCY TO RECONSTRUCTION AND REHABILITATION PROGRAMS.

FROM OUR EXPERIENCE WITH FOOD AID, WE CAN CLASSIFY FOOD AID PROGRAMS INTO SEVERAL CATEGORIES:

EDUCATION AND COGNITIVE DEVELOPMENT: IMPROVING THE VALUE AND POTENTIAL OF HUMAN CAPITAL, I.E., PROGRAMS WHICH HAVE LITERACY, WITH ITS HIGH BUT DEFERRED RATE OF RETURN, AS THEIR MAJOR OBJECTIVE.

INFRASTRUCTURE IMPROVEMENT: THE UPGRADING AND MAINTENANCE OF RURAL FEEDER ROADS, THE CONSTRUCTION OF MINOR IRRIGATION WORKS, THE REFORESTING AND CARE OF FRAGILE SOILS, LAND RECLAMATION AND DRAINAGE AND WASTE DISPOSAL IN URBAN SLUMS ARE BUT A FEW EXAMPLES OF PROGRAMS IN WHICH FOOD AID CAN SUBSTANTIALLY REDUCE CAPITAL COSTS OF SUSTAINABLE DEVELOPMENT PROJECTS.

CHILD SURVIVAL AND POPULATION: FOOD AID, WHEN FULLY INTEGRATED WITH LOW-COST HEALTH COMPONENTS, E.G., IMMUNIZATION, ORAL REHYDRATION, BREAST FEEDING AND GROWTH MONITORING, CAN BE HIGHLY EFFECTIVE IN ENABLING CHILDREN TO NOT ONLY SURVIVE BUT ALSO REALIZE THEIR FULL GENETIC POTENTIAL. WHEN COMBINED WITH FAMILY PLANNING EDUCATION AND SERVICES, THESE PROGRAMS CAN HAVE DRAMATIC IMPACT IN REDUCING BIRTH RATES.

EMERGENCIES: DURING THE PAST TWO YEARS, EMERGENCIES HAVE OCCURRED WITH GREATER FREQUENCY AND INTENSITY. IN MOST CASES, BUT ESPECIALLY IN FAMINE SITUATIONS, FOOD AID IS AN INDISPENSABLE RESOURCE TO COMBAT ACUTE HUNGER AND STARVATION. IN RECENT YEARS, EMERGENCIES HAVE ALSO BEEN ACCOMPANIED BY SO CALLED "LOW INTENSITY" WARS AND THE COLLAPSE OF CIVIL AUTHORITY, MAKING THE WORK OF NGOS AND INTERNATIONAL ORGANIZATIONS A GREAT DEAL MORE RISKY..

INCOME GENERATING, COMMUNITY AND COOPERATIVE DEVELOPMENT PROGRAMS SUPPORTED BY MONETIZATION: IN ADDITION TO ADDING TO THE NET AVAILABILITY OF SCARCE ESSENTIAL FOOD COMMODITIES IN FOOD INSECURE COUNTRIES, MONETIZATION ALLOWS NGOS TO GENERATE THE CAPITAL NECESSARY TO ADDRESS THE ROOT CAUSES OF FOOD INSECURITY BY INCREASING THE PRODUCTION AND INCOMES OF POOR AND VULNERABLE GROUPS AND ENCOURAGING THE FORMATION OF COMMUNITY AND COOPERATIVE GROUPS.

*OUR OBSERVATIONS OF THE CONCESSIONAL SALES PROGRAMS OF THE U.S. GOVERNMENT AND OTHER OECD COUNTRIES, ARE THAT THERE IS CONSIDERABLE SCOPE FOR IMPROVING THE TARGETING OF ECONOMICALLY AND NUTRITIONALLY VULNERABLE GROUPS.

KEY POLICY CONCERNS DESERVING THE ATTENTION OF THE HOUSE AGRICULTURE COMMITTEE DURING THE 103RD CONGRESS AND IN PREPARATION FOR THE PUBLIC LAW 480/FARM BILL REAUTHORIZATION IN THE 104TH CONGRESS:

1. THE INTEGRATION OF FOOD AID WITH THE FOREIGN ASSISTANCE ACT. AS THE FOREIGN ASSISTANCE ACT IS REVISED, THE 103RD CONGRESS SHOULD CONSIDER INTEGRATION OF FOOD AID AND DEVELOPMENT ASSISTANCE POLICIES, AND THE COORDINATION OF THESE PROGRAMS WHERE APPROPRIATE, TO ACHIEVE THE GOALS OF FOOD SECURITY, POVERTY REDUCTION AND ENHANCED OPPORTUNITIES FOR ECONOMICALLY DISADVANTAGED PEOPLE TO PARTICIPATE IN THE DEVELOPMENT PROCESS.

THE HOUSE AGRICULTURE AND FOREIGN AFFAIRS COMMITTEES SHARE JURISDICTION OVER PUBLIC LAW 480. APPROXIMATELY 10% OF OUR INTERNATIONAL ASSISTANCE IS IN THE FORM OF FOOD AID. THERE IS NO MENTION OR CROSS REFERENCE IN EITHER THE FOREIGN ASSISTANCE OR P.L. 480 AUTHORIZATION LEGISLATION WHICH SEEKS TO INTEGRATE THE DEVELOPMENT AND HUMANITARIAN RESOURCES MADE AVAILABLE IN THE FOREIGN ASSISTANCE ACT AND THE FOOD AID RESOURCES MADE AVAILABLE UNDER PUBLIC LAW 480. A JOINT POLICY WORKING GROUP, WITH MEMBERSHIP FROM BOTH COMMITTEES, SHOULD BE FORMED TO DEVELOP A COMMON POLICY STATEMENT FOR INCLUSION IN FUTURE INTERNATIONAL ASSISTANCE AND PUBLIC LAW 480 AUTHORIZATION BILLS. THE NGOS ARE PREPARED WORK WITH THE COMMITTEE IN THIS EFFORT.

2. CREATION OF A INTERNATIONAL CEREALS RESERVE TO PROTECT AGAINST GLOBAL FAMINE AND DROUGHT, WITH CONTRIBUTIONS FROM THE PRINCIPAL GRAIN PRODUCING COUNTRIES.

THIS IS NOT A NEW IDEA. IN 1979-80, THE SENIOR MEMBERS OF THIS COMMITTEE WILL REMEMBER THEY SET UP A U.S. WHEAT RESERVE OF 4 MILLION METRIC TONS OF WHICH 300,000 METRIC TONS COULD BE PROGRAMMED IN ANY FISCAL YEAR, THROUGH NON-GOVERNMENTAL ORGANIZATIONS, TO MEET EMERGENCY NEEDS IN DEVELOPING COUNTRIES. THE INTERNATIONAL CEREALS RESERVE WOULD BE ADMINISTERED BY THE DONOR COUNTRIES TO THE RESERVE, INCLUDING DEVELOPING COUNTRIES. WE HOPE THAT THE COMMITTEE WILL RENEW ITS EFFORTS TO ESTABLISH AN INTERNATIONAL CEREALS RESERVE IN THIS SESSION OF CONGRESS.

3. REMEDIES FOR CHRONIC AND ACUTE FOOD INSECURITY. THE 103RD CONGRESS SHOULD CONSIDER POLICY AND PROCEDURAL OPTIONS FOR RESPONDING TO ACUTE SHORTAGES AND EMERGENCIES, WITHOUT DISRUPTING OTHER PROGRAMS OF ASSISTANCE THAT TARGET AREAS OF CHRONIC FOOD INSECURITY.

TITLE II OF PUBLIC LAW 480 IS ENTITLED "EMERGENCY AND PRIVATE ASSISTANCE PROGRAMS" FOR GOOD REASON. ESSENTIALLY THIS TITLE DEMONSTRATES CONGRESS' AND THE EXECUTIVE BRANCH'S HISTORIC RELATIONSHIP WITH THE UNITED STATES NON-GOVERNMENTAL ORGANIZATIONS AND THE WORLD FOOD PROGRAM IN RESPONDING TO GLOBAL FOOD SECURITY, HUMANITARIAN AND DEVELOPMENT PROGRAMS IN THE POOREST COUNTRIES OF THE WORLD. GLOBAL FOOD AID NEEDS ARE EXPECTED TO DOUBLE DURING THIS DECADE.

THE MAGNITUDE AND FREQUENCY OF ACUTE EMERGENCIES ARE MUCH GREATER THAN ANY OF US WOULD HAVE ANTICIPATED-WITNESS THE SOUTHERN AFRICAN DROUGHT, SOMALIA, SUDAN, MOZAMBIQUE, ANGOLA, BOSNIA, BANGLADESH, HAITI EMERGENCIES. ON THE OTHER HAND THERE ARE MANY NON-EMERGENCY PROGRAMS WHERE CHRONIC MALNUTRITION STILL CLAIM THE LIVES OF SOME 40,000 CHILDREN DAILY.

DURING THIS FISCAL YEAR, TITLE II CALLS FOR THE PROGRAMMING A MINIMUM OF 1.5 MILLION METRIC TONS FOR NON-EMERGENCY PROGRAMS, WITH 475,000 METRIC TONS SET ASIDE FOR EMERGENCIES. DURING PREVIOUS YEARS, WE HAVE BEEN ABLE TO DRAW ON OTHER AUTHORITIES AND POOLS OF RESOURCES SUCH SECTION 416 COMMODITIES, HELD BY THE COMMODITY CREDIT COOPERATION [CCC] AND MADE AVAILABLE BY THE SECRETARY OF AGRICULTURE, TO MEET EMERGENCY AND DOMESTIC AND OVERSEAS NEEDS. HOWEVER, THE POOL OF COMMODITIES AVAILABLE FROM USDA UNDER SECTION 416 [B] HAS DIMINISHED AND VARIES IN COMPOSITION FROM YEAR TO YEAR. IN ADDITION TO SECTION 416 [B], THERE ARE OTHER OPTIONS AVAILABLE TO POLICY MAKERS SUCH AS TITLE III OR FOR EXTREME EMERGENCIES, EMERGENCY SUPPLEMENTAL APPROPRIATIONS. MOREOVER, COORDINATION WITH OTHER DONOR COUNTRIES IS ESSENTIAL FOR TIMELY AND APPROPRIATE RESPONSE TO DISASTERS.

4. IN DECEMBER OF 1992, THE UNITED STATES WAS ONE OF 159 NATIONS TO SIGN THE WORLD DECLARATION ON NUTRITION AND THE PLAN OF ACTION AT THE INTERNATIONAL CONFERENCE ON NUTRITION IN ROME; BOTH DOCUMENTS HAVE NATIONAL AND INTERNATIONAL POLICY IMPLICATIONS FOR THE UNITED STATES. WE RECOMMEND THAT THE COMMITTEE SCHEDULE HEARINGS ON IMPLEMENTATING BOTH THE DECLARATION AND THE NATIONAL/INTERNATIONAL PLANS OF ACTION EARLY IN THIS SESSION.

THESE ARE THE POLICY ISSUES WE WOULD LIKE TO TABLE FOR THE COMMITTEE'S CONSIDERATION DURING THE 103RD CONGRESS. WE ARE PREPARED TO WORK CLOSELY WITH THE COMMITTEE AND THE ADMINISTRATION IN HELPING TO CRAFT AND IMPLEMENT THESE POLICY OPTIONS.

THE NGOS ARE AT THE DISPOSAL OF THE NEW MEMBERS OF COMMITTEE TO DISCUSS FURTHER THE FIELD OPERATIONS OF THE PROGRAM AND THE POLICY ISSUES WHICH EFFECT FOOD AID PROGRAMS MANAGED BY NGOS IN THE FIELD.

Overview

HUMAN DEVELOPMENT REPORT 1993

Published
for the United Nations
Development Programme
(UNDP)

People today have an impatient urge to participate in the events and processes that shape their lives

People's participation is becoming the central issue of our time. The democratic transition in many developing countries, the collapse of many socialist regimes, and the worldwide emergence of people's organizations—these are all part of a historic change, not just isolated events.

People today have an urge—an impatient urge—to participate in the events and processes that shape their lives. And that impatience brings many dangers and opportunities. It can dissolve into anarchy, ethnic violence or social disintegration. But if properly nurtured in a responsive national and global framework, it can also become a source of tremendous vitality and innovation for the creation of new and more just societies.

The dangers arise as the irresistible urge for participation clashes with inflexible systems. Although the achievements in human development have been significant during the past three decades, the reality is continuing exclusion. More than a billion of the world's people still languish in absolute poverty, and the poorest fifth find that the richest fifth enjoy more than 150 times their income. Women still earn only half as much as men—and despite constituting more than half the votes, have great difficulty securing even 10% representation in parliaments. Rural people in developing countries still receive less than half the income opportunities and social services available to their urban counterparts. Many ethnic minorities still live like a separate nation within their own countries. And political and economic democracy is still a reluctant process in several countries. Our world is still a world of difference.

But many new windows of opportunity are opening. Global military spending is beginning to decline for the first time since the Second World War. The cold war in East-West relations is over, and there is a good chance of phasing it out in the developing world. The ideological battles of the past are being replaced by a more pragmatic partnership between market efficiency and social compassion. The rising environmental threat is reminding humanity of both its vulnerability and its compulsion for common survival on a fragile planet. People are beginning to move to centre stage in national and global dialogues. There are times in history when the human voice has spoken out with surprising force. These past few years have marked just such a watershed.

Humanity must choose between these dangers and opportunities. But there really is no choice, for the future of our planet depends on grasping the opportunities.

Many old concepts must now be radically revised. Security should be reinterpreted as security for people, not security for land. Development must be woven around people, not people around development—and it should empower individuals and groups rather than disempower them. And development cooperation should focus directly on people, not just on nation-states.

Many of the old institutions of civil society need to be rebuilt—and many new ones created. And because future conflicts may well be between people rather than between states, national and international institutions will need to accommodate much more diversity and difference—and to open many more avenues for constructive participation.

All this will take time, for participation is a process, not an event. It will proceed at different speeds for different countries and

In order to build democracy and defend human rights, we need to provide aid to develop democratic institutions. Democracy begins at the ballot box, but it doesn't end there. it depends on effective and independent legislatures; fair and efficient justice systems; police and military forces that know their role in a democracy and respect it; news media that report the bad as well as the good; political parties, labor unions, business associations, educational and activist groups to collect and transmit the voice of the people. Our assistance programs are designed to respond to these needs, with training for lawmakers, judges, court officials, police, journalists, those in the military and nongovernmental organizations -- and even election officials.

We also need to support the popularly elected leaders of Latin America and the Caribbean as they carry out an unprecedented era of economic reform. After a decade where population growth outpaced economic growth, we have seen two consecutive years of real percapita economic growth. Inflation has been cut in half and tariffs slashed since 1991. The region saw a net capital inflow of $57 billion last year. This good news was not confined to our neighbors; the United States got its share. Latin America and the Caribbean is our fastest-growing export market. Our exports to the region increased 17 percent last year, to $74 billion. U.S. investment in the region in 1991 stood at $77 billion, representing three-quarters of our total investment in developing countries.

Our economic assistance encourages further economic reform. It helps address basic human needs -- food, medicine -- and gives governments a breathing space to build support for reform. It provides funds to protect the environment and improve child survival at the same time as they lock in openings to trade and investment.

In addition to democracy and free markets, our aid addresses other issues that cross national borders and demand our attention in the post-Cold War world. Foremost among these is the threat of narcotics trafficking and consumption, which endanger not just our society but also the democracies of Latin America and the Caribbean. Drugs breed violence, corruption and instability. Most of our military aid to the region goes to support antinarcotics efforts. Our counternarcotics policy is under review and its focus may change; still, we will continue to work with our neighbors, especially in the Andean region, as they face the threats of drug trafficking and consumption.

In conclusion, Mr. Chairman, we ask the Congress to approve this budget request to keep the United States fully engaged in this hemisphere at a time of unprecedented opportunity. To a degree unknown in recent years, we and our neighbors agree on basic policy goals and on ways to cooperate to achieve them. If we engage actively, we can help this hemisphere to defend and strengthen democracy, and to bring the economic and social benefits of free societies to all citizens. That is a challenge worthy of our values, and deserving of our strong support.

15

regions, and its form and extent will vary from one stage of development to another. That is why it is necessary to address not only the levels of participation, but also whether participation is increasing. What is important is that the impulses for participation be understood and nurtured.

The implications of widespread participation are profound—embracing every aspect of development. Markets need to be reformed to offer everyone access to the benefits they can bring. Governance needs to be decentralized to allow greater access to decision-making. And community organizations need to be allowed to exert growing influence on national and international issues.

This Report explores these themes in some detail. But it is not the details that matter. It is the overall vision of societies built around people's genuine needs. This calls for at least *five new pillars of a people-centred world order:*

- New concepts of human security
- New models of sustainable human development
- New partnerships between state and markets
- New patterns of national and global governance
- New forms of international cooperation.

New concepts of security must stress the security of people, not only of nations

1. New concepts of human security must stress the security of people, not only of nations.

The concept of security must change—from an exclusive stress on national security to a much greater stress on people's security, from security through armaments to security through human development, from territorial security to food, employment and environmental security.

The world has already made a good start:

- Global military expenditures have declined cumulatively by around $240 billion since 1987.
- Nuclear warheads will be cut by two-thirds by the year 2003 as a result of the recent US-Russia agreement.
- More than two million people have been demobilized from the armed forces since the beginning of the 1990s.
- Defence industries are expected to have cut nearly a fourth of their workforce by 1998.

This is a beginning, but a formidable agenda still awaits policy-makers.

- *Use defence cuts to finance human development*—Despite major reductions in arms expenditure, the expected peace dividend in industrial countries has yet to materialize. A close link must be created between defence cuts and the unfinished social agendas in these countries.
- *Ease the transition from defence to civilian production*—Industrial countries need to plan the transition to a peace economy by retraining defence workers and creating more jobs for them in the civilian sector. Unless this is done, there will be pressures to give further export subsidies to the arms industries—pressures that several industrial countries have already succumbed to. This way of easing the adjustment problems of today's defence industry is bound to lead to enhanced conflict and deferred human progress in the developing world. It is irresponsible to entice poor countries to buy expensive military toys at the same time they are advised to reduce military spending. For developing countries, even partial demobilization of their standing armies will require large-scale job creation.
- *Accelerate disarmament in the developing world*—Although the cold war has ended between the East and the West, it remains to be phased out in the developing world. If developing countries merely froze their military spending at the 1990 level during the next decade, this would release nearly $100 billion for their essential human development agendas—which, combined with the restructuring of aid allocations proposed later, will be enough for universal literacy, primary health care and safe drinking water by the year 2000. This will also require some major initiative from industrial countries. Needed especially are time-bound targets to phase out military bases and military assistance, internationally monitored restraints on military shipments, and an enlightened donor-recipient policy dialogue on reductions in military spending.
- *Forge new regional and international alliances for peace*—Preventive diplomacy is

156

needed to diffuse tensions around the globe *before* there are blowups. This demands a new role for the United Nations, not just in peacekeeping but in peacemaking and peacebuilding. After all, an ounce of prevention is better than a ton of punishment. During 1992, the UN had to intervene in several internal conflicts, from Bosnia to Somalia, and the number of UN soldiers quadrupled to more than 50,000. With conflicts in countries displacing those between them, the time has probably arrived for the UN to have a permanent military force, mainly for the new goal of peacemaking. But military force is only a short-term response. The long-term solution is faster economic development, greater social justice and more people's participation. The new concepts of human security demand people-centred development, not soldiers in uniform.

2. New models of sustainable human development are needed—to invest in human potential and to create an enabling environment for the full use of human capabilities.

The purpose of development is to widen the range of people's choices. Income is one of those choices—but it is not the sum-total of human life.

Human development is development *of* the people *for* the people *by* the people. Development *of* the people means investing in human capabilities, whether in education or health or skills, so that they can work productively and creatively. Development *for* the people means ensuring that the economic growth they generate is distributed widely and fairly. Earlier *Human Development Reports* (1990–92) concentrated on these first two components. This Report advances the argument by concentrating on development *by* the people—on giving everyone a chance to participate.

The most efficient form of participation through the market is access to productive and remunerative employment. So, the main objective of human development strategies must be to generate productive employment. It has long been assumed that pursuing economic growth through increasing output would necessarily increase employment. This clearly has not happened. Over the past three decades, the growth rate for employment in developing countries has been about half that for output. And as output rose in many OECD countries in the last decade, employment lagged behind. ILO projections for the next decade hold no comfort. On present trends, employment's growth will continue to lag far behind that of both output and the labour force.

We are witnessing a new and disturbing phenomenon: *jobless growth*. And policy-makers the world over are searching for development strategies that combine economic growth with more job opportunities. No comprehensive programme has yet emerged, but governments can do several things to increase employment. Governments can:

- *Invest* generously in basic education, relevant skills and worker retraining.
- *Liberate* private enterprise and make markets more accessible to everyone.
- *Support* small-scale enterprises and informal employment, mainly through reform of the credit system and fiscal incentives.
- *Create* an efficient service economy for the future by investing in the new skills required.
- *Encourage* labour-intensive technologies, especially through tax incentives.
- *Extend* employment safety nets through labour-intensive public works programmes in periods of major economic distress.
- *Reconsider* the concept of work and the duration of the work week, with a view to sharing existing work opportunities.

We are witnessing a new and disturbing phenomenon: jobless growth

Policy-makers are searching not only for development models that are people-centred. They also want development to be more sustainable—to protect the options of future generations. This means that the conventional definition of capital must be broadened beyond physical capital to include human and natural capital.

The supposed choice between economic growth and sustaining the environment is false and dangerous. Growth is imperative if poverty is to be reduced. But the distribution of growth must change, and it must become less wasteful of natural resources in both rich and poor nations. The new models of development must also recognize that poverty is one of the greatest threats to the environment. That is why it is as important to address the "silent emergencies" of poverty (water pollution, land degradation, environmental diseases) as it is to focus on the "loud emergencies" (global warming, ozone depletion) that usually dominate the headlines.

In short, the new models of sustainable development must be much more sensitive to people and to nature.

Markets should serve people—instead of people serving markets

3. New partnerships are needed between the state and the market to combine market efficiency with social compassion.

Heated ideological discussions have often marred an objective analysis of the relative roles of markets and the state. Some believe in the benevolence of the state and the need for constantly correcting the ill effects of the market. Others glorify the virtues of the market-place and argue that the economy should be liberated from the dead hand of state bureaucracy. Both groups assume, to a large extent, that the state and the market are necessarily separate and even antagonistic—that one is benevolent, the other not. In practice, both state and market are often dominated by the same power structures.

This suggests a more pragmatic third option: that people should guide both the state and the market, which need to work in tandem, with people sufficiently empowered to exert a more effective influence over both.

If people's interests are to guide both the market and the state, actions must be taken to allow people to participate fully in the operations of markets and to share equitably in their benefits. Markets should serve people—instead of people serving markets. After all, markets are only the means—people the end.

Changing markets to make them more people-friendly would start by maintaining the dynamism of markets but adding other measures that allow many more people to capitalize on the advantages that markets offer.

• *Preconditions*—People need the education and health standards to take advantage of market opportunities. Also needed is a reasonable distribution of productive assets (particularly land) so that people do not come to the market with totally unequal buying or selling power. Since poorer people often have very little access to credit, governments need to reform their credit systems to give access to the poor. In addition, governments have to ensure that markets are open to all—irrespective of race, religion, sex or ethnic origin. Other preconditions for effective people-friendly markets include adequate physical infrastructure (particularly in rural areas), a free and rapid flow of information, a liberal trade regime and a legal system that encourages open and transparent transactions.

• *Accompanying conditions*—are needed to ensure that markets work as freely and efficiently as possible. One of the most important is a stable macroeconomic environment—especially to ensure stability in domestic prices and external currency values. But markets would also benefit from a comprehensive incentive system, with correct price signals, a fair tax regime and an adequate system of rewards for work and enterprise. Markets should also be able to work untrammelled by arbitrary and unpredictable government controls.

• *Corrective actions*—When markets do not produce a desirable outcome, the state needs to regulate and correct. This would include protecting competition through antimonopoly laws, consumers through regulations on product standards, workers through adequate and well-enforced labour legislation, and such vulnerable groups as children and the elderly. It would also include protecting the environment, by banning certain types of pollution and ensuring that polluters pay.

• *Social safety nets*—must be in place to catch the victims of the competitive struggle. Sometimes, this support need only be temporary, for the short-term unemployed, for example. But there will always be those excluded wholly or partially by the market: the very young, the very old, the disabled

158

and those with heavy domestic commitments. In several developing countries, such social safety nets include employment schemes for the unemployed, pension schemes for the old, feeding programmes for malnourished children and mothers, and free basic health and education for all low-income groups.

The need to create people-friendly markets is all the greater now that so many countries have embarked on strategies of economic liberalization and privatization. Many developing countries have already undertaken bold programmes to liberalize trade and finance, reform their taxation systems, deregulate the labour market and reform or privatize public enterprises. The countries of Eastern and Central Europe and the former Soviet Union have been undergoing an even more dramatic transition—from command economies to market economies. The experiences of 11 developing countries and transition economies—Argentina, Brazil, China, Egypt, Ghana, India, Kenya, Malaysia, Poland, Russia and Viet Nam—are analysed in this Report.

One of the most significant aspects of economic liberalization has been privatization. Between 1980 and 1991, nearly 7,000 enterprises were privatized, around 1,400 of them in the developing world, chiefly in Latin America. As one element in a coherent private sector development strategy, privatization can greatly stimulate private enterprise. But mistakes are already being made in the process of privatization. The Report lists "seven sins of privatization": maximizing revenue without creating a competitive environment, replacing public monopolies with private ones, using non-transparent and arbitrary procedures, using the proceeds to finance budget deficits, simultaneously crowding the financial markets with public borrowings, making false promises to labour, and privatizing without building a political consensus.

For economic transitions to be guided by the interests of the people—and for markets to be made people-friendly—requires new patterns of governance centred around the rising aspirations of the people.

4. New patterns of national and global governance are needed to accommodate the rise of people's aspirations and the steady decline of the nation-state.

Pressures on the nation-state, from above and below, are beginning to change traditional concepts of governance. On the one hand, globalization on many fronts—from capital flows to information systems—has eroded the power of individual states. On the other, many states have become too inflexible to respond to the needs of specific groups within their own countries. The nation-state now is too small for the big things, and too big for the small.

The nation-state now is too small for the big things and too big for the small

National governments must find new ways of enabling their people to participate more in government and to allow them much greater influence on the decisions that affect their lives. Unless this is done, and done in time, the irresistible tide of people's rising aspirations will inevitably clash with inflexible systems, leading to anarchy and chaos. A rapid democratic transition and a strengthening of the institutions of civil society are the only appropriate responses. Among the many specific steps that must accompany such a transition, the two main ones are to decentralize more authority to local governments and to give much greater freedom to people's organizations and non-governmental organizations (NGOs) —instruments of people's participation discussed at length in this Report.

The decentralization of power—from capital cities to regions, towns and villages —can be one of the best ways of empowering people, promoting public participation and increasing efficiency. Many industrial countries delegate 25% or more of total government spending to the local level. But the governments of developing countries remain much more centralized, delegating only 10% or less of budgetary spending and giving local governments few opportunities to raise funds through taxation or borrowing.

Where decentralization has taken place, it has often been quite successful, encouraging local participation, reducing costs and increasing efficiency. This is evident from experiences all over the developing world—from the Rural Access Programme in Kenya to the *gram sabhas* in the Indian state of Karnataka and the local bridge construction in the Baglung district of Nepal.

Decentralization also increases the pressure on governments to concentrate on human priority concerns. Given a fair chance, local people are likely to choose ready access to basic education and health care rather than the construction of distant colleges or hospitals.

Democracy is unlikely to be so obliging as to stop at national borders

One danger of financial decentralization is that the richer regions can raise more through local taxation and so will get better services. But experience shows how to overcome this. Brazil allows states to collect taxes but then redistributes them so that the richer states in the South and South-East get back only a quarter of the taxes collected from them, while the poorer states in the North get back more than twice what is collected there.

Decentralization can, however, end up empowering local elites rather than local people. So, there can never be effective local participation in developing countries without a redistribution of power—if decentralization is to promote human development, it must be accompanied by genuine democracy at the local level.

Another major instrument for people's participation is their organization into community groups. Indeed, people's organizations and NGOs have grown dramatically in recent years, offering a powerful means of correcting the failures of both markets and governments. People's organizations tend to be formed in response to a felt need or a common interest. People might simply form self-help groups to pool their labour, obtain credit or buy goods in bulk. Or they might be responding to a failure by government to provide infrastructure or social services or to a failure of markets to protect vulnerable groups.

Although NGOs have increased in number and financial clout, there have been few systematic evaluations of their effectiveness. In broad terms, they have had a clear impact in four main areas:

• *Advocacy on behalf of the disadvantaged*—On such issues as human rights, the environment, women, poverty alleviation and indigenous peoples, NGOs have organized powerful advocacy groups that have changed the thinking of national and international policy-makers.

• *The empowerment of marginalized groups*—In most developing countries, poverty is often caused less by an absolute shortage of resources than by their skewed distribution. NGOs' emphasis on empowerment and their support of people's organizations have often enabled marginalized groups to resist local elites and claim their rights. In many countries, particularly in Asia and Latin America, they have been pressuring governments to provide land for the landless and embark on agrarian reform.

• *Reaching the poorest*—NGOs often manage to reach groups that governments find the most difficult to help, particularly the poorest 20% of the population and those in the rural areas, where government services may be thin or non-existent. It is doubtful, though, that they reach the very poorest—most NGOs probably miss the poorest 5–10%.

• *Providing emergency assistance*—One strength of NGOs is the ability to respond quickly and effectively to emergencies. Their network of contacts allows them to give advance warning of disasters and urge international action. And their independence means that they can operate in circumstances that are politically difficult for official organizations.

Although NGOs are effective in these and other respects, it is important to keep the scale of their operations in perspective. In the early 1980s, one estimate suggested that NGOs touched the lives of about 100 million people in developing countries—60 million in Asia, 25 million in Latin America and some 12 million in Africa. Today, the figure is probably nearer 250 million and rising—but that is still only a fifth of the 1.3 billion people living in absolute poverty in developing countries.

The small impact of NGOs is also evident at the national level. In Bangladesh, the Grameen Bank, one of the most internationally renowned NGOs providing credit for the poor, accounts for a mere 0.1% of total national credit.

160

This is not a criticism of NGOs—it is a reminder of a stark reality: NGOs can supplement government but never replace it.

The decentralization of government authority and the emergence of NGOs are powerful processes for greater participation by people. But they can be effective only if the overall framework of national governance changes—to become genuinely democratic and participatory.

Let us also recognize that the forces of democracy are not likely to be so obliging as to stop at national borders. This has major implications for global governance. States and people must have the opportunity to influence the global decisions that are going to affect them so profoundly. This means making the institutions of global governance much broader and more participatory. There should, in particular, be a searching re-examination of the Bretton Woods organizations. And the United Nations must acquire a much broader role in development issues. To contribute effectively to sustainable human development will probably require some form of Economic Security Council within the UN, where all nations can participate on the basis of geographical representation—with none holding a veto—to provide a new decision-making forum.

5. New forms of international cooperation must be evolved—to focus directly on the needs of the people rather than on the preferences of nation-states.

The new emphasis on human security coupled with sustainable development will have to be matched by a fresh approach to international development cooperation.

So far, the basic motivation for donors to give aid has been to win friends in the cold-war confrontation between socialism and capitalism. Some bilateral donors did place greater emphasis on developmental and humanitarian concerns, and so did the multilateral agencies. But in general, the dominant objectives have been political.

More than half of US bilateral assistance in 1991 was earmarked for five strategically important countries: Israel, Egypt, Turkey, the Philippines and El Salvador. With five million people and a per capita income of $1,000, El Salvador received more US assistance than Bangladesh, with 116 million people and a per capita income of only $210. And the strategic significance of Egypt has been such that it received aid of $370 per poor person in 1991. Compare that with just $4 per poor person for India—even though Egypt has nearly twice the income of India.

Bilateral official development assistance (ODA) is badly allocated, showing the considerable potential for beneficial restructuring:

- Twice as much ODA per capita goes to high military spenders as to more moderate spenders.
- Only a quarter of ODA goes to the ten countries containing three-quarters of the world's poor.
- Less than 7% of ODA is earmarked for human priority concerns.
- Most of the $15 billion in technical assistance is spent on equipment, technology and experts from industrial countries—rather than on national capacity building in developing countries.

At least 20% of total aid should be allocated to human priority concerns

Aid is allocated this way because it suffers from the scars of the cold war, from a focus on nation-states rather than on people, from a bias towards the public sector and from a reliance on western development models.

The changed circumstances of the 1990s demand an entirely new approach to ODA:

- *Focus aid on human priority issues*—Aid should be directed at human priority issues, such as health and basic education, and at environmental security and reducing population growth. Clear and specific goals in these areas—identified, implemented and monitored—would obtain greater public and legislative support in donor nations. At least 20% of total aid should be allocated to human priority concerns, three times the present 6.5%.
- *Base ODA allocations on levels of poverty*—ODA should be allocated to people rather than to countries, and it should go where the need is the greatest, to the poorest people wherever they happen to be. For example, the ten countries containing three-quarters of the world's poorest peo-

163

ple should get around three-quarters of ODA, not the present one-quarter.

• *Link ODA with mutual concerns*—ODA must be in the mutual interest of recipients and donors. Recipients would be justified in insisting that ODA allocations be guided by their priorities in the fields of human development, poverty alleviation, employment creation and accelerated economic growth. Donors, by contrast, could legitimately link their ODA policy dialogue with their concerns on such matters as human rights, reducing international migration pressures, pollution, nuclear proliferation and drug trafficking—as well as the control of terrorism. Perhaps as much as 3% of aid funds could be earmarked for spending within donor nations to prepare public opinion for these post-cold-war realities and to increase public awareness of the interdependence of the North and the South.

Poverty anywhere is a threat to prosperity everywhere

• *Adopt a new people-centred policy dialogue*—ODA should be accompanied by a new form of policy dialogue based on the real interests of people, rather than those of the developing country governments that negotiate aid. This means putting much more pressure on governments to improve the distribution of income and assets, to direct spending away from military towards social concerns and to attend to the larger issues of better national governance.

• *Use technical assistance for national capacity building*—Technical assistance should be used increasingly to hire national experts, to invest in local institutions and to accelerate human development in the recipient countries. The ultimate criterion for judging the success of any technical assistance programme must be that it has built adequate national capacity and phased itself out over a predefined period.

• *Place ODA in a larger framework of sharing global market opportunities*—ODA can make a significant contribution to developing countries, but it must also be conceived in a larger framework. As the 1992 Report pointed out, developing countries are being denied market opportunities worth ten times the annual flows of ODA. The long-term solution to poverty is not charity. It is more equitable access for poor nations to global market opportunities.

• *Create a new motivation for aid*—The old motive of fighting the cold war is dead. The new motive must be the war against global poverty, based on the recognition that this is an investment not only in the development of poor nations but in the security of rich nations. The real threat in the next few decades is that global poverty will begin to travel, without a passport, in many unpleasant forms: drugs, diseases, terrorism, migration. Poverty anywhere is a threat to prosperity everywhere.

* * *

The implications of placing people at the centre of political and economic change are thus profound. They challenge traditional concepts of security, old models of development, ideological debates on the role of the market and outmoded forms of international cooperation. They call for nothing less than a revolution in our thinking. This Report touches on only a few aspects of a profound human revolution that makes people's participation the central objective in all parts of life. Every institution—and every policy action—should be judged by one critical test: how does it meet the genuine aspirations of the people? A simple test, vast in its reach.

This is the vision national and global decision-makers must consider if the 1990s are to emerge as a new watershed in peaceful development—and if the 21st century is to see the full flowering of human potential all over the world. The process of change ushered in by the events of the past few years must now be carried forward—with great courage and resolution. There are no engraved milestones on this road. There are no decorated heroes. It is a process of change led by people—and a promising journey we all must join.

An opportunity for this will arise fairly soon. All nations are committed to meet in 1995 at a World Summit on Social Development. It is a chance to focus on the building blocks for a new people-centred world order. It is a time to agree on a concrete agenda of national and global actions. That agenda will be the theme of the 1994 *Human Development Report*.

162

BOX 1.2

Balance sheet of human development—developing countries

PROGRESS	DEPRIVATION
LIFE EXPECTANCY	
• Average life expectancy increased by over one-third during the past three decades; 23 countries have achieved a life expectancy of 70 years and more.	• Of the 300 million people above the age of 60, only 20% have any form of income security.
HEALTH AND SANITATION	
• In the developing world, more than 70% of the population has access to health services. • Nearly 60% of the population has access to sanitation.	• About 17 million people die every year from infectious and parasitic diseases, such as diarrhoea, malaria and tuberculosis. • More than 80% of the 12–13 million HIV-infected people are in the developing world, and the cumulative direct and indirect cost of AIDS during the past decade was around $30 billion.
FOOD AND NUTRITION	
• Between 1965 and 1990, the number of countries that met their daily per capita calorie requirements doubled—from about 25 to 50.	• Some 800 million people still do not get enough food.
EDUCATION	
• Primary school enrolment increased in the past two decades—from less than 70% to well over 80%. In the same period, secondary enrolment almost doubled—from less than 25% to 40%.	• Nearly one billion people—35% of the adult population—are still illiterate, and the drop-out rate at the primary level is still as high as 30%.
INCOME AND POVERTY	
• In South and East Asia, where two-thirds of the developing world's population live, the GNP growth averaged more than 7% a year during the 1980s.	• Almost one-third of the total population, or 1.3 billion people, are in absolute poverty.
CHILDREN	
• During the past 30 years, infant and under-five mortality rates were more than halved.	• Each day, 34,000 young children still die from malnutrition and disease.
WOMEN	
• The secondary enrolment ratio for girls increased from around 17% in 1970 to 36% in 1990.	• Two-thirds of illiterates are women.
HUMAN SECURITY	
• With the end of the cold war, developing countries no longer have to serve as proxies for superpower rivalry, and in 1990, about 380,000 refugees returned to their homelands in Asia, Africa and Latin America.	• Internal conflicts afflict some 60 countries, and about 35 million people are refugees or internally displaced.
ENVIRONMENT	
• The percentage of rural families with access to safe water has increased from less than 10% to almost 60% during the past two decades.	• More than 850 million people live in areas that are in various stages of desertification. • The rate of tropical forest destruction is about the equivalent of one soccer field per second.

Balance sheet of human development—industrial countries

PROGRESS	DEPRIVATION
LIFE EXPECTANCY AND HEALTH	
• In 1960, life expectancy was more than 70 years in only 12 countries. Now, it is more than 70 years in all industrial countries.	• Nearly two million people are HIV-infected, and the direct and indirect cost during the 1980s was $210 billion
EDUCATION	
• The tertiary enrolment ratio more than doubled between 1965 and 1990.	• More than one-third of the adults lack any upper-secondary or higher education.
INCOME AND EMPLOYMENT	
• The per capita GNP grew at an annual rate of 2.4% between 1965 and 1990.	• The average unemployment rate is about 7%, and a quarter of the more than 30 million unemployed have been out of work for more than two years.
SOCIAL SECURITY	
• Social security expenditures now account for just under 15% of GDP.	• About 100 million people live below the poverty line.
WOMEN	
• Women now account for more than 40% of total employment.	• Women hold fewer than 10% of parliamentary seats.
SOCIAL FABRIC	
• There are now five library books and more than one radio for every person, and more than one telephone and one TV set for every two people. One in three people reads a newspaper.	• There are more than 15 suicides, more than 100 drug crimes and more than 15 deaths from road accidents per 100,000 people. • The number of divorces is now one-third the number of marriages contracted, and well over 5% of households are single-parent homes.
POPULATION AND ENVIRONMENT	
• Energy requirements per unit of GDP fell by 40% between 1965 and 1990.	• People in industrial countries make up about one-fifth of world population but consume ten times more commercial energy than people in developing countries, and they account for 71% of the world's carbon monoxide emissions and 68% of the world's industrial waste.

POPULATION
Headliners

4 June 1993

Highlights of interventions at meeting for 1994 Inter-

Dr Nafis Sadik, Executive Director of the United Nations Population Fund (UNFPA) and Secretary-General of the International Conference on Population and Development, said recently that the final document of the Conference, to be held next year at Cairo, should include goals to be achieved by all countries over the next 20 years, including a goal of 20 per cent of public sector expenditure in all countries to be devoted to the social sector.

Addressing the Preparatory Committee for the Conference (see page 1 for details of the Committee meeting) as it began consideration of her proposed conceptual framework for that document, she said that by the year 2015, developing countries should aim to reach the level achieved by developed countries in such areas as maternal and infant mortality, life expectancy, education, gender equality and access to a full range of modern family planning services.

She said the Conference should clearly affirm the central importance of reproductive rights, reproductive health and family planning. Noting that less than 1.5 per cent of official development assistance (ODA) was currently directed to population activities, she suggested it would be both reasonable and attainable to raise that figure to 4 per cent.

Dr. Sadik pointed out that, during the session, the Committee was expected to reach agreement on the format and content of the final document to be adopted by the Conference, which will take place from 5 to 13 September 1994. The overall theme of the Conference, as defined by the Economic and Social Council, is population, sustained economic growth and sustainable development.

Also at the opening session, Mr Jean-Claude Milleron, Under-Secretary-General for Economic and Social Information and Policy Analysis, said that socio-economic development thinking at the United Nations should be at the forefront of the new global trends. Citing the increasing gap between the world's developing and developed regions, he said the only guarantee of peace in today's world lay in development.

He also noted that since the first session of the Preparatory Committee in March 1991, an extensive exercise of restructuring of the economic and social sectors of the United Nations Secretariat had been initiated. He said that his Department was mandated to focus its activities on the analysis of socio-economic trends, global monitoring of economic and social policies trends and the elaboration of new emerging issues. He said his department was responsible for the execution of technical cooperation in the areas of statistics and population, and the provision of substantive support for the relevant intergovernmental bodies, including the Statistical and Population Commissions.

Literacy, especially for females, is a major issue as developing countries attempt to improve the lives of all their people. Not only does education result in lower fertility, but it empowers people by removing one of the barriers that keeps them marginalized. (UNICEF photo by Satyan)

Mr. Rafeeuddin Ahmed, Executive Secretary of ESCAP, said the Commission had recognized in the early 1950s the importance of population questions, when it decided to hold regional ministerial meetings every 10 years. Its Fourth Asian and Pacific Population Conference, held in August 1992 in Bali, Indonesia, served as a preparatory event for the International Conference on Population and Development. With the support of UNFPA, ESCAP had enlisted the involvement of the non-governmental organization community and the media at the Bali Conference.

That Conference had issued the Bali Declaration on Population and Sustainable Development, which contains a set of 67 recommendations, covering such related issues as environment, social dimensions, poverty alleviation, the status of women, human resources development, urbanization, internal and international migration and ageing, he continued.

Mr. Chang Chong-xuan of China said that excessive population growth was a grave problem in his country, which is the most populous in the world. Not including Taiwan Province, and the cities of Hong Kong and Macao, China's population had reached 1.17 billion and would approach 1.3 billion by the end of this decade. That figure was far in excess of what had been projected during the early 1980s and placed great demands on a comparatively weak economic foundation. In order to control population growth, his Government had to promote family planning through strengthened public education and improved contraceptive services.

Mr Thakur Phanit, representative of Thailand, stressed the connection between population, environment and development in his statement. He said the final document of the International Conference should be forceful and realistic, filling the gap between principles, laws and practices. It should include a plan of action, as well as an effective system for monitoring. The Bali Declaration on Population and Sustainable Development should serve as a blueprint for population strategies in the Asian and Pacific region.

Mr Javad Amin-Mansour, representative of the Islamic Republic of Iran, said that education played a major role in controlling the population growth. Familiarizing people, particularly women in rural areas, with family planning programmes was of paramount importance.

Mr A T P L Abeykoon of Sri Lanka said that, since the time his country had received the world's first bilateral international population assistance (from Sweden in 1957), it had made substantial progress in the field of human resources development and

(Continued on page 3)

national Conference on Population and Development

(Continued from page 4)

population change. Relative to its per capita annual income of $US 550, the country's social indicators were among the best in the world.

Mr Makoto Atoh, representative of Japan, said due attention should be paid to the issue of ageing, which would be one of the most critical problems of the twenty-first century. He announced that Japan this year intended to earmark $US500,000 of its contribution to UNFPA for preparations for the Cairo Conference.

An international conference on global population issues would be held next summer at Tokyo, hosted by the Government of Japan and co-sponsored by UNFPA and United Nations University, he said. The conference would draw the attention of world leaders to the population and development issues of the next century.

The representative of the United States said his country was determined to help lead and be part of a renewed global effort to address population problems. His Government intended to contribute to the United Nations Population Fund. President Clinton has requested a $US100 million increase in population assistance for fiscal year 1994.

Ms. Sarah L. Timpson, of the United Nations Development Programme (UNDP), said population as a factor in development could no longer be ignored. How could one deal with human resource development and poverty alleviation without discussing the problems of providing education, health services and employment for growing numbers of people? she asked. Poverty was not only an income gap, but also a power gap. The poor must be empowered to remove the socio-economic and political barriers that kept them marginalized.

Mr. Roy Brown, of the World Population Foundation, speaking on behalf of a number of European non-governmental organizations, emphasized that family planning saves lives. Even without other forms of empowerment, he said, giving women control over their own fertility helped them to buy time and improve their health. Poverty should not deprive people of access to family planning services, he said.

Mr. Abdullah Cholil of Indonesia stressed the link between population, economic growth, sustainable development and the environment. "Development is not only about economic growth, national income, debts and loans, but also about people", he said. Its main objective was to enhance living conditions. The issues of population and development should be discussed within a wider context, he continued, citing the link between population, poverty and environmental degradation.

The representative of New Zealand, Mr. Terence O'Brien, expressed appreciation for the attention given to the island countries of the Pacific, with a regional conference scheduled for Port Vila, Vanuatu, this September. In his statement, he said that his country favoured a new world plan of action, which should place individuals at the centre of population and development policies.

Ms. Ruth Begun, of Disabled Peoples' International, said that because people with disabilities were thought to be asexual, they had been omitted from the proposed conceptual framework. However, those people were faced with an inconvenience, to which they must adjust and go on living life to the fullest. That meant being sexually active. Therefore "issues of special concern to people with disabilities" should be specifically included in the conceptual framework.

People with disabilities often had no access to family planning information, she said. Facilities must be barrier-free, including information in braille, on tape and in sign-language translation. Choices in the areas of genetic engineering and abortion should be based on knowledge, rather than fear, she said.

Dr. Raj Karim of Malaysia supported the proposal that the Conference should adopt a new plan of action. The Conference's final document should reflect a balanced view of broader population issues, as well as issues concerning families and individuals.

The representative of India said the Conference should not become a melting pot for issues addressed by other international conferences but should focus on population issues as essential elements of a development strategy. Ms. Usha Vohra said poverty was the most urgent issue facing the developing countries, and she stressed that poverty alleviation was an essential element of an environment strategy.

Ms. Mariyam Waheeda, of the Maldives, said that population factors played a decisive role in all human endeavours, particularly in safeguarding the environment and in the pursuit of sustainable development. She stressed the importance of creating awareness not only of family planning but of all population issues.

Mr Rabindra Shakya, the representative of Nepal, said that the final Conference recommendations should be practical and affordable, and above all consistent with the aspirations of the developing countries. He also said that to reduce the pressures caused by the influx of refugees on the developmental processes of host countries, assistance should be given to host countries to design measures to deal with the problem.

Sher Afgan Khan, representative of Pakistan, said that the Conference should build on the Bucharest and Mexico City Conferences without renegotiating them, while taking account of the lessons learned from the United Nations Conference on Environment and Development (UNCED).

CEPAL news

Washington Office of the United Nations Economic Commission for Latin America and the Caribbean (ECLAC)
1735 Eye Street, N.W., Suite 809, Washington, D.C. 20006 Tel: (202) 955-56 .3

Vol XIII
No. 5

May
1993

In This Issue

CEPAL News is published monthly by
United Nations Economic Commission for Latin America and the Caribbean (ECLAC)
Washington Office
1735 Eye Street, NW
Suite 809
Washington, DC 20006 USA
Telephone: (202) 955-5613

Ines Bustillo, Editor
Isaac Cohen, Director

POPULATION AND DEVELOPMENT IN LATIN AMERICA AND THE CARIBBEAN

Latin America and the Caribbean countries, as a whole, are undergoing a process of transition to slower rates of population growth, says a newly released report by ECLAC's Latin American Demographic Centre (CELADE).

LATIN AMERICA: POPULATION CONCENTRATION IN LARGE CITIES,[a] 1350, 1970 AND 1990

	Cities with 1 million or more inhabitants in:			Cities with 5 million or more inhabitants in:		
	1950	1970	1990	1950	1970	1990
Number of cities	7	18	38	1	4	5
Population (thousands of persons)	17 099	56 803	132 245	5 042	32 899	66 057
Percentage of total population	10.72	20.51	30.26	3.16	11.88	15.11
Percentage of urban population	25.77	35.63	42.61	7.60	20.64	21.28

	Cities with 1 million or more inhabitants in 1990:			Cities with 1 million or more inhabitants in 1950:		
	1950	1970	1990	1950	1970	1990
Number of cities	3[illegible]	38	38	7	7	7
Population (thousands of persons)	26 931	69 008	132 245	17 099	38 648	67 840
Percentage of total population	16.88	24.91	30.26	10.72	13.95	15.52
Percentage of urban population	40.59	43.29	42.61	25.77	24.25	21.86
Average annual growth rate (per thousand)	47.05	32.52		40.77	28.13	
Index of urban predominance (per thousand)[b]	3.22	-0.79		-3.04	-5.19	

Source: CELADE.

a Does not include the city of San Juan, Puerto Rico.

b Corresponds to the average annual rate of growth of the percentage of the urban population living in cities with one million or more inhabitants.

Population, Social Equity and Changing Production Patterns, attributes this phenomenon to an initial decrease in mortality rates, followed by a more marked decline in birth rates. The demographic transition seems to be also related to the region's social and economic development and to the historic realities of each country. Increasing urbanization and educational coverage, especially for women, greater participation of women in the labor market, the application of population policies at the public and private levels, and the globalization of communications, are among the factors that explain rapid drop in birth rates, the report says. The trend towards a decline in the average number of children per woman seems to have continued, and even intensified during the crisis of the 1980s.

The current demographic situation and trends in Latin America and the Caribbean and their impact were recently discussed at the Latin American and Caribbean Regional Conference on Population and Development, sponsored by ECLAC, CELADE and the United Nations Population Fund (UNFPA) in Mexico City, April 29 through May 4, 1993. On May 3rd and 4th, sessions were held at the level of Ministers to issue guidelines for national and regional actions, and to develop a Latin American and Caribbean position for the upcoming International Conference on Population and Development in Cairo, Egypt, in September, 1994. The discussions in Mexico took place amid a policy environment of renewed interest on population issues in the United States and other developed nations.

The ECLAC and CELADE report on population and development examines trends and socio-economic implications of the region's recent variations in population growth; women and population dynamics; implementation of policies and programs; family planning; and current trends in external migration. The document seeks to provide useful tools for policy-makers in the area of population.

The population of the region has grown from 165 million in 1950 to around 460 million in 1992, which represents approximately 8.5% of the total world population at the present time. The overall annual rate of population growth during the 1980s was 2.1%, and it is expected to decrease to 1.7% by the year 2000, meaning an increase of 82 million people. Of that increase, 80% will take place between the ages of 15 and 64 years old, which implies a sizable growth in the available workforce and of persons at child-bearing years. According to the report, this poses a clear challenge to create jobs. The young workforce is basically urban and will grow until it constitutes three fourths of the overall workforce by the end of the century.

Since 1950, average birth rates remained around 6 children per woman and the range of variation of the total fertility rate among countries implied a difference of 4.5 children. In the period between 1985 and 1990, the average fell to 3.4 children per woman. Studies indicate that the use of contraceptives is the mos important determinant of decreased fertility. In Colombia, the Dominican Republic, Ecuador, Mexico, Peru and Trinidad and Tobago, contraception is responsible for over 50% of the decrease in fertility. These growth rates are similar to those expected for the global average and for Asia, with higher rates expected only in Africa (2.9%). Despite the current declines in fertility rates, they have been far from homogeneus among countries and within them. The relatively less developed countries still have high birth rates, a situation which can also be found in the pockets of poverty throughout the region.

One of the characteristics traits of the Latin American population distribution is its relatively high degree of urbanization, a fact which has distinguished it from other developing regions for many years. In 1950, nearly 60% of Latin Americans lived in areas defined as rural, but in 1990 less than 30% lived in those areas, and by the year 2000, it is expected that three quarters of the population will live in urban areas. Countries vary, however, in terms of both the degree of urbanization reached and the persistence of a predominantly rural population profile, especially in the Caribbean and Central America.

Overcoming poverty in the region is still, however, a major challenge. In the first half of the 1980s, the post-war trend towards poverty reduction, which lasted into the late 1970s in most countries of the region, reversed itself. A 1990 estimate, based on date from households surveys, puts the Latin American population living below the poverty line at 196 million or approximately 46% of the total population, in comparison to 136 million in 1986. This means that the poor grew at an annual average of 3.6%. Therefore, in the coming years, the recovery of economic growth will be associated with the creation of productive jobs and wage increases to reverse the trend towards ever greater poverty.

Poverty in the region is predominantly urban, in terms of volumes of population affected, although in many countries the incidence and severity of poverty are greater in rural areas. The bigger the rural population, as in Bolivia, Guatemala and Honduras, the more people enter the workforce through independent activities, without professional or technical training. In these countries, the dissemination of modern activities is limited, and they have achieved neither the scope nor the linkages to have a significant medium-term impact on occupational and wage levels.

COUNTRY SITUATION ACCORDING TO STAGE OF DEMOGRAPHIC TRANSITION, 1985-1990

Birth rate \ Mortality rate	LOW	MODERATE	HIGH
HIGH		NICARAGUA 3.5 GUATEMALA 3.2 HONDURAS 3.2 EL SALVADOR 2.6 PARAGUAY 2.8 II	BOLIVIA 2.6 HAITI 2.3 I
MODERATE	DOMINICAN REPUBLIC 2.5 MEXICO 2.4 COSTA RICA 2.5 VENEZUELA 2.3 SURINAME 2.2 PANAMA 2.2 COLOMBIA 2.0 TRINIDAD AND TOBAGO 1.9	ECUADOR 2.5 PERU 2.2 III BRAZIL 1.9 GUYANA 1.9	
LOW	JAMAICA 1.7 CHILE 1.7 BAHAMAS 1.5 MARTINIQUE 1.2 CUBA 1.1	IV GUADELOUPE 1.3 ARGENTINA 1.3 PUERTO RICO 1.1 URUGUAY 0.8 BARBADOS 0.7	

Rates per thousand:	LOW	MODERATE	HIGH
Birth:	HIGH: 32 - 45	MODERATE: 24 - 32	LOW: 10 - 24
Mortality:	HIGH: 11 - 16	MODERATE: 7 - 11	LOW: 4 - 7

Source: CELADE.

Note: The figures next to the country names correspond to the natural growth rate, expressed as percentages. The countries included are those for which the United Nations prepares population estimates and projections, which are those with at least 200,000 inhabitants.

\k'\

news release

Inter-American Development Bank
1300 New York Avenue, N.W., Washington, D.C.

FOR IMMEDIATE RELEASE March 8, 1993

IDB EXPANDS SUPPORT FOR WOMEN IN DEVELOPMENT

Working to maximize women's contributions as economic actors

The Inter-American Development Bank made important advances during 1992 in helping to expand women's contribution to economic and social development in Latin America and the Caribbean, and in ensuring that women actively participate in and fully benefit from IDB-financed projects in the region, the institution said today.

The IDB capitalized on experience it has gained in identifying working women's special needs, their particular economic contributions, and the legal and market environments in which they work.

The Bank's approach has been, according to IDB Special Advisor on Women in Development Marguerite Berger, "to maximize women's participation in its projects by viewing them not as mere beneficiaries, but as economic decision-makers."

The Bank's project support for women's role in development concentrated on six main areas: microenterprise, vocational and technical training, health, agricultural and rural development, housing and urban development, and natural resource management. Many projects included specific measures to improve women's participation, and the groundwork was laid to increase the number of projects with such a focus in 1993.

Also in 1992, the Bank began implementing a classification system to rate all its projects in terms of their effectiveness in addressing women's issues. The system will help the Bank both to target its assistance and to gauge progress in implementing its policies.

Project support

Special attention was given in 1992 to strengthening women's participation in key IDB projects: a labor force training program in Chile, housing sector programs in Paraguay and Uruguay, a regional development program for Western Pichincha in Ecuador, a health services program in Colombia, primary education improvement in Jamaica and Barbados, and social investment funds in Honduras and Nicaragua.

The labor force training program in Chile targets 100,000 disadvantaged youths, approximately half of them women, to provide them with skills and on-the-job training to help them move into the economic mainstream. The Chilean program incorporates promotional materials and counseling targeted at women and provides expanded access to day care facilities to allow single mothers to participate. It also trains women in nontraditional jobs, which have greater demand in the labor market and command higher pay.

Two technical cooperation projects approved recently address women's concerns through research and policy reform. One, approved in

late 1992, provides financing to strengthen women's role in agriculture in the Caribbean and South America. Another, approved in January 1993, will help identify and disseminate cost-effective models for expanding the access of women entrepreneurs to financial services.

The Bank has also financed an innovative technical cooperation project in Paraguay to promote women's training in productive activities, environmental management and child care.

Women microentrepreneurs

Among the most effective means for providing assistance to women in 1992 were the Bank's microenterprise credit programs. The 49 microenterprise and rural projects approved within the Bank's Small Projects Program in 1992 are expected to benefit an estimated 27,000 women through credit, training and marketing assistance. Nine of these projects are being carried out by women's NGOs.

In addition to these, new global microenterprise credit programs approved for Chile, Guatemala and Costa Rica are expected to have a significant impact upon women, who represent a large portion of microentrepreneurs in these countries.

Progress in planning

The Bank also took steps in 1992 to address women's issues in project programming, design and preparation. A pilot project being carried out in Colombia, El Salvador, and Trinidad and Tobago will identify the priority concerns of women, develop a strategy to address them, and ensure that Bank projects fully support women's contributions.

The Bank is extending this programming activity to other countries, and is preparing guidelines to address women in development concerns in all Bank programming.

Similarly, a multisector preinvestment program in Bolivia is developing a methodology to analyze poor women's social and economic roles and activities, and suggest ways of overcoming barriers to their participation in development projects. This gender analysis methodology will be included in all future preinvement programs.

To strengthen awareness about and improve analysis of women's issues, the Bank in 1992 began designating staff in all relevant departments to represent women in development issues, and began holding regular meetings to coordinate progress in this area.

In addition, special field missions were undertaken in 1992 to assist national women's bureaus in Argentina, Colombia, Costa Rica, Suriname, Barbados, Nicaragua and Trinidad and Tobago, with a focus on strengthening their capability to influence national policy and programs, particularly with regard to women's employment.

The government of Norway has granted the IDB 1 million kroner to support the implementation of the Bank's policy on women in development.

Agenda 21 & NGO Treaties

December 1992 ISSN 0250-9989

ECOFORUM

A Publication of the Environment Liaison Centre International
Global Coalition for Environment and Development

Women and forestry in Africa

A collaborative project has examined Women's Participation in Forestry Activities in Africa. The Environment Liaison Centre International (ELCI) organized two meetings based on a series of case studies, and published the project results. The Ford Foundation supported ELCI's work on the project.

Sixteen researchers, primarily African women, conducted the case studies. Five documented NGO forestry projects in Kenya, Sudan, Cameroon, Zimbabwe, and Botswana. At the workshop, an NGO project in Somalia was also discussed. Case studies also examined three bilateral forestry projects in Tanzania, Senegal, and Mali. The case studies were supported by the Forest, Trees and People Programme of FAO, the World Bank, the World Resources Institute (WRI), the Institute of Current World Affairs (ICWA), and the General Service Foundation.

ELCI held two meetings of non-governmental organizations and researchers. The first meeting, in Nairobi in January 1990, reviewed the draft case studies, discussed emerging issues, and planned a larger workshop. The second meeting was a bilingual NGO workshop, held in M'Bour, Senegal, in October 1990. The African Network for Integrated Development (ANID), based in Dakar, co-hosted this meeting. Thirty-five participants attended from Sudan, Kenya, Tanzania, Zimbabwe, Namibia, Mali, Benin, Burkina Faso, Senegal, and Ghana. At the workshop, seven projects were presented and three village projects were visited. Participants identified major issues, strategies, and lessons from the case studies and other experiences, and recommended how existing NGO efforts could be strengthened.

Issues and strategies

In Africa, women participate in many forestry project activities. In the case study projects, women were involved in agroforestry, woodlots, tree nurseries, horticulture, natural forest management, environmental rehabilitation, and fuel-efficient cookstoves. The case studies examined constraints to women's participation in forestry activities, and strategies used to overcome those constraints.

Workshop participants identified major issues that influence women's activities: (1) forestry, energy, and environmental policies; (2) restricted land and tree tenure rights; (3) general approaches and policies for development and promoting women's participation in development; (4) inadequate or inappropriate education and training for women; and (5) difficulties in communication and sharing of information. While these issues affect individual projects, they have implications broader than forestry projects or the forestry sector. Therefore, broader responses are needed.

The role of NGOs

Workshop discussions considered the activities, constraints, and potentials for NGO activities in working with women. NGOs have several advantages over

An African woman approaching the forest with a "relating wholeness" governmental organizations in reaching and working with rural communities, particularly with women and women's groups.

Many operational NGOs work closely with grassroots groups. They often have extension agents who live in rural communities, speak the local languages, and share the local concerns. This advantage can be particularly important in reaching and working with rural women, who may not speak national languages.

NGOs can often adopt a more flexible approach to development activities. They can undertake small-scale pilot or experimental activities, adapting their approach as they go along. It is often easier for NGOs to adopt an integrated rather than sectoral approach to development, or to focus on concerns identified by a community or a women's group.

Few African NGOs have trained foresters working on their staff. In many African countries, most forestry agents are men and generally work for the government. NGOs may be able to hire women to work as village facilitators or extension agents. Most NGOs that successfully work with women have women extension staff. At the end of NGO project activities, however, the government may be unable to hire these experienced extension workers.

Workshop participants agreed that a crucial question for community forestry projects is whether participants derive significant benefits. Women may earn income from growing trees. Other benefits include firewood, timber, access to land and water, improved nutrition (greater access to fruits and vegetables), savings in time, skills development and training, improved living conditions (for example, planting of shade trees), and environmental rehabilitation.

NGOs can complement government approaches to forest management and reforestation activities in implementing forestry activities, undertaking forestry research, and working on policy issues. Some NGOs launched nationwide reforestation activities with local participation. Some NGOs have actively promoted research on indigenous tree species, and spurred government forestry departments to follow suit. Others focus research attention on natural resource priorities of women, forge links between grassroots women and women researchers, and advise governments and multilateral organizations. Grassroots experience and applied research of NGOs also can be used to lobby for policy change.

NGOs can play a vital role in networking and information-sharing. Often a major problem for field-level natural resource activities, especially for women, is the lack of information -- information about technical issues, or the availability of government resources, policies, and support. Many grassroots groups lack information about what other groups are doing, what has been successful and what has not. Some NGOs, such as the ELCI, share such information through regular publications. NGO workshops and training programmes also provide important information-exchange opportunities.

ELCI shares information among NGOs concerning NGO activities, natural resource issues, local participation, and women's activities. Since 1990, ELCI has sponsored research on women's indigenous environmental management. ELCI's Women, Environment and Development Network (WEDNET) Project's newsletter, *WEDNEWS*, provides information on women and environment activities and research. Four WEDNET researchers attended the Women and Forestry Workshop in Senegal, and workshop participants have been receiving *WEDNEWS*.

Besides environment and development organizations, some women's networks and organizations provide information on women's activities. NGOs can share information by workshops, study tours, and training courses.

Many participants in the Women and Forestry Workshop were keen to apply concrete suggestions to their own work. Only three days after the workshop ended, the President of the Women's Group in Popenguine, Senegal, held a meeting with the village women to discuss possibilities for building improved cookstoves, which she had learned about in the workshop.

Although NGOs have strengths in working with local people and women in particular, they also face certain constraints. In Africa many NGOs are relatively young and inexperienced. They may face organizational, institutional, or funding difficulties. Some have limited expertise in working on forestry and natural resources issues. Through education and training, policy changes, and funding, governments and donors can support NGO activities.

Visions for change

Out of the case studies and the NGO workshop discussions came shared visions of development, forestry, and women in Africa. These visions suggest broader NGO strategies, beyond the scope of individual forestry projects. Workshop participants discussed strategies to communicate these visions, to advocate for change.

The workshop participants share a vision of development that is people-centred and sustainable. Development must be a bottom-up, participatory process. Women must be involved not only in the labour for forestry activities, but also in decision-making and control of resources. Key concerns for promoting women's participation in natural resource development activities focus on their access to and control over resources. At the planning meeting and workshop, discussions emphasized the importance of two major types of resources -- land, trees, and other natural resources, and information and knowledge. Building on women's existing knowledge and environmental management skills is fundamental for their empowerment and control of their lives. This approach to development is one widely endorsed by many African NGOs.

Discussions of popular participation in forestry -- whether by NGOs, communities, or women -- usually focus on "community forestry," "farm forestry," or "agroforestry." Proponents of community forestry stress that participants should obtain direct benefits from the trees they grow, and be motivated to undertake voluntary, i.e., unpaid, work. Workshop participants stressed three concerns about this focus.

First, we need to consider more carefully whether women and other participants actually benefit from their participation in forestry and tree planting activities. Do participants retain or gain access to and control over resources? Second, we must focus more on income-generation and other short-term benefits. While women may provide voluntary labour for environmental rehabilitation efforts, they also need income. Many

Information is knowledge -- and power

In order to better understand the problem of information and communication of Zairean women and to identify the level of awareness of these issues by the women themselves, the coordinator of women's activities of the "Fondation d'Inter-Action du Zaïre" (F.I.A.Z) organized in Bukavu (6-8 August 1992) a forum called "Women and information in African society today". This forum has generated much interest in Zaire and neighbouring Rwanda.

The participants came from various backgrounds: churches, NGOs for development, public services, banks, army, lawyers, the media, teaching and private societies. This diversity enriched the contributions as well as identified the common information and communication preoccupations of women beyond their sociological and professional interests.

This forum constituted an important stage in the process of reflection and action, initiated in the context of our mandate as an organization servicing women and people in development. To promote information for women in Zaire is an urgent task which has to be integrated into any development programme.

For example, during the Earth Summit in Rio, the Zairean delegation was made up of 15 men -- and not a single woman! What a crime! The same was true of the National Conference where women's representation was only 2 percent. Yet, in nearly each country, the number of women is half the total population. If today the institutions, organizations and families of each African country could educate and give women access to information the same way the men are given, Africa would develop faster.

Information is knowledge – and is power. It is true that men who should have been observers in this forum became the principal actors because they had information the women needed. It is also true that men don't want their wives to be better informed, because they are frightened of the result: the inevitable equality. So, we had to acknowledge the men who accepted our invitation to talk to us because it contributed to women's liberation process.

The debates which followed the talks and exchanges enabled the participants to put together some recommendations for concrete action in order to ameliorate women's access to information and NGOs.

The recommendations were:

• share with other women information and ideas developed during the Forum for their own promotion;
• F.I.A.Z should work with other concerned NGOs and institutions to set up a communication and information network; and
• F.I.A.Z should establish a documentation centre and an information bulletin for women; they should also organize meetings for women to create a "Caisse Financière et d'Investissement" for women, managed by women. This Caisse has already been working since 26 September 1992 in Bukavu ■

-by Mutunwa Nambale

(Translated from french by Nathalie Lianune)

Contact Mrs Mutunwa Nambale, Coordinatrice des Activités Féminines de la F.I.A.Z. P.O. Box 263, Cyangugu, Rwanda.

forestry projects typically offer paid employment to men, but only expect voluntary unpaid labour from women. Third, we must broaden beyond "community forestry" to encompass "commercial forestry." In many African countries, community forestry activities encompass only a minor portion of the forestry sector. To understand human use of trees, and whether forestry responds to people's needs, we must consider the entire orientation and funding of forestry activities, and the respective roles of governments and non-governmental organizations.

International policy debates, such as those surrounding the Tropical Forestry Action Programme (TFAP), must include women's active participation. For such policy discussions, ELCI and other NGOs can play an important role in ensuring that women participate in discussions at all levels.

In some countries, efforts are needed to train more women in forestry and natural resource activities to enhance their participation at all levels -- from grassroots to international policy levels. NGOs play a vital role in training extension officers and rural participants. They also can work with governments to change professional and technical training of foresters to focus more on working with people.

Planning meeting participants decided that the crucial issue was not just one of networking, but developing larger communication strategies. Such communication is important for advocacy work, solidarity-building, policy and legal reforms, sharing information, and developmental strategies. Communication linkages are crucial: NGOs need to exchange ideas with other NGOs, with their governments, local groups, and donors.

To communicate these ideas and visions, ELCI has prepared two documents. *Women, Trees and Forests in Africa: A Resource Guide* presents information from the case studies and workshop. It discusses issues and strategies for enhancing women's participation in forestry activities, and ensuring that women benefit from their participation. This resource guide can assist NGOs and others working on both field- and policy-level forestry activities with women. It also lists resource people, organizations, and useful references.

The second document, *Women's Participation in Forestry Activities in Africa: Project Summary and Policy Recommendations*, summarizes the project findings and recommendations. It is aimed at policy-makers in NGOs, governments, and donor organizations. Both documents are now available in English. They will be available in French at the end of March 1993 ■

-- by Paula William, author of the two documents an women and forestry in Africa

WORLD BANK NEWS

Government Policies Rob Africans Of Precious Drylands

Every year, rapid population growth forces many African families to settle on outlying dryland areas to eke out a living growing crops or raising livestock. But some observers say that farming those drylands degrades the areas, leaving them drier and unusable for future generations of African farmers.

The controversial trend of "land degradation" worries many development experts who fear it robs African communities of precious farmland while population growth rates soar across the continent.

But many differ on what causes land degradation. Some say a natural reduction in vegetative cover and a spreading of sand, or a process known as "desertification," is responsible. But a new World Bank study says that climatic changes may have some effect on dryland areas, but the problem of losing marginal land is mostly man-made and is therefore preventable.

Burdensome government policies, taxes and regulations together make it tough for African farmers to earn a profit from their farms and use the land in a "sustainable" manner, says the study by John English, formerly principal economist in the World Bank's Environment Department. English's paper, *Economic and Social Policies and Land Degradation in Dryland Areas*, was delivered on May 25 at an international conference on desertification in Nairobi, Kenya.

"Desertification is not the main issue. Land degradation is," says English. "The problem in marginal dryland areas is that farmers have very few crops that they can grow, taxes and levies are often slapped on exported crops, and the markets for selling the products are scarce. Basically, the prospect of growing crops on these areas is not very profitable to the average farmer. So, it's not surprising to see that farmers do not invest in maintaining a resource—land—that appears to have no long-term value."

Of all African farmland, the drylands are the most vulnerable to loss, says English. Rainfall is low and unreliable, and sparse vegetation provides a poor cover to guard against soil erosion. Because the areas are economically unproductive, they are not linked to national commercial centers by roads, and the inhabitants often do not have a say in governmental decisions that affect their lives.

To stop land degradation, African governments must eliminate oppressive economic and social policies that cause farmers to abandon degraded drylands, says English. Instead, governments should create incentives to allow rural households to use the drylands sustainably and keep agricultural production up.

Governments should cut taxes on agricultural products to make farming more profitable and make life more stable by granting enforceable property rights to farmers. Governments should also continue to encourage farming innovations, introduce alternative crops that can be best grown on the drylands, and not discourage seasonal migration.

Overall, leaving farmers to grow their crops or raise their livestock may be the best way to ensure that the lands stay viable and usable, says English.

"Farmers will take the right steps to prevent land degradation from happening if they have the incentive of using that land to earn income and if they see a future for themselves and their families. A farmer will not deliberately go out on a limb and cut it off behind him." □

Economic and Social Policies and Land Degradation in Dryland Areas *is offered free of charge. To get a copy, write to the World Bank, Room S-5131, 1818 H St., Washington, D.C., 20433, U.S.A.*

Photos from 1930 (left) and 1990 show how Kenyan land policies encouraged farmers to terrace a hillside and restore degraded land in Machakos district.

People & the Planet

Regional water scarcity - a widely

The global population is now over 5.5 billion, increasing by about 95 million people *every year*. Most of this growth is taking place in the poor countries of the developing world. The issue of feeding these extra people – the equivalent of adding another Mexico or Nigeria to the planet each year – will have to be seriously addressed in the near future.

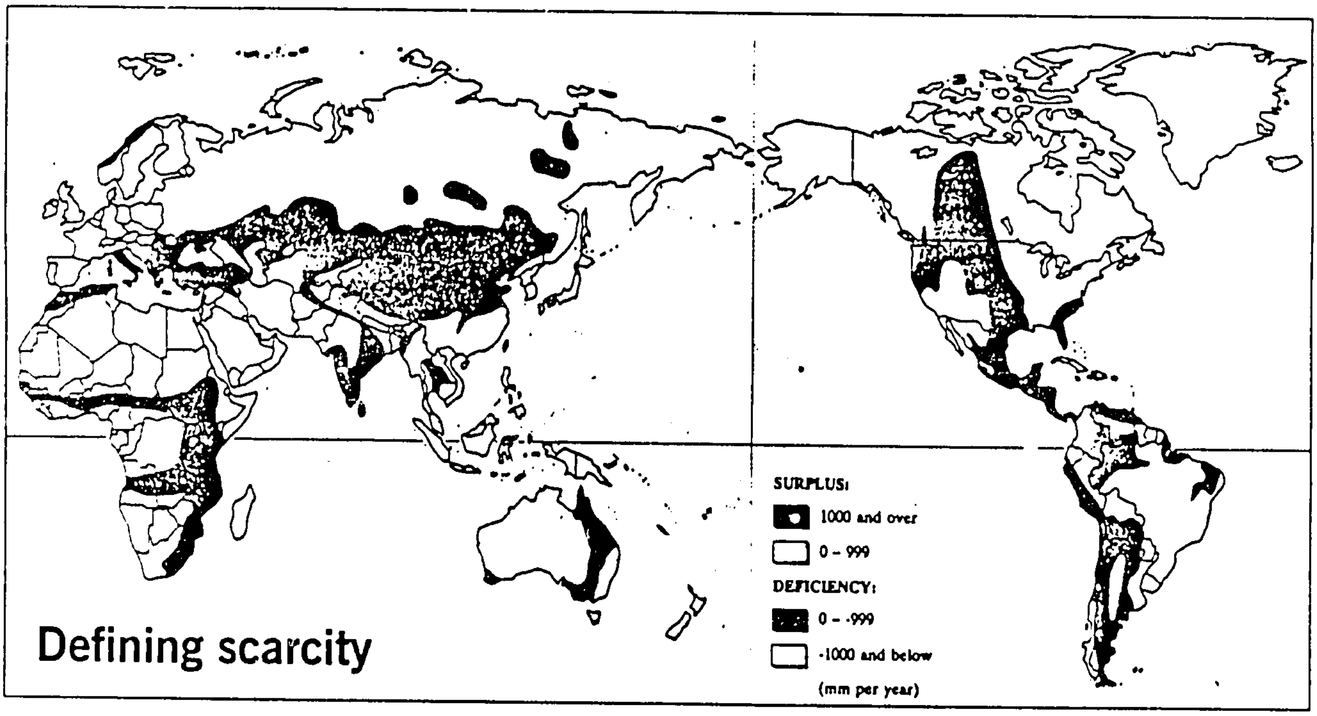
Human life depends on continuous access to two things: freshwater and food resources. Crop production, however, is critically dependent upon huge amounts of water passing through the plant from its roots out through the foliage.

The conventional approach to water supply problems in the developed North is: How much water do we need and where do we get it? Unfortunately, this approach is inadequate in poverty- stricken regions – for example in Sub-Saharan Africa and southern Asia – where water may very well be a limiting resource. The evident question to ask is: How much water is in fact moving through the landscape above and below the ground surface, and how to best benefit from the available amount?

In essence, a country's available water consists of the non-evaporated rainfall over its territory. In addition, some water may be imported through aquifers and rivers.

The dilemma of Southern water-short countries is fivefold: they have intermittent wet and dry seasons; the main part of the year is often dry; recurrent drought years are part of the climate; vulnerable soils are erodible or impermeable, leading to land desiccation; and the recharge of aquifers and rivers is low since most rainfall evaporates.

These conditions complicate the achievement of self-reliance in food production, especially in those countries with rapidly growing populations. Securing crop yields depends on ade-



Defining scarcity

ATLAS OF THE ENVIRONMENT

Water will increasingly become a constraint on economic and social development. This will impact most on countries with limited water supplies, rapid population growth and/or fast-expanding industry and agriculture. With poor management this can result in over-exploitation and pollution.

Regions of water scarcity can be defined as those with more than 600 people for every million cubic metres (MCM) of available water per year. At present 300 million people are living in such regions. By 2025 3 billion people will be affected – a tenfold increase.

In 1990, 26 countries including most of North, East and Southern Africa and the Middle East, fell in this category. By 2025, 65 countries will be water-short, according to this definition, including India, Korea, Nigeria, Peru and Poland. Others will suffer from localized shortages.

To maintain today's water use per capita, the amount of water mobilized would have to increase by 1,500,000 MCM. That is equivalent to all the water in the reservoirs of the world's 10 largest dams (excluding Owen Falls).

Irrigation accounts for about 70 per cent of the world's total water use. In the dry developing countries farmers need to use more water than in the humid tropics for the same biomass yield. In the past 40 years, irrigated cropland has tripled. But farmers usually obtain this water at a fraction of the actual cost, often leading to wastage. Good irrigation techniques, skilfully used, not only save water they also cause less damage.

In the map above, the surplus areas can support a wide range of crops and vegetation without irrigation. In the deficit areas, they cannot.

Mikael Arnestrand

People & the Planet is a joint publication of the United Nations Population Fund, the World Conservation Union and the International Planned Parenthood Federation. It is published by Planet 21, an independent, non-profit, publishing company, in association with a wide range of international organizations which have an interest in various aspects of population, environment and development, and with funding support from the Swedish International Development Authority.

neglected challenge

quate root-zone water security. Since rainfall is erratic, this calls for specific measures: either protective irrigation or careful, integrated soil-water management.

The challenge for water-short countries is to cope with vulnerable soils, short growing seasons, and a constant risk of droughts. In addition, the best possible use has to be made of the limited amount of water available in aquifers and rivers. In Africa this is often less than 100 mm per year.

Hence, development in low income countries is a completely different issue from development in temperate zones. The conventional water management approach is poorly adapted to the prevailing conditions in the dry tropics. What is needed instead is an integrated approach to land and water. The rationale for integration is that land use is both water-dependent and water-impacting.

For example, the runoff of water is influenced by forestry and land use practices in each country. The more rainwater that is consumed for tree growth and crop production and returned to the atmosphere through photosynthesis, the less will remain to feed aquifers and rivers. The importance of this phenomenon is well known in countries with a high evaporative demand, such as Australia and South Africa; where runoff is extremely sensitive to vegetation changes, even forest fires. In the same way, imported water is vulnerable to changes in biomass production upstream.

Also, water is a mobile solute and chemically active. It picks up soluble pollutants along its pathways through the landscape.

A critical challenge is the availability of water from wet to dry seasons. In order to be able to make use of more water than is available during the dry season – typically only some 10-20 per cent of the overall availability – water storage is a key measure. But this calls for the construction of dams and reservoirs; an option that is proving to be increasingly controversial. The massive World Bank-funded Sardar Sarovar dam project on the Narmada River in India is only one of the most recent examples.

It is urgent that a dialogue be opened between hydrologists, water resource engineers and ecologists in an effort to avoid the mistakes of one-sided solutions. In the long-term there is a growing conflict of interest between the human rights of local people who suffer from the construction of dams (and get little of the benefits) and the rights of neighbouring populations in poverty-stricken, drought-prone areas, to an increased share of the resource.

Urbanization introduces another dilemma. First of all, looking at the predicted population explosion in urban areas – especially the growth of megacities such as Mexico City, São Paulo, Bombay, Calcutta, and Cairo – it is hard to imagine how governments can possibly provide safe water and sanitation to such rapidly-growing numbers. The urban population in the developing world is expected to jump from 2 billion in 1990 to nearly 4 billion by 2025. Servicing such numbers will call for a doubling or even trebling of the efforts made by the International Water Supply and Sanitation Decade for the next three decades. The problem is the overwhelming impact on water supply of such huge 'point sources of demand'. As cities grow, more water has to be brought from further and further afield. In the end, water will be one of the main factors limiting urban growth in many water-short areas.

Urban populations also produce immense quantities of waste: human, industrial and municipal. Untreated human waste threatens the local groundwater supplies, since during wet seasons it will percolate through the soil and into groundwater aquifers. Industrial waste threatens both groundwater and rivers, making the water toxic and unfit for most uses.

At present, urbanization is running out of proportion to the growth of the rest of the population. Some cities, like Nairobi, increased by over 600 per cent in one decade. With rural areas often starved for development, the city represents a chance for employment, as well as access to needed services. Those people forced off marginal lands hope to find a better life in the city; often they find only more misery. One way to limit the push from the hinterlands is to improve rural living conditions and concentrate on land rehabilitation and job creation.

As urban areas grow, water allocation problems are intensified. Where water is already scarce, urban areas tend to claim a larger share, cutting the amount available for irrigated cropland. This is already a serious problem in the Indian State of Tamil Nadu, where irrigation water from the Bhavani River system is being diverted to feed industrial expansion in the Coimbatore district. It may be more politically expedient to provide water to urban dwellers at the expense of rural needs. But the emerging question for politicians and resource managers is: where will the water be more useful – in the city, or drought-proofing agriculture to produce more food to feed ever-growing populations?

There is a clear need to take a completely new approach to water supply in a world that is facing increasing conflicts over its use (and misuse). The crucial questions in the dry tropics and sub-tropics – where most of the poorer countries are located – is how much water is actually available, moving through the landscape? How does reforestation and deforestation change that amount by influencing the flow of water that returns to the atmosphere? How do we get the maximum production out of the amount available in terms of both biomass and social and economic advancement?

The world is faced by the daunting prospect of an emerging water crisis in many areas of the developing world. How we answer these questions will have a tremendous impact on future management of critical resources. It will also have a tremendous impact – for better or worse – on the development prospects of many poor, water-short countries. ■

Malin Falkenmark is the world's first Professor of International Hydrology and a Global 500 Laureate. Her special interest is how the water cycle links environment and development, especially in the South.

ORGANIZATION OF AMERICAN STATES

OFFICE OF PUBLIC INFORMATION

E-49/93
March 30, 1993

CONTACT: Miguel H. Frankenfeld
(202)458-3754

NICARAGUA REQUESTS OAS ASSISTANCE FOR PROGRAM TO STRENGTHEN DEMOCRATIC INSTITUTIONS

The Government of Nicaragua is asking the Organization of American States (OAS) to develop and implement a two-year program aimed at bolstering democratic institutions in the Central American country.

The request is contained in a letter sent to OAS Secretary General Joao Clemente Baena Soares by the Permanent Representative of Nicaragua to the OAS, Ambassador José Antonio Tijerino. The Nicaraguan diplomat explained that the program to be implemented effective next July 1 and financed through contributions from OAS member states and observers to the regional organization would be directed to help "in the exceptional circumstances being confronted by Nicaragua."

The OAS has been assisting Nicaragua through its CIAV-OAS mission, which devoted its efforts to the most urgent problems faced by the country immediately after the war, namely disarming of those participating in the civil war that ravaged Nicaragua and re-inserting them in Nicaraguan society through social and economic development projects.

Ambassador Tijerino said that under the new program, CIAV-OAS would continue its original mandate, but would also expand it to include all segments of Nicaraguan population affected by the civil war.

He outlined the following objectives of the new program: A) Professionalization of the Police force, B) Promotion of human rights at the state level through the official Office of Human Rights and non-governmental agencies, C) Improvement of the court system through training projects for prospective judges and training for court employees, as well as technical assistance in the legal process,D) Assistance in the field of elections, and E) Education for peace and promotion of non-violence.

###

FOCUS

THE IDB

Inter-American Development Bank • April 1993

Strengthening the roots of economic reform

In a few short years, most Latin American countries have transformed their debt-ridden, inefficient economies into models for economic reform.

But the reforms are new and shallowly rooted. Their value is not yet apparent to the millions of Latin Americans who remain poor— and see others getting rich. How long will these people be content to stay on the sidelines with no prospects for improvement? Equally important, how can the new Latin America achieve its economic potential without their full participation?

Despite general economic improvements, Latin America has more poor people today than 10 years ago. These are the orphans of the new Latin America: the foreman who was laid off when the state electricity company was privatized, the single mother who struggles to keep her children in school, the rural migrant who sought opportunity in the city and found only a tarpaper shack. The train of prosperity is passing these people by, and they know it. Pushed to the margins of society, they feel they have no real voice in the political decisions that affect their lives. They grow cynical over the inequitable distribution of wealth and despair that the future holds fewer, not more, opportunities for their children.

Opportunity, not charity. How to address the persisting problem of poverty was the subject of a three-day forum held at the IDB last month. Adding their voices to a growing chorus, leaders from government, international organizations and private groups agreed that social reform is now the number-one priority in the region.

Social reform is both an ethical imperative and an economic necessity.

While presenting a diversity of views (see article page 4), forum participants agreed that social reform cannot be achieved in isolation. Nor can the needs of poor people be met through charity.

In his closing statement before the forum, IDB President Enrique V. Iglesias spelled out the steps that society must take to integrate social reform into the broader economic and political process.

First, he addressed the issue of governability. The answer to bad government is not less government, but better government. He called for a streamlined state, better able to discharge its responsibilities in the fields of education, health, sanitation, housing, and reduction of poverty.

Second, Iglesias called on the state to take the lead in building a national consensus on social reform, just as it did so successfully in the area of economic reform.

Third, he called on governments to provide their people with the means to grow with their economies, through training, credit and technology.

Fourth, he urged countries to press ahead with political reforms, broadening and deepening their democratic institutions. They must vest greater responsibility in local governments, community organizations and private entrepreneurs.

Finally, multilateral organizations must expand their role from providers of resources to promoters of a dialogue among countries and between governments and their people.

Social reform has always been an ethical imperative. But today, more than ever, it is an economic necessity as well.

— *the editor*

IDRC
REPORTS
VOLUME 21 NUMBER 1 APRIL 1993

THREADS OF COMMON KNOWLEDGE

Rice crop, Vietnam: preserving plant diversity requires documenting the practices of local farmers

More and more, researchers on sustainable development are taking a serious look at indigenous knowledge (IK). They can hardly avoid doing so since IK is like a thread running through the human community, touching on biodiversity, climate and countless other activities. Take shamanism, for instance.

"The origins of Amerindian shamanism are Asiatic, possibly proceeding from millenia of shamanistic religions in Northern Asia and Southeast Asia," says Elizabeth Reichel, a professor of anthropology at the Universidad de los Andes, Colombia.

Prof Reichel defines shamanism as a political and religious technique for managing societies through certain ritual performances, myths, and world views, such that a community respects the natural environment and community life as a social common good. Shamanism is still the basic worldview of 70,000 Amazonian Indians in Colombia and of more than 30 million Amerindians in Latin America, she adds.

Prof Reichel shared her observations with participants at a symposium on indigenous knowledge and sustainable development, held in late 1992 in Silang, Philippines. It was convened by the International Institute for Rural Reconstruction (or IIRR, based in Silang) and IDRC.

In the Miriti-parana area near the Colombian-Brazilian border, says Prof Reichel, shamans practice environmental "accounting" an awareness that action upon the environment always begets reaction. "These indigenous societies can be said to be among the few ones left with a strong cultural tradition of indigenous sustainable development. In Colombia, shamanism is a form of eco-politics, a mechanism for the regulation and control of resources."

Prof Reichel laments the diminishing role of shamans as the government opens Amazonian lands by recognizing land titles. The system creates new forms of land tenure and political representation on top of the old. Where before the shaman decided the best ways to hunt or harvest food and forest products, he is now unrepresented in the new system of elected officials.

"The native pe ple in Asia, Africa, Canada or Latin America have far more in comm n terms of their conceptualization of nature and its bearing on our life compared to the rest of the population," observes Kirit K. Patel of the Center for Management in Agriculture, Indian Institute of Management, in Ahmedabad. "The Inuit, Australian Aborigines, Mohawk and other Indian tribes have always considered that a common thread runs through animals, earth and human beings."

On Malalison Island in the central Philippines, reefs are known by names handed down through generations, and islanders reckon distances in terms of fathoms and take their bearings from human landmarks such as a house on the mainland. The island was chosen by the Southeast Asian Fisheries Development Center (SEAFDEC) as a pilot site for sea-farming technologies, sea-ranching and the granting of territorial use rights in fisheries. The cornerstone of the project was local involvement, so the research turned to the ways of the fisherfolk.

While the people's fishing methods are specific to the island, "Malalison fishers are not unique," said SEAFDEC's Susana V. Siar. "The islanders are no different from the islanders of the Torres Strait or the raft fishermen and shore dwellers of Brazil, who possess a system of naming sea space and marking specific fishing spots through landmarks."

SUSTAINABLE DEVELOPMENT AND IK

"Many people realize one cannot talk of the value of natural resources in human terms without falling back to what people know about them and how they use them," says Christine Kabuye, the botanist in charge of the National Museums of Kenya's East African Herbarium. "And when it comes to sustainable development, incorporating indigenous knowledge is a must."

The Herbarium has collected data on plant uses since 1900, mostly on medicinal and chemically interesting plants. But it was not until three years ago that it started looking at wild food plants as substitutes for common crops that cannot be grown sustainably on marginal land. The results show that some indigenous food plants are far more nutritious than exotic ones.

"Because indigenous knowledge has been largely derived through oral traditions passed down over generations, much has been lost forever," says Raymond Obomsawin, a senior consultant at the ONAKE International Applied Research Project in Ontario, Canada. "The question of its preservation, expansion and practical use is especially urgent."

IK can be lost in unpredictable ways. The Green Revolution, for instance, made its own contribution, says Gordan Prain of UPWARD (User's Perspective with Agricultural Research and Development), based in the Philippines. "The successful exploitation of wheat and rice germplasm diversity was causing the disappearance of that diversity as farmers switched to the new varieties." The response to vanishing diversity was to collect accessions for more than 50 crops in over 100 gene banks worldwide. But little in the collections has been characterized properly. Without systematic characterization, gene banks are like "pharmacies filled with miracle drugs without labels."

"Almost absent from this potted history of plant genetic resources are the past and present users and originators of genetic diversity: farming households the world over, but especially rural people living in the more diverse and difficult environments of tropical and sub-tropical regions where the great majority of crop diversity is to be found," says Mr Prain. "Modern crop varieties often bring with them novel practices and these combine to erode the communal memory." UPWARD has completed "memory banking" in two communities in southern Philippines where the practices of local farmers with traditional varieties of staple and supplementary crops were documented systematically.

TIME-TESTED RESOURCE MANAGEMENT

Conservationists emphasize the importance of IK with respect to biological diversity, which must be preserved before as yet undiscovered species are lost forever. For David Hyndman, a senior lecturer in anthropology at Australia's University of Queensland, converting rainforests and inshore coral reefs into wilderness preserves is "no more than robbing indigenous peoples of their homeland and assigning it an artificial idealized landscape in which humans have no place. Biological and cultural diversity would best be achieved by keeping indigenous people on their homeland and allowing them to employ their own time-tested sustainable resource management."

Another theme addressed by the symposium was access to IK and intellectual property rights. How can local people be protected from exploitation of their knowledge and resources? What compensation can they get for their valuable information?

The annual value of medicinal plants derived from IK is estimated at some $54 billion in 1989. But indigenous people see no financial compensation for the hundreds of years of experimentation and innovation that led to the use of these plants.

"At present there are no provisions for the protection of knowledge rights of indigenous peoples," says Prof Hyndman. "Dissatisfaction with this exploitation led to the fight for indigenous intellectual property rights of the kind granted to universities and individuals for innovative R & D in the form of patents and copyrights."

The keynote speaker at the symposium, the Honourable James Bourque, a Canadian indigenous person, urged participants to focus on the practical application of IK in development activities to the advantage of local people. He saw a danger that the retrieval of IK would benefit only the scientific community and the Western world.

"For whose benefit?" asks Shahid Akhtar, Director of the Information and Communication Systems and Networks Program at IDRC. "The indigenous populations must be the main beneficiaries of any information system or network that is established. Western researchers [can] also be users and participants but fundamental issues related to intellectual property rights and research ethics make it essential that original owners and keepers of the knowledge retain access and control."

There must also be opportunities for giving IK wider relevance, according to D. Michael Warren, director of the Center for Indigenous Knowledge for Agriculture and Rural Development in the United States. Research should look "on the utility of indigenous knowledge and innovations from one

Access to IK should consider provisions for protecting the knowledge rights of indigenous groups and local communities.

IDRC

ecological zone to a similar zone in a different part of the world."

The symposium identified many such research gaps. These included agriculture, genetic resources, forestry, natural resource management, aquaculture, human health, veterinary medicine and livestock management, and communication and organizations. The role of primary and elementary education in promoting and displacing local knowledge among children also attracted attention.

"A study in a rural Mexican village revealed that non-Indian school age children identified and knew the uses of 37 plants compared to Otomi children able to do the same for some 138 plants," observes Raymond Obomsawin. "Yet, it is the Indian Otomi children who are deemed ignorant and in need of an education." Around the world, institutionalized childhood education, "has undermined viable indigenous traditions of familial based education," he says.

In other disciplines too the professional perspective takes on special importance. To many foresters doing research in Nepal, a formerly forested area that has been reduced to shrubland is considered "degraded." They often advise replanting with high canopy timber.

"From the perspective of the local farmer, with his need for fuel, fodder and grazing land for cattle, such shrubland often has survival meaning, in contradiction to its production meaning to foresters," says Dr Donald A. Messerschmidt, a social forestry adviser to the Institute of Forestry in Pokhara, Nepal. "The benefits of tall timber generally go to loggers and middlemen and seldom to poor farmers. Benefits of shrubland may be many — more species to harvest, more land available to graze, less erosion and gullying."

Forestry, education and the many other issues related to IK will be further explored by IDRC in coming months, with a view to determining IK research and information priorities. It has begun consulting with IK scholars, indigenous groups and others to guage the need for IK networks.

The symposium has advanced this work by developing recommendations for recording IK, preparing training manuals, communicating and using IK, and for research and policy relating to IK. It also formulated an action plan for an IK network. Discussion on methodology dealt with recording, storage, validation and selection of IK as well as training in all these aspects.

Indigenous knowledge, says IDRC's Shahid Akhtar, "provides the basis for grassroots or local-level decision-making, much of which takes place at the community level in rural areas where the majority still lives. Very little of this knowledge has been recorded, yet it represents an immensely valuable data base with insights on how numerous communities have interacted with their changing environment."

Paul Icamina in the Philippines

THE CSD - NO BACKPEDDLING YET

By William R. Pace

As the negotiations of the United Nations 47th General Assembly on the follow-up to UNCED and establishing a U.N. Commission on Sustainable Development neared completion, it was evident that those who predicted the Earth Summit commitments would be eviscerated by governments, agencies and other reactionary forces of the UN, had been proven wrong. It was clear during both the General Assembly and the ECOSOC negotiations that governments are still taking the UNCED commitments very seriously.

A number of key government representatives have expressed that, unlike the vast majority of their assignments, the establishment of the Commission on Sustainable Development (CSD) may be, as was the Human Rights Commission in 1946, an historically important event. As an example, the EC has been trying to establish unprecedented bargaining powers for itself in the new Commission, so it seems already that the CSD has become a field involving very high level negotiations and manoeuverings.

Furthermore, the developing countries and activist Third World NGOs are clearly hoping to use the CSD to monitor the lending policies and practices of the international financial institutions, including the Global Environmental Facility of the World Bank. The ECOSOC resolution calls for the World Bank, IMF, and other intergovernmental organisations and specialized agencies to appoint special representatives to the CSD.

But What Role Have NGOs Achieved?

NGOs hope to use the CSD to examine linkages between trade, development and environmental degradation, and to look at country sustainable development plans, including the consumption practices of Northern industrialized societies. UNCED involved the greatest number of citizen activists and organisations ever in an international intergovernmental process. This included 400 NGOs who were already in consultative status with ECOSOC, who can participate in all U.N. conferences and commissions, and 1000 others; referred to as "UNCED NGOs" in this article.

Many believe that the North-South dialogue between NGOs and governments was as important as the main "products" of UNCED: the treaties, declarations and Agenda 21. But this dialogue and debate about perceptions, power, roles, rights and wrongs, was far from complete after Rio. Many hope that the meetings of the CSD will become the setting for an ongoing global debate, examining what the "enhanced" roles of NGOs, citizens activists, and representatives of major groups will be in the post-Cold War, post-Earth Summit, United Nations.

Secretary General's Report

The report of the Secretary-General (SG), based on the General Assembly decisions and Agenda 21 commitments, made a number of progressive proposals and assumptions. It proposed accrediting the 1000 additional UNCED NGOs to the U.N. Roster for participation in the work of the CSD. [This was extraordinary, as the number put on the Roster via SG recommendation over the last 40 years is reportedly less than 30.] It assumed unprecedented involvement of NGOs in the CSD and recommended expanded consultations such as meetings with NGOs in advance of CSD meetings.

Initially, the only vocal opposition to these recommendations came from a few representatives of the international NGOs, all members of the Conference of NGOs in Consultative Status with ECOSOC (CONGO). While these representatives did not completely agree with each other, in general they expressed opposition to language in the SG report, which they interpreted as calling for UNCED NGOs to be able to participate in the CSD on an equal footing with Category I and II consultative status NGOs. (See *The Network* #22 for an explanation of these roles). They opposed language which called upon NGOs to organise themselves into networks and coalitions and establish mechanisms, when limitations of space and time required, to select representatives to be in CSD meeting rooms and to speak on behalf of NGOs.

Though publicly supporting the calls in Agenda 21 for more enhanced, inclusive, regionally balanced NGO involvement and participatory rights in the follow-up to UNCED, they have not offered any alternatives to the UNCED vs. existing ECOSOC procedures dilemma, since last July. Their defensive actions have backfired badly and are creating the conditions they claim to be trying to prevent.

Despite the fact that India, the Philippines and China also opposed accrediting the UNCED NGOs, the decision appears to be to grant all the UNCED NGOs accreditation, "subject to the approval of the Council, bearing in mind the provisions of Article 71 of the Charter of the U.N." This disappointing compromise will probably allow governments to vet lists of NGOs from their countries to exclude those they do not want on the Roster. This could eliminate important grassroots national and regional NGOs.

The Way Forward

During the General Assembly debate on UNCED/CSD resolutions, there was open and frank recognition that the new Commission would fail if its meetings and work were confined to government representatives. Thus, the support for active citizen and NGO participation in the CSD was dramatic. Governments and others who expected that the UN would return to business as usual after UNCED, have been rebuffed.

The Secretary-General has delivered more than most had hoped for in terms of recommended procedures and in establishing the Department of Policy Coordination and Sustainable Development. Governments have not closed the door on the needed citizen, NGO and major group involvement. Nor have governments yet imposed the kind of restrictive and hypocritical types of procedures on the CSD, which have straight-jacketed and darkened the work of the Human Rights Commission for the last 40 or so years.

The mandated monitoring functions of the CSD are daunting: the implementation and elaboration of Agenda 21; the establishment of sustainable development plans and practices by governments and agencies including multilateral financial institutions; reviewing international ODA commitments, and so on. The scene is being set for the CSD. The key question now is will NGOs take their place in it?

William R. Pace, is Executive Director, Center for Development of International Law and Co-convener, International NGO Task Group on Legal and Institutional Matters (INTGLIM).

Contact: c/o Center for Development of International Law, PO Box 53149, Washington, DC 20009; Tel: (1 202) 462 5251. Fax: 462 4941.

MONDAY DEVELOPMENTS

The Impact of AIDS on Sustainable Development

A computer presentation model to convey the impact of AIDS on the developing world and an overview of the new AIDSCAP program were featured in the workshop, "Demographic Implication of AIDS on Sustainable Development."

AIDS Impact Model. The AIDS Impact Model (AIM), funded by the Agency for International Development (AID), is an interactive program for graphically illustrating the current status and possible future of the HIV/AIDS epidemic in individual countries. The primary use for the AIM model is to brief decision makers, government leaders and other influential people in developing countries about the background, epidemiology, impact and interventions for AIDS.

> *"The situation is too serious to be left to governments."*
> — Anthony M. Schwarzwalder
> AIDSCAP Deputy Director

The model, demonstrated by John F. May, demographer and senior associate for The Futures Group, depicted the HIV/AIDS status and future for a hypothetical sub-Saharan country with a typical level of infection. Presentations are usually prepared for individual countries and shown by local presenters to key audiences.

The model's background section shows audiences what we know about the history and current status of the epidemic. It graphically shows the "AIDS pyramid" of reported and unreported cases, prevalence, age distribution, incubation period and cumulative numbers.

The epidemiology section shows alternative projections of future infection levels, such as what would happen if there were no interventions to prevent the disease. The impact section describes the socioeconomic impact of AIDS in the future. Key points are:

- One of the worst impacts of AIDS deaths will be the increase in the number of orphans, which will in turn cause a tremendous strain on the social system;
- AIDS will eventually require a large portion, in some cases half, of the health budget of some countries;
- AIDS will become a major threat to child survival, as important as measles and malaria; and
- [illegible]

The computer model shows how various interventions will affect the prevalence of HIV and what can be done to prevent a worsening epidemic. The model shows the individual and collective effect of interventions such as blood screening, condom promotion, education and communications to reduce the number of partners, and programs to detect and treat sexually-transmitted diseases. "Interventions make a difference," said May. "We can control the epidemic through these interventions. The best effects will be achieved when the interventions are combined."

AIDSCAP Program. The AIDS Control and Prevention Project (AIDSCAP) is a $168 million, five-year program whose purpose is helping developing countries deal with the prevention of AIDS. AIDSCAP was created in 1991 by a cooperative agreement between USAID and Family Health International (FHI), with the support of nine subcontractors.

A major focus of the project is helping NGOs build the capacity to carry out AIDS prevention programs. "The situation is too serious to be left to governments," said Anthony M. Schwarzwalder, AIDSCAP deputy director. "We expect that three-quarters of the money for this project will go to PVOs and NGOs." The program emphases are:

- Increased acceptance, availability and utilization of condoms;
- Behavior change, including partner reduction; and
- Improved management and treatment of sexually-transmitted diseases, including HIV.

Strategies for enhancing the capacity of NGOs to deliver effective and sustainable AIDS prevention programs include institutional needs assessment, collaborative institutional goal setting, collaborative skills transfer, formal training programs, training of trainers and field-generated materials and systems. Some of the issues faced by AIDSCAP, according to Schwarzwalder, include "the trade-off between relief and sustainable development, and the decision when to move from targeted interventions (such as working with intravenous drug users) to large, nationwide education programs."

AIDSCAP has a competitive grant program for US-based, AID-[illegible]red P[illegible] with S[illegible]on all [illegible] for P[illegible] working in collaboration with NGOs in priority countries in Africa, Asia and Latin America/Caribbean. The first round of grant awards were to World Vision (Thailand), Save the Children (Haiti), American Red Cross (Jamaica) and CARE (Cameroon). Schwarzwalder reminded the audience that the second round of competitive grants is coming up with concept papers for funding work in Brazil, Côte d'Ivoire, Malawi and Senegal due June 4.

There are also sub-projects for PVOs or NGOs displaying outstanding ability in the HIV/AIDS field in priority and selected associate countries. NGO support activities include "rapid response/seed money," which funds small, short-term projects; and "institution building and networking," which provides management or technical training.

More information on AIDSCAP is available by contacting Anthony Schwarzwalder or Wendy Githens at the project's headquarters, 2101 Wilson Blvd., Suite 710, Arlington, VA 22201; 703/516-9779. For more information on AIM model, contact John May at The Futures Group, 1050 17th Street, NW, Suite 1000, Washington, DC 20036; 202/775-9680.

FOREIGN POLICY
NUMBER 91 SUMMER 1993

JUMPSTARTING DEVELOPMENT

by James P. Grant

Anyone who thought, amidst the euphoria of dizzying change starting in 1989, that the end of the Cold War would usher in an age of global harmony and easy solutions has long since been disabused of the notion. Every day we open our newspapers to dark headlines confirming that the world is still a very dangerous place—in some ways more dangerous than before. We are confronted with a host of problems, both old and new, that are reaching crisis proportions. Is there a way of "jumpstarting" solutions to many of those problems? In fact, there is.

To many, it may not seem so. Ethnic conflict, religious hatred, failed states, economic devastation in Eastern Europe and the former Soviet Union, AIDS, and environmental degradation all seem intractable problems. Meanwhile, the number of poor in the world continues to increase at about the same rate as the world's population. The World Bank put their number at 1.1 billion in 1990. A fifth of the world's population is living on less than one dollar a day, and during the 1980s the poor actually lost ground. The 1990s show little evidence that the world economy will return anytime soon to a high growth trajectory.

The negative trends have even begun to afflict the rich. In the last decade, poverty increased in a number of industrialized countries, most notably in the United States and the United Kingdom and, of course, in the former communist countries of Europe. In most of those countries, children bore the brunt of the reversal. In America today, one in five children is poor, the highest level of child poverty in a quarter century in the world's richest country. In both the United Kingdom and the United States, child poverty has nearly doubled in a

JAMES P. GRANT *is the executive director of the United Nations Children's Fund (UNICEF).*

decade.

Small wonder that the lead article in this journal's spring issue contended that "all the trends" are in the wrong direction and that the world "appears to be at the beginning, not of a new order, but of a new nightmare." Such pessimism, however, can be misplaced. The world is in fact on the threshold of being able to make vastly greater progress on many problems that have long seemed intractable. Rather than merely reacting to situations after they have become critical, as in Somalia, the world has an opportunity in the 1990s to make an effective—and efficient—social investment to convert despair into hope and go a long way toward preventing future crises and building healthy societies.

The situation today may be analogous to that of Asia in the mid 1960s, when population growth seemed set to outrun the food supply. Many predicted widespread famine, chaos, and instability for the last third of this century. But then, quite suddenly, within four or five years, the Green Revolution took hold in Asia, extending from the Philippines through South Asia to Turkey. In country after country, wheat and rice production increased at annual rates unprecedented in the West. The immediate cause was not so much a scientific breakthrough—strains of the miracle wheats had been around for as many as 15 years—as a political and organizational one. Only by the mid 1960s had fertilizer, pesticides, and controlled irrigation become widely used, thanks in large part to earlier aid programs. At the same time, the combination of Asian drought and increasing awareness of the population explosion created the political will to drastically restructure price levels for grains and agro-inputs, and to mobilize the multiple sectors of society—rural credit, marketing, transport, foreign exchange allocations, media—required for success. U.S. president Lyndon Johnson deserves credit for his leadership contribution to that effort, though his deep personal involvement remains a largely untold story.

We may be in a similar position today, but on a much broader front—poised for advances in primary health care, basic education, water supply and sanitation, family planning, and gender equity, as well as food production—and covering a much wider geographical area, including Africa and Latin America as well as Asia. With an earnest effort from the major powers, the 1990s could witness a second green revolution—extending, this time, beyond agriculture to human development.

For the first time since the dawn of history, humankind is making long-term plans for improving the lives of the young.

Frequent illness, malnutrition, poor growth, illiteracy, high birth rates, and gender bias are among poverty's worst symptoms. They are also some of poverty's most fundamental causes. We could anticipate, therefore, that overcoming some of the worst symptoms and causes of poverty would have far-reaching repercussions on the national and global level. The recent experiences of such diverse societies as China, Costa Rica, the Indian state of Kerala, Sri Lanka, and the Asian newly industrializing countries (NICs) suggest that high population growth rates, which wrap the cycle of poverty ever tighter, can be reduced dramatically. Reducing poverty would give a major boost to the fragile new efforts at democratization that will survive only if they tangibly improve the lives of the bottom half of society. As we know from the experience of Singapore, South Korea, Taiwan, and the other Asian NICs, such progress would in turn accelerate economic growth. By breaking the "inner cycle" of poverty, we would increase the capacity of the development process to assault poverty's many external causes, rooted in such diverse factors as geography, climate, land tenure, debt, business cycles, governance, and unjust economic relations.

We are uniquely positioned to succeed in the 1990s. Recent scientific and technological advances—and the revolutionary new capacity to communicate with and mobilize large numbers of people—have provided us with a host of new tools. The world's leaders can now use them together to produce dramatic, even unprecedented, results.

For example, the universal child immunization effort—the largest peacetime international collaboration in world history—has since the mid 1980s established systems that now reach virtually every hamlet in the developing world and are saving the lives of more than 8,000 children a day—some 3 million a year. Here, too, the technology was not new; vaccines had been available for some 20–30 years. Success has been the result of applying new communication and mobilization techniques to the immunization effort, often led personally by heads of state, making use of television and radio advertisements, and supported by a wide range of local leaders. School teachers, priests, imams, local government officials, nongovernmental organization (NGO) workers, and health personnel all joined the effort. By 1990, more than 80 per cent of the developing world's children were being brought in four or five times for vaccinations even before their first birthdays. As a result, Calcutta, Lagos, and Mexico City today have far higher levels of immunization of children at ages one and two than do New York City, Washington, D.C., or even the United States as a whole.

A similar effort is now being made to spread the use of oral rehydration therapy (ORT) to combat the single greatest historical killer of children, diarrhea, which takes the lives of some 8,000 children every day, down from 11,000 daily a decade ago. ORT was invented in the late 1960s, but only recently have leaders mobilized to use this lifesaver on a national scale. Every year it now saves the lives of more than 1 million children, a figure that could easily more than double by 1995 with increased national and international leadership.

The arsenal is now well stocked with other new technologies and rediscovered practices that can bring tremendous benefits with inspired leadership and only modest funding. Thus, the simple iodization of salt—at a cost of five cents annually per consumer—would prevent the world's single largest cause of mental retardation and of goiter, which affect more than 200 million people today as a result of iodine deficiency. Universal access to vitamin A through low-cost capsules or vegetables would remove the greatest single cause—about 700 cases per day—of blindness while reducing child deaths by up to a third in many parts of the developing world. The scientific rediscovery of the miracles of mother's milk means that more than a million children would not have died last year if only they had been effectively breast-fed for the first months of their lives, instead of being fed on more-costly infant formula. In such diverse countries as Bangladesh, Colombia, Senegal, and Zimbabwe, it has proven possible to get poor children, including girls, through primary education at very little cost. Recent advances have shown how to halve the costs of bringing sanitation and safe water to poor communities, to less than $30 per capita. New varieties of high-yield crops—from cassava to corn—are now ready to be promoted on a national scale in sub-Saharan Africa.

Meanwhile, with such tools in hand, the new capacity to communicate—to inform and motivate—empowers families, communities, and governments to give all children a better chance to lead productive lives. In short, we are now learning to "outsmart" poverty at the outset of each new life by providing a "bubble of protection" around a child's first vulnerable months and years. Strong international leadership and cooperation—facilitated enormously by the end of the Cold War and the expansion of democracy—could leverage that new capacity into wide-ranging social progress.

A Children's Revolution

Notwithstanding the media image of the Third World as a lost cause, there is real momentum there for change. In fact, for all the difficulties and setbacks, more progress has been made in developing countries in the last 40 years than was made in the previous 2,000, progress achieved while much of the world freed itself from colonialism and while respect for human and political rights expanded dramatically. Life expectancy has lengthened from 53 in 1960 to 65 today, and continues to increase at a rate of 9.5 hours per day. Thirty years ago, approximately three out of four children born in the developing countries survived to their fifth birthdays; today, some nine out of ten survive.

At the same time, the birth rates in countries as disparate as Brazil, China, Colombia, Cuba,

Korea, Mexico, Sri Lanka, Thailand, and Tunisia have been more than halved, dramatically slowing population growth and the inherent strains it places on limited natural resources and social programs. Among the factors that have helped contain population growth, improving children's health is undoubtedly the least well-known and appreciated. As the United Nations Population Division puts it, "Improvements in child survival, which increase the predictability of the family building process, trigger the transition from natural to controlled fertility behavior. This in turn generates the need for family planning." While they are important priorities themselves, reductions in child mortality, basic education of women, and the availability of family planning make a strong synergistic contribution to solving what Yale historian Paul Kennedy calls, in *Preparing for the Twenty-First Century* (1992), the "impending demographic disaster." As population specialist Sharon Camp noted in the Spring 1993 issue of FOREIGN POLICY:

> Measures like quality reproductive health care, greater educational and economic opportunities for women, and reductions in infant and child death rates can and will bring about rapid birthrate declines. If all developing countries were to emulate the most effective policies and programs and if donor governments such as the United States were to provide adequate levels of assistance, the population problem could be resolved in the lifetime of today's children.

In fact, a children's revolution is already under way in the developing world, often led by those in power. Developing country leaders took the lead in seeking history's first truly global summit—the 1990 World Summit for Children—with an unprecedented 71 heads of state and government participating. They also pressed for early action on the Convention on the Rights of the Child, which was adopted by the General Assembly in November 1989 and which has since been signed or ratified in record time by more than 150 countries—with the United States now being the only major exception.

The experience of the past decade showed it possible—even during the darkest days of the Cold War and amid the Third World economic crisis of the 1980s—to mobilize societies and the international community around a package of low-cost interventions and services, building a sustainable momentum of human progress. The United Nations Children's Fund (UNICEF) and NGOs called it the Child Survival and Development Revolution, and as a result more than 20 million children are alive today who would not otherwise be; tens of millions are healthier, stronger, and less of a burden upon their mothers and families; and birth rates are falling.

Leaders are learning that productive things can be done for families and children at relatively low cost, and that it can be good politics for them to do so and bad politics to resist. More than 130 countries have issued or are actively working on National Programmes of Action to implement the goals set by the World Summit for Children, all of which were incorporated into Agenda 21 at the June 1992 Earth Summit in Rio de Janeiro. Those ambitious goals—to be met by the year 2000—include controlling the major childhood diseases; cutting child malnutrition in half; reducing death rates for children under five by one-third; cutting in half maternal mortality rates; providing safe water and sanitation for all communities; and making family planning services and basic education universally available. In 1992, most regions of the developing world took the process a step further by selecting a core of targets for 1995, when the first World Social Summit will review children's progress within the broader development process. For the first time since the dawn of history, humankind is making long-term plans for improving the lives of the young.

In part, that new concern has its roots in the communications revolution that brings daily pictures of large-scale famine or violence into our homes. At the same time, the new communications capacity has permitted deprived populations everywhere to see how much better people can live, firing grassroots movements for reform and democracy. But most of the Third World's suffering remains invisible. Of the 35,000 children under age five who die every day in the developing countries, more than 32,000 succumb to largely preventable hunger

and illness. No earthquake, no flood, no war has taken the lives of a quarter million children in a single week; but that is the weekly death toll of the invisible emergencies resulting from poverty and underdevelopment. In 1992, 500,000 children under the age of five died in the kind of dramatic emergencies that attract media attention, but that is a small portion of the nearly 13 million children under five who are killed every year by grinding poverty and gross underdevelopment. The tragic deaths of 1,000 children per day in Somalia last year captured far more public attention than those of the 8,000 children around the world who die every day from the dehydration caused by ordinary diarrhea, which is so easily treated and prevented.

Calcutta, Lagos, and Mexico City today have far higher levels of immunization of children at ages one and two than do New York City, Washington, D.C., or even the United States as a whole.

As the international community assumes greater responsibility for proliferating civil strife and other emergencies, it must come to terms with the realities of limited resources. How many operations to rescue failed states like Somalia can the international community afford? It is estimated that the U.S. component of the Somalia operation alone will cost more than $750 million for just four months' involvement, nearly comparable to UNICEF's average annual global budget of recent years, much of which is used to prevent future crises. There are now 48 civil and ethnic conflicts in progress around the globe. The United Nations is involved in 14 peacekeeping operations on five continents. Last year, those operations cost more than $3 billion, about four times higher than the previous record. Those operations are the most expensive way to relieve suffering, and it is clearly time to invest far more in *preventing* emergencies and conflicts, and in buttressing the new democracies, even as we put out the world's fires. As U.N. secretary-general Boutros

Boutros-Ghali argues in his *Agenda for Peace*, prevention can prove far less costly—and produce far greater results—than relying on expensive and sometimes ineffective rescue operations.

As the international community shifts toward prevention—as it must—it makes the most sense to focus on eradicating poverty's worst manifestations early in the lives of children, breaking the cycle of poverty from generation to generation. At the World Summit for Children, the international community identified the basic package of high-impact, low-cost interventions that can make a difference in the short and medium term, while helping to build long-term development. Now it has only to make them work, albeit on a massive scale.

The overall price tag for reaching all the year 2000 goals for children and women, which would overcome most of the worst aspects of poverty, would be an extra $25 billion per year. The developing countries themselves are trying to come up with two-thirds of that amount by reordering their domestic priorities and budgets, while the remaining third—slightly more than $8 billion per year—should come from the industrialized world in the form of increased or reallocated official development assistance (ODA) and debt relief. That is a small price for meeting the basic needs of virtually every man, woman, and child in the developing world in nutrition, basic health, basic education, water and sanitation, and family planning within this decade.

In Russia and the other former Soviet republics, such aid could produce rapid grassroots results at an affordable cost, easing pain and helping to buy time until democratic and macroeconomic reforms show concrete progress. Plans for restoring democracy to Cambodia, Haiti, and Mozambique will need to alleviate suffering among the poor quickly; and targeting the essential needs of children and women can produce the biggest impact at the lowest cost. International relief programs for Somalia must rapidly give way to assistance that constitutes an investment in human development, and no such investment has been found to be more cost-effective than primary health care, nutrition,

and basic education for children and women. The road to power for many of the world's extremist movements—whether based in religion or political ideology—is paved with the unmet needs of the poor.

With an earnest effort from the major powers, the 1990s could witness a second green revolution.

Sadly, the U.S. has stagnated or regressed over the past decade with respect to children, even while much of the developing world has been making impressive progress. The United States has provided little leadership for that progress, except for that provided by the bipartisanship of Congress, which actively encouraged U.S. support to child survival and development programs abroad. But by increasing investment in American children and strengthening American families, and by reordering foreign assistance to reflect that new priority, the United States, the world's sole superpower, could once more set the global standard and give a major boost to human development and economic growth.

First, few actions would have more immediate impact than the signature and ratification this year of the historic Convention on the Rights of the Child. President Bill Clinton's signature of the convention and its submission to the U.S. Senate for early ratification (as has been urged by bipartisan leadership) would send an important message to the world, bringing the rights of children close to becoming humanity's first universal law.

Second, the United States needs to demonstrate a new culture of caring for its own children. The much-needed reordering of priorities for American children, women, and families is already under way, with initiatives on Head Start, universal immunization, parental leave, family planning, and health services for all. A "Culture of Caring," the American plan in response to the World Summit for Children that was issued at the end of the Bush administration—in January 1993—provides a useful base for bipartisan action.

Third, the United States needs "20/20

vision." It should support the May 1991 proposal of the United Nations Development Programme, which had two components: It called on developing countries to devote at least 20 per cent of their budgets to directly meeting the basic human needs of their people, roughly double current average levels. It also argued that 20 per cent of all international development aid should go to meet those same basic needs: primary health care, nutrition, basic education, family planning, and safe water and sanitation. Today, on average, less than 10 per cent of already inadequate levels of ODA are devoted to that purpose. Different ways of defining and reporting social sector allocations within national and ODA budgets make precise quantification of those proportions somewhat difficult, and efforts are therefore underway to achieve a common form of reporting. But even if subsequent research changes the target percentages, the "20/20 vision" concept underscores the importance of restructuring both sets of budgets in line with the priorities established at the World Summit for Children, which may require—on average—a doubling of existing allocations.

On the ODA side, the United States today devotes less than $1 billion to basic human needs. Of the projected $25 billion extra annually that will be required globally by mid-decade to meet the World Summit year 2000 goals, the U.S. share would be $2 billion. The roughly $3 billion total would then still be less than 20 per cent of all U.S. foreign and military assistance. It is a small price to pay for jumpstarting solutions to so many of the overwhelming problems of population, democracy, and the worst aspects of poverty, to say nothing about saving tens of millions of young lives this decade. The additional funds can be obtained from reductions in the military and security component of the U.S. international affairs budget.

Fourth, the new spirit of democratic change and economic reform in Africa will not survive if its creditors do not give it some debt relief: Together, the sub-Saharan African countries pay $1 billion in debt service to foreign creditors every month, and its debt is now proportionally three or four times heavier than

that of Latin America. At the November 1992 Organization of African Unity–sponsored International Conference on Assistance to African Children, donor countries and lending agencies alike pledged to promote more debt relief while expanding or restructuring ODA in order to help Africa protect and nurture its children. Here again the United States could help lead the way, preventing Africa from deteriorating into a continent of Somalias. The G-7 Summit in Tokyo in July 1993 should make a definitive commitment to debt relief, with much of the local currency proceeds going to accelerate programs for children, women, and the environment through a variety of debt-swapping mechanisms. With the right mixture of domestic and international support, and with apartheid ending in South Africa, we could see dramatic progress in most of Africa by the year 2000. That could include a food revolution every bit as green as Asia's—but African countries will need help. The alternative could be a return to authoritarian rule, corruption, and conflict throughout large parts of the continent.

Fifth, the United States must actively support multilateral cooperation. With human development and poverty alleviation increasingly accepted as the focus for development cooperation in the 1990s, the United States has an opportunity to transform rhetoric into reality. Active U.S. support and leadership along those lines in the World Bank, the International Monetary Fund, the regional banks, and throughout the U.N. system will go a long way toward overcoming, in our time, the worst aspects of poverty in the South, where it is most acute. Landmark U.N. conferences have been scheduled on human rights (1993), population (1994), and women (1995); U.S. leadership at those conferences and at the U.N. summit on social development in 1995 will strengthen their impact. The U.S. role will also be critical in reducing poverty in the North and in the transitional societies of Eastern Europe and the former Soviet Union.

Finally, the United States must strengthen its commitment to the United Nations. The new administration's initiative to seek restoration of U.S. funding for the United Nations Population Fund is a welcome step—a step that

Congress should rapidly implement. That and a decision to rejoin the United Nations Educational, Scientific, and Cultural Organization (UNESCO) would not only give an important boost to family planning and global education, but—together with full payment of its U.N. arrears—it would signal long-term U.S. commitment to the United Nations as the global village's central vehicle for development cooperation and safeguarding the peace.

Focusing on children as a means of attacking the worst aspects of poverty will not solve all the world's problems, but it would make a historic contribution—at this all-too-brief juncture of opportunity—to the better world we all seek. It could change the course of history.

DAVID C. MORRISON

WHOSE RIGHTS?

If nothing else, the just-concluded World Conference on Human Rights, at which representatives from 168 nations gathered in Vienna for 12 days of furious jawboning, was an epic arena for the clash of two conflicting notions of human rights: the Western and the Asian.

"There is a real danger that with the end of the Cold War, a new ideological battle may occur between the West and Asia over democracy and human rights," Tommy Thongbee Koh, former Singapore ambassador to the United States and the United Nations, warned in a much-remarked-upon May 6 op-ed piece in *The International Herald-Tribune*. "The West asserts that economic development and democracy are inseparable. An opposed thesis, heard often in Asia, maintains that a benign but authoritarian government is superior to a democratic government in achieving economic progress."

India, often touted as the world's largest democracy, is, after all, a badly splintered basket case, barely able to feed its own people. Under the stern hand of a comparatively benign authoritarian regime, by contrast, Singapore has built an enviably prosperous, if obsessively orderly, society.

In Vienna, Washington and the West prevailed in securing a final declaration affirming the "universal nature" of the much-ignored U.N. human rights standards. Going in, Zhang Yishan, the deputy chief of China's delegation to the Vienna meeting, had insisted that the United Nations "consider the rights of poorer countries to survival and development and stop using human rights as an excuse for interfering in the internal affairs of nations." In April, 34 Asian and Arab nations inked a statement in Bangkok, Thailand, urging that human rights guidelines be shaped by "regional peculiarities and various historical, cultural and religious backgrounds."

Amidst all the brouhaha in Vienna, Asian critics may have scored at least a few debating points in questioning an often self-righteous Western perspective that values political over economic rights. Without siding with the torturers and the worst human rights abusers, it can fairly be observed that Asian development patterns seem to suggest that enhanced political freedoms tend to follow, not precede, economic development. On its way to becoming the world's largest economy, after all, the United States tolerated slavery, child labor, an awesome concentration of power in the hands of a few "robber barons" and a host of other practices now considered unthinkable in a developed democracy.

South Korea provides a similar case in point. Gen. Park Chung-hee, who seized power in 1961 and ruled for the next 18 years, launched a "developmental dictatorship." Wielding slogans such as "Building a Self-Reliant National Economy," Park and subsequent military despots boosted South Korea's per capita gross domestic product from less than $70 at the end of the Korean civil war to more than $6,000 today.

This burgeoning "economy in armor" gave birth to an increasingly assertive middle class, which, inevitably, demanded more political freedom than the general-presidents had been inclined to grant. In February, as a result, South Korea's first freely elected civilian president, veteran dissident Kim Young-sam, was inaugurated with a mandate to craft a "New Korea," free of the corruption and abuses of individual rights that ran rife under the ancien regime. "Now comes the hard part," a Western diplomat in Seoul observed in a mid-May interview: "crafting legislation to institutionalize these reforms." Having had their fill of authoritarianism, South Koreans seem up to that daunting task.

Taiwan also experienced an economic miracle under the rigid rule of an unelected president, Chiang Ching-kuo, and has also recently come to enjoy expanded democratic rights thanks to overwhelming domestic political pressure. And, according to a new Asia Foundation study on democratization in Asia, the May 1992 demonstrations in Thailand that brought down the government of Gen. Kraprayoon Suchinda "may indicate that the rising middle class is no longer willing to let the military dominate politics."

None of this is to argue that there is an unswerving straight-line correlation between despotism and development. "Authoritarian systems do not equal economic growth," Muthiah Alagappa, formerly a Malaysian army officer and now an analyst of international economics and politics at the East-West Center in Honolulu, noted in an interview. "It depends on the policies and goals of the government." Pakistan, one of Asia's least democratic nations, remember, is also one of its least developed. And the shell-shocked Philippines have yet to show signs of sustained economic revival, despite having thrown off a dictatorship seven years ago.

But Asia's recent track record suggests that this issue is more complex than some Western advocates like to think. Western nations also have a rather frail foothold on the high ground, considering that most of them were once colonialist occupiers and that Western adherence to human rights was spotty at best during the long Cold War. Human rights "is, in part, a power play, a Western imposition brought to bear when it serves Western interests," Alagappa added. "But the cultural argument that Asian society approaches human rights differently is also a rationale. You have to put these things in the context of the society in question."

The Asian society most often in question in Washington is China. But it is not inconceivable that as China develops, as it is now doing at a breakneck pace, Western-style political rights will follow, as they have in South Korea and Taiwan. "There are unrealistic expectations on our side about what we can and should do about human rights," a U.S. diplomat in Beijing observed in a recent interview there. "Is China the worst violator? Not necessarily. And there are some promising trends. Driven by economics, we are closer than we may recognize to fundamental changes in individuals' relations to the state, which will have less of an invasive role in the everday lives of people" as the inexorable logic of development and middle-class ascendance takes hold in China. ■

U.S. AND GLOBAL

MACROECONOMIC TRENDS

U.S. and GLOBAL MACROECONOMIC TRENDS

Statement of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Committee on Finance, U.S. Senate, March 24, 1993, Federal Reserve Bulletin, The Federal Reserve of the United States, 1993.

Address by Lawrence H. Summers, Under Secretary-Designate of the Treasury at the Annual Meeting of the Inter-American Development Bank, Hamburg, Germany, March 30, 1993, Treasury News, U.S. Department of the Treasury, March 30, 1993.

Tobin, James. "Thinking Straight About Fiscal Stimulus and Deficit Reduction," Challenge, March-April 1993.

World Economic Outlook (Overview), Survey by the Staff of the International Monetary Fund, May 1993.

Dobson, Wendy. "Should G-7 Cooperation be Buried?" International Economic Insights, Institute for International Economics, May/June 1993.

"Brighter Economic Outlook Projected for Developing Countries in the 1990s," World Bank News, The World Bank, April 15, 1993.

Hager, George. "Clinton's Plan to Cut Deficit Begins Moving in House," Congressional Quarterly, May 15, 1993.

Rubin, Alissa J. "Are U.S. Taxpayers Ready for Health-Care Reform?" Congressional Quarterly, April 17, 1993.

FEDERAL RESERVE
BULLETIN

Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Committee on Finance, U.S. Senate, March 24, 1993

As I have indicated to other committees of the Congress in recent days, our burgeoning structural budget deficit, unless addressed, will increasingly threaten the stability of our economic system. Time is no longer on our side. At 5 percent of gross domestic product (GDP), the current deficit is very large by historical standards. After declining through 1996, the current services deficit starts on an inexorable upward path again. On a cyclically adjusted or structural basis, the deficit has hovered around 3 percent of potential GDP for the past ten years, a phenomenon without precedent in our peacetime history.

I am encouraged that the President and the Congress are making serious efforts to restore a measure of balance to our fiscal affairs.

It is beguiling to contemplate the downtrend in inflation in recent years in the context of very large budget deficits and to conclude that the concerns about their adverse effects on the economy have been misplaced. Regrettably, this notion is dubious. The deficit is a corrosive force that already has begun to eat away at the foundations of our economic strength. Financing of private capital investment has been crowded out, and, not surprisingly, the United States has experienced a lower level of net investment relative to GDP than any other of the Group of Seven countries in the past decade.

To some degree, the impact of the federal budget deficits over the past decade has been muted as we imported resources to help finance them. This can be seen in our large trade and current account deficits. However, we should not—indeed, we probably cannot—rely on foreign sources of funds indefinitely. If we do nothing, the markets will ultimately force an adjustment; by acting now to redress our internal imbalance, we can lower the risk of unpleasant stresses down the road.

I shall eschew, as I have in previous testimonies, comments on the specific elements of the deficit-reduction proposals currently under review by the Congress. I should like, nonetheless, to take the time you have made available to outline my views on the principles that should underlie current deliberations.

First, according to both the Office of Management and Budget and the Congressional Budget Office, deficits are likely to be held in check by relatively good economic performance over the next few years. But from 1997 on, budget outlays under existing law are projected to rise appreciably faster than the tax base. If such trends are not altered, stabilizing the deficit-to-GDP ratio solely from the receipts side, not to mention reducing it, will necessarily require ever-increasing *tax rates*. This would surely undercut incentives for risktaking and inevitably damp the long-term growth and tax revenue potential of our economy. The gap between spending and revenues will not close under such conditions. Thus, there is no alternative to achieving much slower growth of outlays if deficit control is our objective. This implies the need not only to make cuts now, but also to control the growth of future spending so that it does not exceed, and preferably is less than, the projected growth in the tax base.

The thought expressed by some that we can inflate our way out of the budget deficit is fanciful. Aside from its serious debilitating effects on our economic system, higher inflation, given the explicit and implicit indexing of receipts and expenditures, would not reduce the deficit. As I indicated in testimony to the Joint Economic Committee in January, there is a possibility that productivity has moved into a significantly faster long-term growth channel, which would boost real growth and tax revenues over time. But even if that turns out to be the case, short of an increase beyond anything that we can reasonably anticipate at this time, productivity, in itself, would not be enough to resolve the basic long-term imbalance in our budgetary accounts. Thus, while economic growth is necessary to contain budget deficits, it regrettably is not sufficient.

In deciding how to pare a structural budget deficit, it is important to be clear on the different roles of boosting taxes, on the one hand, and cutting spending programs, on the other. All feasible taxes, by their very nature, restrain business activity. Hence, excluding so-called sin taxes and possibly environmental taxes, increases in taxes can be justified only to finance expenditures that are deemed essential. The level and composition of outlays to be financed by revenues is, in our society, a political matter, as is also the degree of progressivity and incidence of taxation. But over the long run, it is important to recognize that trying to wholly, or substantially, address a structural budget deficit by increasing revenues is fraught with exceptional difficulties and is more likely to fail than succeed.

All else equal, reducing the deficit would enlarge the pool of savings available for private capital investment. But investment will not automatically occur unless there are adequate incentives for risktaking.

A greater willingness of a society to consume less of its current income should lower real interest rates and spur such investment. But if risktaking is discouraged through excessive taxation of capital or repressive regulation, high levels of investment will not emerge and the level of saving will fall as real incomes stagnate.

The process by which government deficits divert resources from private investment is part of the broader process of redirecting the allocation of real resources that inevitably accompanies the activities of the federal government. The federal government can preempt resources from the private sector or direct their usage by several different means, the most important of which are (1) spending, financed by taxation; (2) spending, financed by borrowing, that is, deficit spending; (3) regulation mandating private activities such as investment in pollution control or safety equipment, which are likely to be financed through the issuance of debt; and (4) government guarantees of private borrowing.

What deficit spending and regulatory measures have in common is that the preemption of resources, directly or indirectly, is not sensitive to the rate of interest. The federal government, for example, will finance its budget deficit in full, irrespective of the interest rate it must pay to raise the funds. Borrowing with government-guaranteed debt may be interest sensitive, but the guarantees have the effect of preempting resources from those without access to riskless credit. Government spending fully financed by taxation does, of course, preempt real resources from the private sector, but the process works through channels other than through real interest rates.

Purely private activities, on the other hand, are, to a greater or lesser extent, responsive to real interest rates. The demand for housing, for example, falls off dramatically as mortgage interest rates rise. Inventory demand is clearly a function of short-term interest rates, and the level of interest rates, as it is reflected in the cost of capital, is a key element in the decision about whether to expand or modernize productive capacity. Hence, to the extent that the demand for saving exceeds its supply, interest rates will rise until sufficient excess demand is finally crowded out.

The crowded-out demand cannot, of course, be that of the federal government, directly or indirectly, because federal government demand does not respond to rising interest rates. Rather, real interest rates will rise to the point that private borrowing is reduced sufficiently to allow the entire requirements of the federal government, including its on- and off-budget deficits and all its collateral guarantees and mandated activities, to be met.

In these circumstances, there is no alternative to higher real interest rates diverting real resources from the private to the public sector. In the short run, nominal short-term interest rates may temporarily be held down if the Federal Reserve accommodates the excess demand for funds through a more expansionary monetary policy. But this will only produce greater inflation and, ultimately, have little, if any, effect on the allocation of real resources between the private and public sectors.

In such an environment, inflationary forces too often lead to increased risk premiums, higher real interest rates, and a higher cost of capital. This, in turn, engenders a foreshortening of the time horizon of investment decisions and a decreasing willingness to commit to the long term, a commitment that is so crucial to a modern technologically advanced economy. Structural budget deficits and excessive collateral credit preemptions are symptoms of a society overconsuming, undersaving, and underinvesting.

While there is no substitute for political will in resulting in outsized structural budget deficits, there are changes, I believe, that could make the budget process more effective. In particular, it is worth reconsidering sunset legislation, which would impose explicit termination dates on spending programs. Expiring programs that still have merit should have no difficulty being reauthorized, but programs whose justification has become less compelling would not receive the necessary votes. Indeed, it is hard to imagine that sunset legislation would not lead to at least some improvement over the current situation, quite possibly fostering nontrivial budget savings.

It also would be useful to take a look at the current-services methodology for evaluating budget changes. A baseline estimate obviously is a necessary ingredient in the budget process that helps inform policymakers about the impact of policy proposals. However, the current-services concept assumes that no further taken to alter existing programs. This is quite unrealistic, but it would be of no particular significance were it not for the fact that the bias of such actions is patently toward more spending rather than less. Hence, merely owing to ongoing congressional deliberations, administrative rulings, and decisions, an add-on to the current services outlay estimates is required to get a better view of what might be termed the "expected" deficit of the future. It is not possible to know in advance which spending programs will be expanded, except that some will. In recent years, congressional current services outlay estimates have consistently been adjusted upward in response to such technical reestimations of program costs. Indeed, technical reestimates explain a significant part of the failure of the deficit to fall as contemplated at the time of enactment of the Omnibus Budget Reconciliation Act of 1990.

Finally, although I do not favor a balanced budget amendment on the grounds that it might be impossible to enforce, I would support a constitutional amendment, or even a legislative provision, that stipulates that all revenue and expenditure initiatives require supermajorities (for example, 60 percent) to pass both houses of the Congress. Combined with sunset legislation, such a procedure could probably go far to neutralize the obvious propensity of our political system toward structural deficits.

Let me conclude by reiterating my central message. The deficit is a malignant force in our economy. How the deficit is reduced is very important; that it be done is crucial. Allowing it to fester would court a dangerous erosion of our economic strength and a potentially significant deterioration in our real standard of living. Fortunately, we have it in our power to reverse this process. This committee has an important role in this process. Speaking as a citizen, I wish you well. □

TREASURY NEWS
Department of the Treasury Washington, D.C. Telephone 202-622-2960

ADDRESS BY LAWRENCE H. SUMMERS[1]
UNDER SECRETARY-DESIGNATE OF THE TREASURY AND
TEMPORARY ALTERNATE GOVERNOR FOR THE UNITED STATES
AT THE ANNUAL MEETING OF THE
INTER-AMERICAN DEVELOPMENT BANK
HAMBURG, GERMANY
MARCH 30, 1993

Distinguished Governors, Mr. President, delegates and friends: I am extremely pleased to be here in this historic city of Hamburg and among so many friends of the Americas. I want to thank our German hosts for their gracious hospitality which has added so much to the quality of our deliberations. I also want to offer our warmest congratulations to President Enrique Iglesias on his recent reelection as President of the Inter-American Development Bank.

Together, we look to the Inter-American Development Bank to be a catalyst for sustaining and deepening the truly historic social and economic trends in the Latin American region that have occurred over the last several years. We look to the IDB as an institutional commitment of our hemispheric partnership for prosperity.

As President Clinton's nominee to be the Under Secretary for International Affairs at the Department of the Treasury, I welcome this opportunity to underscore the commitment of President Clinton and Secretary Bentsen to this strong and growing relationship with Latin America and the Caribbean. Presidents from Roosevelt to Clinton have understood the shared destiny of our peoples. The new Administration in Washington sees Latin America as a partner, and we are working closely with our Congress to shape the many dimensions of our partnership.

Our countries and cultures have much in common. We are a young, vibrant hemisphere with an optimistic outlook. We believe in markets, yet we also believe that governments have an appropriate role to play. We have common interests in the areas of trade, investment and debt. We share similar views of problems and solutions. We are not plagued by the negative aspects of nationalism, and we believe in the promise of the modern state. Our hemisphere has a new generation of post-Cold War leaders, leaders committed to democratic principles.

[1]As presented by James H. Fall, Deputy Assistant Secretary of the Treasury.

For both Latin America and the United States, the early 1980s were marred by high interest rates and record debts; the 1990s offer the promise of the opposite, low interest rates and reduced debts. The 1980s saw regional disputes over contras, commandantes, and human rights; the 1990s will be devoted to promoting greater regional integration. The early 1980s witnessed protectionism, government-led growth and burdensome regulation in Latin America, but the 1990s can be a decade of mutual accord over hemispheric growth, political plurality, and environmental sustainability.

There is a distinct echo in the reform efforts underway in Argentina, Chile, Mexico, and elsewhere in Latin America and President Clinton's economic plan for domestic renewal. Each effort was thought to be politically impossible, but each actually has received a broad base of public support. President Clinton's program and the Latin American reform plans also share an activist approach to economic policy, with a two-pronged approach marrying pro-growth and anti-poverty measures.

The President's plan has a number of critical components. First, the President proposed the most serious deficit reduction package in the history of the United States. By 1997, when the provisions of the plan are fully phased in, the annual deficit will be reduced by $140 billion. Second, the package includes short-term stimulus measures to sustain and push forward the nascent recovery. Third, the package includes an investment component to start shifting the composition of the federal budget from consumption to investment. Finally, the President's plan includes a broad-based energy tax. This will not only help cut the deficit but will promote environmental standards by effectively taxing pollution.

The domestic economic plan will advance American foreign policy. By restoring fiscal responsibility and promoting long-term investment and growth, the United States is setting a strong economic foundation for the 21st century.

The President's plan was designed to create jobs and spur growth at home, but there are powerful benefits in its adoption for all the Americas. The plan will be good for Latin America in several important respects. It will secure financial stability and growth in the United States economy, offering larger markets for Latin exports. United States imports from Latin America and the Caribbean were $70 billion for 1992, with the prospect of reaching $100 billion by the end of the century. A one percent increase in U.S. GDP would boost regional non-fuel exports by $1 billion, and the secondary effects of that export growth would boost regional GDP by a further $2 billion.

Lower long-term world interest rates will have a major impact on Latin America. A one percentage point reduction in interest rates would reduce annual debt service by at least $1 billion on the $430 billion in Latin American and Caribbean debt. The economic plan has already had a significant impact on long-term rates.

A new focus on our national infrastructure and a promotion of high-tech, high-wage industries, sharpens U.S. competitiveness and strengthens our trade. This Administration is committed to the maintenance of a free and fair trading system among the Americas, and elsewhere, that will promote global export opportunities for all. We believe in the benefits of an open trading system. Where barriers to trade exist, we will work vigorously to enforce existing agreements or, where necessary, negotiate new ones.

In his recent speech at American University in Washington, D.C., the President stated his desire for a strong Uruguay Round agreement that will not only eliminate tariffs on goods, but will also secure financial market liberalization on a global scale. And we will work to ensure that just as our market is generally open to foreign friends that wish to invest in America, foreign markets should also be open to American investment.

The President has also pledged his strong support for the new North American Free Trade Agreement. To finalize NAFTA, we are working with Canada and Mexico to reach key understandings in the areas of environmental quality and workers' rights. And we hope to be able to negotiate and extend the benefits of NAFTA to other nations as well.

The President's vision of a new economic prosperity will reinforce and accelerate three positive trends in Latin America: 1) a redefined role of the state; 2) financial stability; and 3) political openness. Let me touch on each of these:

> **Redefined role of the state:** There are serious efforts now underway to de-regulate for higher productivity, a willingness to abolish tariffs, a desire to accept technology and allow market access to foreign firms, a drive towards privatization and a commitment to regional integration. These are mutually reinforcing actions that imply and mean less state intrusion in economies.
>
> **Financial stabilization:** This is a crucial ingredient for regional economic growth. Latin America's finance ministries have rationalized government spending, cut deficits, improved tax collection, and, in some cases, introduced fairness into the tax code. Exchange rates

> are now more responsive to market forces. Inflation has been cut. As a result, real GDP growth rates in 1992 are up by roughly 10% in Chile, Argentina, and Venezuela, and up by 3% in Mexico.
>
> **Political openness:** A new political process is ascendant in Latin America. Popular, democratic elections and institutions are the rule rather than the exception. The entire region is more open -- politically, culturally, socially and commercially. In the last two years, intraregional trade has exploded. As both democracy and capitalism are under siege in the former communist states, the appeal and credibility of these ideas depend importantly on whether Latin America continues to succeed. The revolution in economics in Latin America is no less sensational than the revolution in Russia, and the immediate prognosis is far better in Latin America.

There has been profound progress and revolutionary change in Latin America and the Caribbean over the last several years. The Enterprise for the Americas Initiative (EAI) reflected a bipartisan U.S. approach to help speed these changes. We continue to support its goals in the areas of debt, investment and trade. The IDB's Investment Sector Loan Program has made a major contribution to the reform effort across the hemisphere. The foreign debt problems affecting the region have been reduced to manageable proportions with the help of the IDB. The IDB has played a major role in the EAI and will continue to do so in developing investment sector loans and administering the Multilateral Investment Fund.

Indeed, much remains to be done. Many countries' physical infrastructure is deteriorating, and in several countries the extent of poverty and suffering has increased. Millions still struggle to scratch out a living on less than $1 a day. Distorted income distribution remains a potential source of serious social conflict. In some places, the richest twenty percent of the population controls over twenty-five times the wealth of the poorest twenty percent. And inflation continues to pose a threat, having refused, even in the best cases, to drop back to single digits. Political and social inequality persists where economic reforms have not been accompanied by the modernization of political institutions.

Several important countries in the region, including Brazil and Peru, face serious political and economic challenges. If the fledgling market reforms are to be sustained, Latin leaders must address critical issues, including the alleviation of poverty, human rights, environmental protection, and removing government impediments to innovation and growth.

To redress these problems, some would call for a return to state ownership and a massive redistribution of wealth. But statist economies and government-dominated enterprises are a thing of the past. The fact is that over time, state control has done more to damage their people than fair, efficient and open markets ever did. The legacy of state economies is a series of failed governments, repressed democracies, damaged environments, economic stagnation and poverty. We cannot go back. Governments clearly have a necessary role to play in ensuring economic vitality and realizing human potential. But governments must get out of those areas where markets and the private sector work better.

Look at a success story. Chile is an excellent example of a country that has implemented far-reaching macroeconomic reforms, encouraged the development of the private sector and markets, in part through an aggressive privatization program. Now the government can concentrate its resources on the social sector. As Minister Foxley stated here in Hamburg on Sunday, the Alwyn Administration will spend $6 billion on social programs this year, a thirty percent increase over 1991. Chile's wide-ranging reforms have led to a substantial increase in economic growth. Chile has demonstrated the political will to make social programs a priority. This is a good example for other countries and it is a good example for the Bank.

We believe the Bank must now play a far more aggressive role in advancing human welfare by supporting better programs in basic education, health and sanitation. The Bank can be in the vanguard in ensuring that education is broadly available, especially to the poor. A vibrant private sector can assume greater responsibility for university education, freeing scarce public resources for primary education. We believe the Bank also has a critical role in advancing health care; there are too many big hospitals that benefit the elite in Latin America and too few primary health care facilities for the poor and in rural areas. The Bank can help address judicial reform and important issues such as land tenure.

For the Eighth Replenishment, the United States is asking the IDB to advance the quality of its lending program. We are asking the Bank -- and more importantly its member governments -- to maintain a strong commitment to structural reform and the private sector. We are also asking the Bank to strengthen its commitment to environmental protection and to support social programs. There is no reason why structural adjustment and environmental integrity cannot go hand in hand, and the U.S. will work closely with member countries and Bank officials to help realize this potential.

We are asking that the Inter-American Development Bank become a leading force for transparency and accountability in public finance. We ask the Bank to seek public participation in all its development activities and decisions, especially among the people who will be affected. We believe that the Bank should be an institutional leader in providing prompt public access to project information in donor and borrowing countries.

We are also asking the Bank Group to further rationalize its lending practices, streamline its management operations and increase the professionalization of its staff. We believe the Multilateral Investment Fund must remain a lean operation and the Inter-American Investment Corporation should restructure its management to achieve cost savings. We believe the Bank itself can reduce overhead expenses, and we encourage the Board of Directors to lead the way in reducing its own costs. Finally, we believe that the Bank and its members, both within the Western Hemisphere and beyond, should change the way they view the Bank and the allocation of its resources. Notions of fixed allotments and lending targets, along with inappropriate use of concessional and grant funds should be retired once and for all.

Governors and Friends, we believe this Bank can move to the forefront of social, environmental and economic development for the region. We depart Hamburg with full confidence that Latin America and the Caribbean are on a path to sound social and economic development.

I thank you again for your warm hospitality, and I look forward to working with you all in a spirit of close cooperation in the months and years ahead.

- ♦ -

JAMES TOBIN

Thinking Straight About Fiscal Stimulus and Deficit Reduction

Keeping ends and means straight may be too much to ask of politicians and pundits, but it is not too much to ask of economists and policy wonks.

On February 17th, President Clinton presented to a joint session of Congress that was televised to a nationwide audience, a fairly detailed economic program that is to be the central work of his administration.

This article is based on a memo prepared in November, 1992 for the Congressional Budget Office panel of economic consultants. It has been modified only slightly to reflect subsequent events prior to President Clinton's February 17th address.

The purpose here is not to present a policy proposal that in any way competes with President Clinton's proposed plan, but rather to indicate how professional economists should analyze our current budget problems and fiscal corrections.

Putting first things first

Deficit reduction is not an end in itself. Its rationale is to improve the productivity, real wages, and living standards of our children and their children. If the measures taken to cut deficits actually diminish GDP, raise unemployment, and reduce future-oriented activities of governments, businesses, and households, they do not advance the goals that are their raisons d'être; rather, they retard them.

This perverse result is likely if deficit reduction measures are introduced while the economy is as weak and as constrained by effective demand as it is now and will be in 1993, and quite possibly in 1994 as well. Moreover, if public sector future-oriented expenditures are the victims of such mistimed and misplaced fiscal austerity, the contradiction between rationale and actual consequence is compounded.

By the same argument, it does not make sense to oppose, on the ground that they will raise the deficit, fiscal measures which would stimulate demand, reduce unemployment, raise the GDP, and very likely raise private investment too. It is especially illogical to do so if the measures in question are themselves future-oriented, public sector investments and tax incentives for private investment.

Keeping ends and means straight may be too much to ask of politicians and pundits, but it is not too much to ask of economists and policy wonks.

JAMES TOBIN, Nobel Laureate, is Sterling Professor Emeritus of Economics at Yale University.

Isn't recovery already in the bag?

That's what some critics asked when Bob Solow and I, and one-hundred or so like-minded business and academic economists, tried to advance the idea of investment-oriented fiscal stimulus last March. Some of those critics later repented. The current signs of macroeconomic improvement are more credible. However, it is too soon to bet that the growth recession that began in the second quarter of 1989 is over.

So far, what is heralded as recovery is two quarters of growth above the sustainable growth of potential output. The third and fourth quarters were comfortably above the sustainable rate, but still two percentage points below usual performance in the first year of recovery. If, on its own, the economy grows faster than its sustainable rate in 1993 and 1994, the consensus is that it will do so by much less than has been normal in postwar cyclical recoveries.

While the unemployment rate has declined seven-tenths of a point from its peak, employment growth remains sluggish. The number of new jobs has not been quite enough to absorb the labor force growth expected in prosperity. We need 8 or 9 million net new jobs in the next four years to keep up with the labor force and productivity, and bring the unemployment rate down to 5.5 percent

At present the economy is producing real GDP 5 or 6 percent below its potential capacity anticipated with 5.5 percent unemployment. Closing this gap in four years requires exceeding the economy's sustainable growth rate by 1.25 to 1.5 points on average. The sustainable growth rate is estimated to be 2.25 or 2.5 percent per year. Thus, recovery over four years requires average growth on the order of 3.5 to 4.0 percent.

Recent good news about productivity suggests that the gap may be larger and the sustainable growth rate higher than the estimates used above. It is too soon to tell if the good productivity numbers are just cyclical and transitory, as has happened in the early stages of many recoveries. But they reflect the success of the competitive adjustments, downsizing, and layoffs of American businesses in improving efficiency, productivity, and productivity growth. If so, it will take bigger gains in GDP in the next four years to achieve the same gains in employment.

The outlook for stable price inflation, with or without a catch-up recovery, is extraordinarily favorable. In these circumstances, the risks of overheating the economy by modest deficit-increasing fiscal stimulus—say, on the order of 1 percent of GDP for both 1993 and 1994—are minimal. With the help of the multiplier, that would raise the level of GDP by 1.5 or 2 percent (if the Fed is accommodative), and raise its rate of growth by 0.75 or 1.00 percentage points. The inflationary risks are minimal relative to the downside risks to GDP and employment of doing nothing. Anyone who used to believe in well-behaved cycles, in which well-defined recession troughs automatically turn into monotonic and accelerating recoveries, must be considerably chastened by now.

Can't the Fed do the job?

Evidently the Fed can't or won't. I still think that, with 300 basis points between the Funds rate and zero, the Federal Open Market Committee can, and should, try harder. But there are reasons why monetary policy has been less potent than usual—the weak balance sheets of banks, the overhangs of debt among potential borrowers, the stickiness of long-term interest rates. Moreover, the growth recession lingered so long and the responses of monetary policy were so grudging that businesses and households lost the confidence in future prosperity that has historically facilitated most postwar recoveries. The 1990s slowdown, moreover, has been accompanied by unusually large downward structural adjustments, to defense cutbacks and to global competition. As James Medoff has been pointing out, vacancies—as proxied by the Help Wanted Index—are extraordinarily scarce relative to current unemployment rates. In addition to the direct contractionary effects of irreversible layoffs, these adjustments have generated pervasive feelings of insecurity, which also inhibit spending.

Won't the Fed offset fiscal stimulus?

My guess is that the Fed, while unable or unwilling to take the initiative to generate or accelerate recovery, is willing to allow and accommodate one driven by "natural causes" or by moderate fiscal stimulus. Given the outlook for recovery and for inflation, there is little likelihood of a sudden overheating beyond the capacity of the Fed to arrest. Certainly the new president and his team will make every

200

effort to persuade the Fed of the prudence of its policy and the reality of its commitment to deficit reduction once prosperity is restored.

In 1960-61 the Fed checked the predictable fall in interest rates in recessions because it was worried about outflows of short-term funds to higher-interest-rate European markets, and the losses of gold that might result. For this reason, monetary policy could not be an active agent of recovery. But the Kennedy Administration was able to persuade the Fed to lean only gently against the wind, as aggregate demand recovered for other reasons, including fiscal stimulus.

Won't the bond market offset fiscal stimulus?

I don't really believe in some super-central-bank whose mandarins pass judgment on policies and control the macroeconomic path of the nation by moving long-term bond rates. If these omnipotent governors existed at all, I suppose their policy objective would be to maintain a slack economy with negligible risks of inflation or capital market congestion, like the one we've enjoyed the last four years. They would render ineffectual any monetary or fiscal policies aimed at recovery.

Actual bond investors are institutions, insurance companies and pension funds, that manage growth portfolios on behalf of policy-holders and future beneficiaries. Those funds have to go somewhere, and if the alternatives to long-term bonds offer unattractive returns, they will go into long-term bonds even at lower yields. That's why it is important for the Fed to keep short rates low. One of the fruits of that policy has been the bullish stock market, which has made the cost of equity capital to non-financial corporations low even though the decline in long-term bond rates has been disappointingly small. Presumably, low prospective returns on stocks bring downward pressure on bond rates; interactions between the markets occur in both directions.

High bond rates in foreign markets are another alternative to dollar-denominated bonds. While the dollar was steadily falling against the Deutsche mark, the likelihood of capital gains in the currency market was compounding the interest rate attraction of German and other European bonds. But this could not be sustained. Apparently, the dollar fell far enough that dollar appreciation could be expected to compensate for the interest differential.

The federal government itself is the principal heavy long-term borrower. The Treasury should stop adding to the supply of long-maturity bonds. The Fed should, when its monetary policy involves supplying more bank reserves to the money market, remove long-maturity bonds from the market. No law of man or nature requires that all central bank open-market-interventions occur in the shortest possible instruments.

Naturally, the new administration will do its best to explain to the "bond markets" its strategies for short-run recovery and long-run fiscal discipline. One hopes that the Federal Reserve will join in this effort of persuasion and reassurance. But there is no getting around the fact that the kind of economy those mythical mandarins prefer is one that will make President Clinton run for re-election in 1996 not as the "failed governor of a small state" but as the failed president of a great nation.

Is less more?

Some financial pundits and some economists say that fiscal austerity is actually expansionary because it reduces long-term interest rates. As a proposition regarding fiscal policy in 1993, with given monetary policy, this is surely a fallacy. If the problem with fiscal stimulus is that it increases aggregate demand and thus raises interest rates, then fiscal austerity cannot at the same time raise aggregate demand and lower rates. It can lower rates only by curtailing demand and economic activity.

Deficit reduction expected in future, inadequately offset by easier monetary policy and lower interest rates, could be unfavorable to 1993 investment and economic activity by perpetuating expectations of weak demand and low economic activity. However, deficit reduction expected in the future, during prosperous times, would be quite favorable to aggregate demand and economic activity in 1993, provided that the Federal Reserve's monetary policy was expected to assure interest rates sufficiently low to make up for the future demand lost by fiscal austerity. A scenario that generates "model-consistent" expectations, expectations supporting the scenario itself, consists of expansionary fiscal policy and accommodative monetary policy for recovery, followed by deficit reduction and appropriately easy monetary policy in prosperity.

Will it ever be time to remove the fiscal stimulus needed now?

If the economy can't generate enough demand at today's low interest rates without a bigger deficit, what reason is there to think it will be able to do so in 1995 or 1996? The question is reminiscent of the old debate about pump-priming. It is a vulgar error to think that a burst of spending turned off after a few months would jump-start the economy into vigorous self-sustaining growth of demand. It is likewise an error to think that the present situation is an equilibrium, in particular, that investment demands by business, households, and state and local governments are permanently as low relative to national saving as they are currently. Recovery itself will revive those demands once economic agents regain confidence in a viable path of recovery and growth. Then, judging from the 1980s, interest rates will be higher than they are now in the absence of deficit reduction, and a correction in the mix of fiscal and monetary policies will be possible and desirable.

Can future fiscal austerity be made credible?

It's never possible to make wholly credible guarantees of future policies in a democracy. Yet somehow the republic has managed to muddle through. Some deficit reduction measures can be legislated in 1993 to take effect in later years. It would then take both Congress and the President to reverse them, assuming vetoes are sustained. This should certainly be done for tax increases. A phased-in carbon tax or gasoline tax increase would be an excellent, though not politically popular, idea. Cuts in defense expenditures can be credibly budgeted for years ahead. In other cases, the new administration may be able to do no more than state reasonably realistic intentions.

The most important budgetary area is health care reform, a critical item on the legislative agenda for its own sake. Unless federal net health care costs are brought under control, their explosion later in the 1990s will bust the budget for sure.

There ain't no justice!

The new president faces a large chronic budget deficit bequeathed to him by the unparalleled, irresponsible fiscal policies of his two predecessors. It is ironic that people who displayed remarkable tolerance of those policies for twelve years now insist that the highest and most immediate priority of the new president, the very test of his statesmanship, is to solve this deficit problem in the face of the stagnant economy he has also been bequeathed, at the sacrifice of his own programmatic priorities.

Recoveries from almost every previous postwar recession have had the help of fiscal stimulus. The much touted 1983-88 recovery was driven by fiscal demand stimulus massively greater than any previous peacetime fiscal expansion. It took two main forms: consumption by affluent taxpayers enjoying lower tax rates and a rapid build-up of defense spending. Neither of these uses of resources left in its wake lasting gains in future productivity and growth; Clinton's spending and tax-cutting initiatives, in contrast, are tilted towards investment, public and private.

During the past twelve years, the ratio of publicly held federal debt to GDP has increased by twenty-five percentage points. The future of the United States surely does not hinge on whether it increases by a couple of extra points in the next few years, in the interest of an economic recovery that would make the economy strong enough to allow serious deficit reduction.

204

WORLD ECONOMIC OUTLOOK

I

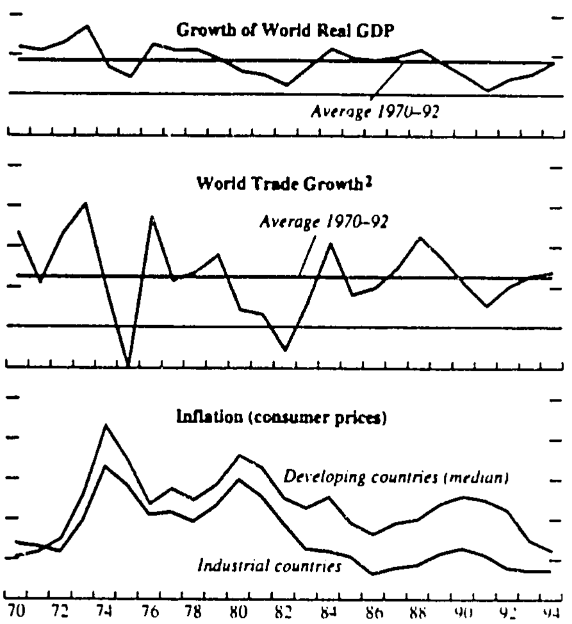
Overview

The recovery of global economic activity after the 1991 downturn remains hesitant and uneven. Although some industrial countries have emerged from recession, growth has declined sharply in many other countries because of extensive balance sheet restructuring, persistently high short-term real interest rates, considerable financial tensions, and depressed levels of consumer and business confidence. As a result, the growth of world output picked up only modestly, from ½ of 1 percent in 1991 to 1¾ percent in 1992, which was the third consecutive year of below-trend performance (Chart 1). World output is projected to grow by 2¼ percent in 1993 and then to strengthen by 3½ percent in 1994, but the outlook remains unusually uncertain. On the positive side, inflation has continued to abate in most industrial and developing countries.

Encouraging signs of stronger growth in North America contrast with the recent marked deterioration in economic performance in Japan and especially in Europe, where recessionary tendencies are expected to persist through much of 1993. For Japan, growth in 1993 has been revised down to 1¼ percent, from 2½ percent in the January 1993 *Interim Assessment* and 3¾ percent in the October 1992 *World Economic Outlook*. These revisions are due partly to the effects of balance sheet adjustments by households, corporations, and financial institutions after the recent correction of inflated asset prices. The sharp slowing of growth in Europe—to a revised projection that suggests stagnation in 1993 compared with 1 percent growth in the *Interim Assessment* and 2¼ percent in the October *World Economic Outlook*—reflects a range of adverse factors, including tight monetary conditions, inadequate progress toward inflation convergence and budgetary consolidation in many countries, and the attendant weakness of consumer and business confidence. More generally, the turbulence in foreign exchange markets since the middle of 1992 and an escalation of tensions over trade have contributed to increased uncertainty in many countries.

Many developing countries have continued to show resilience to the weakness of activity in industrial countries. Low interest rates on dollar-denominated external liabilities, and considerable

Chart 1. World Indicators[1]
(In percent)



[1]Blue shaded areas indicate IMF staff projections.
[2]Excluding trade among states of the former U.S.S.R.

207

capital inflows in some cases, have helped to offset the effects of declining terms of trade for commodity exporters and of generally weak demand in the industrial countries. But the most important reason for the comparatively strong performance of a growing number of developing countries has been the beneficial effects of sustained stabilization and reform efforts in the context of outward-oriented economic strategies. For many other developing countries, however, economic performance has remained unsatisfactory, and living standards are continuing to decline in many of the poorest countries.

The economic situation also remains difficult for the countries in transition from central planning, following what has already been a sizable decline in output. The contraction now appears to be bottoming out in parts of central Europe, where some countries are projected to register positive growth in 1993 and 1994. But key aspects of the reform and stabilization efforts have not yet been fully implemented, and there remain risks of policy slippages. In the Russian Federation and most other countries of the former Soviet Union, economic conditions are of particular concern because of inadequate attention to macroeconomic stabilization and because of political unrest and armed conflicts in many regions.

Notwithstanding the continued economic difficulties in many countries, recent positive developments offer hope for a cooperative growth strategy in the near term, which could also permit a strengthening of global economic performance over the medium term (see the IMF Interim Committee's declaration, facing the opening of this chapter). Many developing countries are reaping the fruits of sustained reform and stabilization efforts. There are now early signs of recovery in some of the economies in transition. Efforts to enhance assistance to countries affected by the transition to market-based trading systems occurring in central Europe and the former Soviet Union, and to low-income countries to support strengthened stabilization and restructuring efforts, are moving forward. In Europe, exchange market tensions have eased, and interest rates have been falling and should continue to do so as evidence accumulates of the waning of inflationary pressures. The near-term fiscal stimulus announced by the Japanese government should help to restore confidence and promote economic recovery. Other industrial countries have announced programs of budget deficit reduction that have been favorably received in financial markets. Implementation and further strengthening of these deficit-reduction plans would lay the foundation for sustainable increases in growth and living standards over the medium term. To be successful, it is vital that these efforts are supported by an immediate conclusion of the Uruguay Round: a failure to complete the Round would deprive the world of the benefits of further liberalization and would risk aggravating protectionist pressures, which would seriously harm all countries.

Industrial Countries

The present difficulties in the industrial world owe much to the failure to implement key elements of the medium-term strategy that was adopted in the early 1980s as the appropriate guide for economic policy. In particular, inadequate budgetary consolidation and structural rigidities have left countries in a weak position to cope with the recent—and continuing—sluggishness of global economic activity. Large budget deficits have contributed to high real long-term interest rates and have also been an important factor in the recent turbulence in European currency markets. And labor market policies have been unsuccessful in addressing persistently high unemployment, especially in Europe.

Despite success in reducing inflation in most countries, important challenges still confront monetary policy. The speculative excesses in asset markets in the late 1980s were at least partly a result of excessive credit expansion and risk taking by financial institutions. The eventual tightening of monetary policy did succeed in puncturing the speculative bubbles, but the tightening occurred too late to prevent the unwarranted run-up and subsequent abrupt correction of asset prices. Although important lessons have been learned about the need to strengthen prudential oversight and to pay greater attention to asset markets in the conduct of monetary policy, many countries continue to suffer the consequences of asset deflation.

In the United States, monetary conditions were eased substantially between 1990 and the end of 1992 in response to the recession and to the weakness of the recovery (Chart 2). This has helped to stimulate demand and has also promoted balance sheet adjustment by lowering debt-service costs. Monetary conditions have also been eased significantly over the past two years in Japan as evidence of financial strain and slowing activity has accumulated. The cuts in the official discount rate together with recent fiscal measures should help to support activity, but the experience of other countries that are going through similar balance sheet difficulties suggests that the weakness of private demand may persist for some time. In Europe, by comparison, the level of real short-term interest rates has remained very high, which has delayed balance sheet adjustment and weakened activity.

Looking ahead, the industrial countries now need to take effective action to strengthen growth and to diminish exchange and financial market tensions while preserving progress in reducing inflation. In the United States, the first steps toward meaningful medium-term fiscal consolidation are being taken.

206

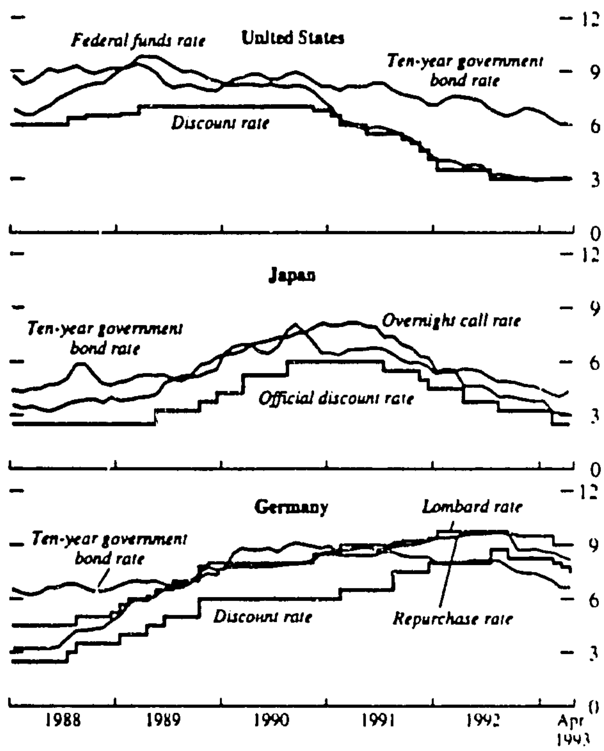
Japan has recently announced a new package of stimulatory measures. At the same time, conditions are improving for significant reductions of official interest rates in Europe, which should help to contain recessionary forces and ensure that recovery takes hold by 1994. There is also an urgent need for positive steps to resist protectionist pressures, especially by bringing the multilateral trade negotiations under the Uruguay Round of the General Agreement on Trade and Tariffs (GATT) to a successful conclusion. Determined action to alleviate short-term difficulties and to achieve key medium-term objectives would unquestionably strengthen consumer and business confidence.

For the *United States*, as recognized by the administration, the most pressing priority of economic policy is the need to reduce the large federal budget deficit and to strengthen saving and investment. The economic plan presented in mid-February represents a considerable effort, but its full enactment and implementation could still leave the structural federal fiscal deficit in FY 1998 at about 3 percent of GDP (more than 4 percent if the social security surplus is excluded)—that is, at the same level as in the late 1980s. Thus, further action is needed to ensure an adequate degree of fiscal consolidation over the medium term. Recent economic developments suggest that the natural forces of recovery, aided by earlier monetary stimulus, are taking hold and that significant short-term fiscal stimulus is now less necessary than might have appeared earlier. As the recovery gathers momentum and economic slack is reduced, the authorities may need to allow monetary conditions to tighten in order to avoid any resurgence of inflationary pressures.

In *Canada*, where recovery is not yet as firmly established as in the United States, interest rates have been coming down after a sharp rise associated with exchange market developments in the fall of 1992. In light of the cyclical situation, there should be room for a further easing of interest rates without jeopardizing the progress made toward price stability. Continued perseverance in reducing the structural budget deficit also is required.

In *Japan*, the authorities announced a large package of stimulative fiscal measures in August 1992, and the official discount rate was reduced further in the face of a sharp weakening of activity. While there are recent signs of a bottoming out of the recession, uncertainties remain with respect to the timing and strength of the upswing. To give recovery the desired momentum, substantial additional measures, supplementing the FY 1993 budget, have recently been announced. Given Japan's efforts at fiscal consolidation in the past, these measures do not jeopardize the credibility of the authorities' medium-term budgetary objectives. The low inflation rate and the recent strength of the yen suggest

Chart 2. Three Major Industrial Countries: Policy-Related Interest Rates and Ten-Year Government Bond Rates[1]
(In percent a year)



[1]End of month except for the federal funds rate, which is the average of daily observations, and the repurchase rate, which is the average of weekly data.

that there also remains some room for interest rate reduction should economic weakness persist.

In Europe, although conditions differ among countries, an essential contribution to stronger growth would come from a further reduction of interest rates in *Germany* as the inflationary consequences of unification fade. Recent small reductions in official German interest rates have helped to reduce the tensions in the European Monetary System (EMS), but monetary conditions remain unduly tight in most countries. Substantial interest rate differentials relative to Germany, associated with the recent exchange market turbulence, have exacerbated this situation. Large budget deficits in most of Europe generally preclude short-term fiscal stimulus, since this would only delay the critically needed decline in both short- and long-term interest rates, further complicate the achievement of medium-term fiscal objectives, and jeopardize policy credibility.

Conditions for a further reduction of short-term interest rates in Germany are improving, however. Although increases in prices have remained high in recent months, the pronounced weakening of the economy, early indications of a slowdown in money growth, and favorable developments on the wage front suggest that inflation should soon begin to moderate. Progress toward fiscal consolidation, which would need to go beyond the recent solidarity pact, would also contribute to the reduction of macroeconomic imbalances. These developments should ensure a durable reduction of inflation in Germany and would allow a marked easing of monetary conditions that would be fully consistent with both domestic objectives and the broader interests of the world economy.

For *France*, persistent pressure on the exchange rate since September 1992 had necessitated the maintenance of a very large short-term interest rate differential relative to Germany, despite lower inflation than in Germany, but these pressures seem now largely to have subsided. The differential has recently narrowed substantially, following the new government's reaffirmation of the strong commitment to the current exchange rate mechanism (ERM) parity and the announcement of plans to give more autonomy to the Banque de France. The reduction of exchange market tensions should permit a further narrowing of the interest differential. While fiscal policy is allowing the automatic stabilizers to cushion activity during 1993, it will be important to reduce the budget deficit as activity recovers in 1994 and beyond.

For the *United Kingdom*, the lowering of interest rates and the sharp depreciation of the exchange rate following the suspension of the pound sterling from the ERM have improved prospects for recovery. The sustainability of the recovery, however, will depend on the authorities' ability to safeguard the credibility of their anti-inflationary commitment, especially in light of the potential inflationary consequences of sterling's decline. This, in turn, depends critically on the adoption of further measures, in the 1994 budget or even before, to secure a faster reduction of the large budget deficit. A general decline of interest rates throughout Europe would help to alleviate the downward pressure on the exchange rate, but any further easing of monetary policy in the United Kingdom should be resisted unless there is good reason to believe that a further cut in interest rates would not endanger the goal of containing inflation.

The need for a substantial reduction of the fiscal deficit is particularly critical in *Italy*. The large depreciation of the lira has improved the competitive position considerably, but a sizable interest rate premium relative to Germany persists, particularly on long-term interest rates. Important measures have been taken to contain the budget deficit, but, as the government recognizes, further action is required to strengthen the credibility of the fiscal consolidation efforts and permit a decline in interest rates. Additional measures will be needed both to achieve the 1993 budget objective and to meet the government's medium-term target of bringing the overall deficit below 5 percent of GDP by 1995. Substantial financial assistance has been granted by the European Community (EC) to help to establish the conditions under which the lira could rejoin the ERM. An adequate degree of fiscal consolidation will be crucial to permit such a move.

The recent crisis in the EMS witnessed the suspension from the ERM of two major currencies, four realignments imposed by market pressures in just five months, and the floating of three Nordic currencies that had been pegged to the European currency unit (ECU). In all cases, the direction of the exchange rate adjustments that have taken place appears to have been in accordance with the fundamentals, including differences in policies associated with divergent cyclical positions. For some currencies, however, the large depreciations appear to have overshot, which is adding to strains in economic relations within Europe. Although the pressures on the system have abated since early February, economic policy cooperation within the EMS will need to be strengthened to reduce the risk of a recurrence of turbulence and to promote further progress toward economic and monetary union (EMU). A key requirement remains the need to ensure greater economic convergence. Because some countries may achieve a sufficient degree of convergence only in the medium term, small adjustments of parities within the ERM band on a timely basis could help to avoid new tensions without undermining the character of the system.

More fundamentally, recent experience has demonstrated the crucial importance of strengthening monetary policy cooperation across Europe. It is necessary to recognize that economic and financial integration is rapidly eroding the distinction between resident and nonresident enterprises and financial institutions and appears to be blurring the distinction between national monetary indicators. To ensure that monetary conditions are compatible with sustained noninflationary growth in Europe as a whole, it will therefore be necessary to consider whether—and how—national indicators of monetary conditions, activity, and inflation might be complemented with ERM-wide indicators. While the scope for independent monetary policies has largely disappeared with the close economic and financial integration of the European economies and the commitment to stable exchange rates, monetary policy continues to have a comparative advantage in ensuring price stability across the ERM countries as a group. Increasingly, however, the task of dealing with the consequences of economic disturbances that affect inflation and economic activity in specific countries or regions now falls primarily on fiscal and structural policies rather than on monetary policy.

Especially in the present period of economic difficulty, the ongoing policy responses of the industrial countries need to be complementary if more satisfactory growth is to be achieved during 1993 and beyond. The confidence of markets in the longer-run orientation of U.S. monetary policy toward the objective of low inflation facilitated a significant monetary policy response to the recession of 1990–91 and to the subsequent sluggish recovery, without raising concerns about longer-term inflation that would have been adversely reflected in long-term interest rates. The responsiveness of monetary policy also helped to avoid fiscal stimulus that would have enlarged an already excessive federal deficit. The fruits of this policy can be seen in the relatively rapid pace of economic expansion now under way in the United States, the benefits of which will gradually spread to other countries. Conversely, economic recovery in Europe and Japan, provided that it begins this year and gains momentum by 1994, should help to offset any short-term dampening effect of deficit-reduction measures that the U.S. administration plans to implement during 1994.

More generally, sustained expansion in each of the major industrial countries benefits from, and to an important extent requires, sustained expansion in its partner countries. Within Europe, where economic linkages are particularly strong and getting stronger, economic recovery in one country cannot get very far unless the whole of the continent is also recovering. Mutually reinforcing growth for Europe as a whole would, in turn, help to support economic expansion beyond Europe. Similarly, the monetary and fiscal policy measures already undertaken in Japan, and the additional measures recently announced for FY 1993, will be important in spurring recovery of the Japanese economy and will also contribute to strengthening activity worldwide.

A broadly based recovery would provide better opportunity for governments to pursue determined medium-term programs of fiscal consolidation. Favorable effects on confidence, and on longer-term interest rates, from the announcement of credible programs of consolidation would help to offset any short-term dampening effects from reductions in public expenditure or from tax increases. Moreover, it would be highly desirable if any tendency for overheating during the coming expansion were offset by a tightening of fiscal policy, which in any case is required in most countries to achieve adequate medium-term fiscal consolidation. This would not relieve monetary policy of its primary responsibility for assuring reasonable price stability, but it would make the fulfillment of this goal consistent with a lower path for interest rates. An appropriate fiscal and monetary policy mix would also promote greater calm in foreign exchange and other financial markets, thereby facilitating a general recovery of consumer and business confidence. In addition, improving saving-investment balances through fiscal consolidation in key deficit countries would help to address the most important cause of large, persistent international payments imbalances and thereby reduce the associated tensions over trade and permit increased resource transfers to developing countries and to economies in transition.

The implications of complementary and mutually consistent macroeconomic measures for trade policies deserve particular emphasis. As the experience of the 1930s so dramatically demonstrated, the apparent loss of jobs to foreign competition can easily give rise to calls for protectionist policies during a period of pervasive economic weakness and rising unemployment. Firm adherence to the established rules of the open international trading system—and the reconfirmation of countries' commitments to these rules through early completion of the Uruguay Round—are obviously the first line of defense against self-defeating protectionist policies. But pressures for protection must not be allowed to become too great. Properly attuned and cooperative macroeconomic policies must guard against persistent economic weakness and high unemployment and must seek to limit the extent and duration of cyclical divergences among countries, their impact on international payments imbalances, and the repercussions on financial and foreign exchange markets.

Developing Countries

Output in the developing countries is projected to expand by 5 percent in 1993 and 1994, only slightly less than in 1992, which had the highest growth in more than a decade. Even excluding special factors such as the reconstruction in the Middle East, which boosted growth in that region to 10 percent in 1992, this is an impressive result, especially given the weakness of activity in the industrial countries. Divergences in growth among developing countries have tended to widen in recent years, however, as many countries have failed to register any meaningful improvement in economic conditions. In some of these countries, per capita real incomes remain below the levels experienced ten or even twenty years ago.

The stronger performers among the developing countries share a number of essential characteristics. Compared with the slow-growing countries, the successful countries have markedly higher saving rates; higher investment rates (also in human capital); and higher efficiency of investment and higher overall productivity growth. They also typically finance a larger proportion of investment from domestic saving, and when they have recourse to external saving, it is often in the form of foreign direct investment and equity capital rather than debt-creating capital inflows. Finally, these countries are generally more outward-oriented than the low-growth countries, both with respect to trade links with the industrial countries and in terms of their economic ties with other developing countries. Many developing country exporters have weathered the current sluggishness of growth in the industrial world by expanding their trade with other developing countries.

Government policies explain an important part of the divergences in economic structure and performance across the developing countries. The stronger performers have maintained or restored sustainable fiscal balances, low and predictable inflation, positive but low real interest rates, viable external positions, and competitive and stable exchange rates. In addition to macroeconomic stability, the successful countries have relied on market forces to allocate resources efficiently, through reduced government intervention, through trade liberalization and currency convertibility, and through financial market reform. The impressive growth record of many Asian countries illustrates the longer-term benefits from sustained stabilization and reform efforts, and the recent experience of many Latin American countries demonstrates that economic growth can recover when the necessary policies are put in place.

In some of the successful developing countries, the recent strength of economic performance has been accompanied by substantial capital inflows in the form of both direct and portfolio investment. This has contributed to excess demand pressures and, in several cases, to growing signs of overheating. There is also a risk of speculative excesses in asset markets like those experienced in many industrial countries in the 1980s. In countries where demand pressures are strong, a tightening of fiscal policy may be necessary to make room for higher investment. Allowing some appreciation of the currency may also be appropriate. It may finally be possible to speed up privatization, which would help to retire both domestic and external debt. In China, strong demand pressures generated an increase in output in 1992 of close to 13 percent in the context of accelerated reform efforts; to sustain the momentum of the reforms and to avoid overheating, a cautious stance of stabilization policies will be essential during the period ahead.

In most African countries, major reform efforts are quite recent, and the resulting higher growth rates are only beginning to show up. However, at their relatively early stage of development these countries remain highly vulnerable to adverse terms of trade and other shocks, such as drought, which held back growth in 1992 in most of southern Africa. An important issue is the difficulty of coherent implementation of economic policies during the (often lengthy) transition to democracy. For many countries, it is clear that decisive progress will not materialize in the absence of considerable improvements in governance supported by adequate levels of financial and technical development assistance. Where the required policy changes are implemented, the international community must stand ready to provide strong support—for example, through appropriate debt relief and through the IMF's concessional enhanced structural adjustment facility (ESAF), a successor to which is currently under consideration. As the economic outlook improves in other parts of the world, there should be scope for increased efforts to assist the poorest countries.

Countries in Transition

The early experience of the former centrally planned economies has already demonstrated the crucially important link between structural reforms, macroeconomic stabilization, and successful economic transformation. Among the central European countries, the Czech Republic, Hungary, and Poland have made the greatest progress in structural reform; inflationary pressures there have abated following price liberalization, and output has begun to recover. These achievements will be difficult to sustain, however, in the absence of strong efforts to contain the large fiscal deficits that have accompanied the considerable losses of output and tax revenue since the start of the reform process.

In the Baltic countries there are encouraging signs that reforms are taking hold and are being supported by strong stabilization efforts. In most other countries of the former Soviet Union, in contrast, inadequate stabilization efforts now threaten to lead to hyperinflation, which could derail the reform process. Inflation, which had abated following the immediate impact of price liberalization in early 1992, surged to extremely high levels in late 1992 and early 1993. The main reason for this development has been excessive credit expansion to the government and to state enterprises. The transformation process is being seriously hampered by the widespread subsidization of inefficient enterprises and the resulting misallocation of resources. The lack of effective economic and monetary cooperation among the countries of the former Soviet Union exacerbates other problems by severely constraining trade flows and impeding inflation control. Partly as a result of these difficulties, some countries have decided that the introduction of separate currencies offers the best scope for avoiding hyperinflation and for improving economic conditions. This development can facilitate the implementation of stronger stabilization programs, but it is not a substitute for fiscal and monetary discipline and vigorous structural reform.

The international community must continue to provide support for strong stabilization policies and reforms in the countries of the former Soviet Union as they struggle to overcome the legacies of the past. To ensure the success of the transformation process, it is vital that the rest of the world open its markets to the exports of the reforming countries. Cooperative efforts on trade and payments issues are also crucial to these countries' common task of economic restructuring. Considerable emphasis should be placed on technical assistance and on policy advice in all areas. There is also scope for increasing financial support for specific programs of industrial restructuring, including conversion of defense industries. Financial assistance has a critical role to play, and a new IMF facility has been created to help meet the special needs of countries affected by the transition to market-based trading systems. However, the effectiveness of such assistance will be seriously impeded so long as macroeconomic conditions remain highly unstable.

Trade Policies

The experience of the past forty years offers strong evidence of close linkage between liberal trade and exchange regimes and economic prosperity. The liberalization of trade in manufactured goods among the industrial countries was one of the principal reasons for the rapid growth of world output in the 1950s and 1960s. Many developing countries also have increasingly moved to make their currencies convertible, to promote competition, and to liberalize foreign trade, and this has helped them to overcome the debt crisis of the 1980s and to sustain growth even in the face of weak activity in the industrial countries since 1990. Most recently, central planning has been abandoned as a viable model for economic progress, giving way to market-based economic reforms that will allow a large number of countries to share in, and contribute to, continued gains in global economic performance.

Yet the significant benefits from free trade now seem threatened. The failure to conclude the Uruguay Round is adding to trade tensions and is depriving the world of potentially large gains from further liberalization of tariff and nontariff barriers; from the extension of multilateral rules to new sectors; from a strengthening of rules and disciplines on antidumping, subsidies, and safeguards; and from a strengthening of the dispute settlement mechanism and of trade policy surveillance. The industrial countries are increasingly seeking recourse to countervailing and antidumping duties and to nontariff barriers. Excessive focus on bilateral or even sectoral trade imbalances has led to a dangerous proliferation of managed trade agreements. And there is a risk that regional trading arrangements could become inward looking, rather than serving primarily to promote regional integration in the context of multilateral free trade.

Efforts to bring the Uruguay Round to an early and successful conclusion and reverse the rise in protectionist barriers must be a central element of any cooperative effort to strengthen growth worldwide. Given constraints on financial resources, market-opening measures by industrial countries are crucial to support the efforts of developing countries and economies in transition to implement outward-oriented reform strategies successfully. Such positive steps are also important in view of the likelihood that current account imbalances among the major industrial countries will widen further as cyclical positions are reversed, which threatens to fuel protectionist sentiment. Not only would trade restrictions do little to affect underlying external positions, they would run the risk of triggering a spiral of retaliation and counterretaliation, severely harming business confidence and prospects for recovery. To reduce the large structural components of the external imbalances, it is necessary to tackle their root cause: the inadequacy of national saving relative to domestic investment opportunities, particularly in the United States, but also in several other countries. In these cases, fiscal consolidation is essential to restore external viability. At the same time, surplus countries have a responsibility to maintain adequate growth of domestic demand and to step up market-opening efforts.

209

Should G-7 Cooperation be Buried?

by Wendy Dobson

The G-7 will continue to lose credibility if it persists in neglecting its primary mandate: to improve the economic performance of its members.

A paradox has been created by G-7 finance ministers. At one extreme, they are seen as managing the world economy, supporting Russian reform, rescheduling third world debts, speeding domestic reforms and controlling speculators in foreign exchange markets. Media acceptance of these roles leads non-G-7 outsiders to think important decisions are being taken from which they are unhappily excluded. Perverse signals are given to the world's good economic performers, in Asia, which are treated as threats, while finance ministers spend most of their time on crisis management with Russia, one of the world's worst performers. At the other extreme, international financial markets and prominent policy analysts and economists dismiss the G-7 as a talk shop producing meaningless communiques, ineffective as managers and so weak they are unable to withstand the slightest pressures from markets.

The paradox exists because finance ministers neglect their primary macroeconomic mandate, which is to exert peer pressure to improve economic performance in the major industrial countries. This must change if the G-7 is to restore its tattered credibility and achieve the many other goals wishfully assigned to it.

In 1993, the goal of economic cooperation should be to speed recovery of sustained non-inflationary global growth – one that is within our grasp as OECD inflation declines to its lowest levels in 30 years. There are other bright spots: US recovery is getting underway at a time when the US has an energetic leader whose party holds a congressional majority. East Asia is becoming a growth pole as governments in China and Indochina follow others in the region in opening their economies. There are other hopeful developments: the Bundesbank has begun to lower interest rates and the patience of Russians and East Europeans may be sufficient to make possible the chaotic transition to market economies.

Perverse signals are given to the world's good economic performers.

Achieving the G-7's goal of lasting non-inflationary growth is possible if three preconditions are met, but the chances of this are mixed at best. First, governments must be outward-looking and willing to modify domestic policies; instead they are now inward-looking short-termists which undermines global cooperation. If coalitions and minority governments, not known for fiscal discipline, should be elected the situation could worsen. 1993 is an election year in Germany, Canada and Japan, while France has just elected a government seemingly more concerned with narrow nationalism than with global growth.

Second, governments must recognize that trade promotes growth and jobs but instead, G-7 trading relationships are now fraught with tensions unprecedented in the postwar period. US impatience with Japan's again ballooning current account surplus and US-Europe differences over agriculture are creating pressures for protectionism and managed trade.

The problem is also an opportunity.

Third, governments must recognize that their central concern of job creation is best achieved by establishing sound economic fundamentals, not through deficits, protection, or subsidies.

The biggest problem facing the G-7 nations is how to deal appropriately with slow recovery complicated by their divergent economic fundamentals. However, the problem is also an opportunity. It provides the basis for a coordinated policy package that would promote non-inflationary world growth, while facilitating the economic restructuring necessary for each of the G-7 countries to develop more productive and competitive economies.

To have a hope of credibility, the G-7 must meet the following criteria: ministers must agree on goals and on how to coordinate them; they must create an institutional framework, modest, but more effective than the ad hockery of the 1980s. As an anchor for expectations, they must develop the political will and clout to deliver their commitments. All require effective coordination between fiscal and monetary authorities within countries as well as among them. The G-7 record on all three counts has been inadequate.

The selection of a non-inflationary growth goal implies the G-7 will not adopt explicit exchange rate targets. The lesson for the G-7 from the September 1992 European exchange rate crisis is that exchange rate stability should be an outcome, not a target, of realistic policy cooperation. Despite all the efforts of European governments to achieve convergence, only a few core countries were able to weather the unexpected stresses of German reunification. Divergent inflation and inadequate fiscal performance in the others created doubts about the realism of monetary cooperation and eventually forced realignment in a crisis atmosphere reminiscent of the Bretton Woods era.

The G-7 must also improve its institutional framework. The ad hoc approach of the 1980s is discredited. Changes should include direct participation by central bank staff in G-7 decision making and better analytical support. Benefits of greater central bank participation include better analytical inputs on monetary issues and more balance between the use of fiscal and monetary policies in the underlying adjustments. Such an initiative, recently taken by the new US administration, must become a regular part of the process. Skepticism about increased exposure of monetary decision making to political pressures should be addressed at national levels by making all G-7 central banks independent. Indeed, if governments were serious about low inflation, they would promote central bank independence and the banks' role in the G-7 would be seen to enhance, not jeopardize, that independence.

The goal of economic cooperation should be . . . sustained non-inflationary global growth.

More formalized support, most sensibly from the International Monetary Fund, is required to support a core agenda (which has also tended to be ad hoc), and to support the monitoring, analysis and decision making which are central to effective cooperation. At present, the process is vulnerable to personalities and pressures from individual countries. Here again, if governments were serious about using coordination to improve global economic performance, they would agree to having their goals and performance published and publicly evaluated. To improve its credibility as the "objective referee", the IMF, through its managing director, could create a group of eminent people who are charged with independently preparing assessments of, and prescriptions for, the G7. This mechanism would depoliticize forecasts and augment peer pressure with public pressure.

These changes will make little difference, however, unless the political will exists to exert and accept peer pressure. Macroeconomic cooperation within the G-7 summits, where the whole process should be accountable, has largely fallen off the agenda in favor of fuzzy friendly obfuscation. Macroeconomic cooperation must be restored as a key aim by G-7 leaders who should identify and evaluate precise and public goals for growth and inflation and require accountability from finance ministers. Finance ministers, in turn, should be better led with a chair which rotates regularly among the US, Japan, and Germany.

The motivating idea behind macroeconomic coordination is to stimulate individual economies to follow better long-term domestic policies than they would on their own. Regrettably, such sound cooperation, if not dead, is in a state of suspended animation, which means that we face the challenge of reviving, rather than resurrecting it. While the record is flawed and prospects are dimmed by inward-looking leaders, the picture is not devoid of accomplishment. Inflation is low; exchange rates have fluctuated within a range since 1987; financial crises have (largely) been avoided; and the pressures to fine tune fiscal policies on an international scale have been resisted, thanks mainly to Germany and Japan. Nor is the G-7 devoid of possibility if finance ministers remove the ambiguities they have created, and instead seriously refocus on the disciplined policies that are fundamental to non-inflationary growth.

Policy packages. The keystone to a policy package – long awaited – is a credible US deficit reduction plan. The key issue for international cooperation is to offset any negative impact on growth as President Clinton's budget plan is phased in over the next two years. Germany could help by changing its policy mix during that period more vigorously towards increased monetary ease balanced by fiscal restraint. This change is beginning to appear as inflation pressures in Germany ease, but spending restraint, especially on subsidies to industry has barely begun.

Japan should stimulate domestic demand by easing both monetary and fiscal policy to give a big boost to output, with little increase in interest rates. Recent policy changes are moving in this direction. About half of the large spending package unveiled in mid-April appears to be new spending. If legislative foot-dragging can be overcome, the package will achieve the short-run objective of stimulating domestic activity, but it is not clear that the composition of this activity will reduce the burgeoning external surplus sufficiently to diffuse dangerous trade tensions.

Other members have parts to play in this policy accord, with Canada and Italy making further large budget cuts to contain burgeoning public sector indebtedness; France needing to curb protectionism, and the UK addressing its lack of competitiveness which causes its performance to diverge so far from the European core countries.

Prospects for Cooperation. Identifying a package of complementary policies is one thing. Assuming that it will be adopted is quite another. Still unknown risks to the US deficit plan are Americans' limited tolerance for higher taxes and the Clinton administration's unshaped plans for containing health costs and other spending. In Germany and Japan changes to fiscal policies risk opposition from the public (in Germany) and from bureaucrats (in Japan). Canada and Italy have attacked their debt problems too feebly for nearly a decade with predictably limited results; and the UK shows little will to solve its problems. Can the G-7 provide the necessary collective pressure to persuade its members to make the needed policy changes they are so reluctant to make individually? ■

Wendy Dobson directs the Center for International Business at the University of Toronto.

WORLD BANK NEWS

Volume XII, No. 15

April 15, 1993

Brighter Economic Outlook Projected For Developing Countries in the 1990s

Regional Prospects Vary Widely, New Report Shows

This story on Global Economic Prospects and the Developing Countries: 1993 *is embargoed for release at 4 p.m. EDT (2000 GMT) on Sunday, April 18.*

Developing-country prospects in the 1990s include the promise of higher economic growth rates, despite a mixed outlook for the international economic environment and uncertainties regarding recovery in the industrial countries in the short term.

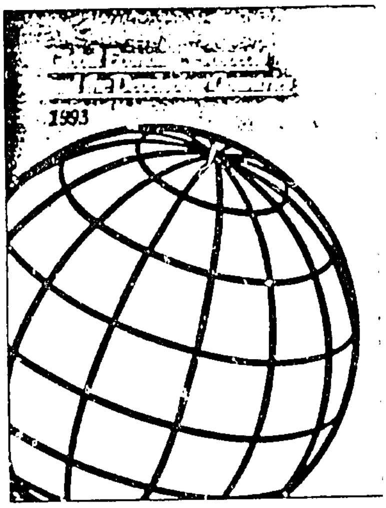
A new World Bank report, *Global Economic Prospects and the Developing Countries 1993*, published in Washington on April 19, says that the growth rate for the developing world is projected to be 4.7 percent a year over the next decade, considerably higher than the performance of the last decade, which averaged 2.7 percent a year.

"This brighter outlook is to a large extent the dividend of the wide-ranging—and often painful—economic policy reforms of the past decade," the report states.

The "tremendous transformation" of developing-country policies in recent years includes trade liberalization and a shift away from import substitution, the report says. Over-valued exchange rates have been corrected and the management of public finances has been improved. Inflation has been cut. Privatization programs have helped reduce the role of the state as greater reliance has been placed on markets. And a number of countries have dealt with their commercial bank debt overhangs. These changes apply particularly to many of the developing countries that experienced slow or negative growth of per capita incomes in the 1980s.

Another factor contributing to higher prospective growth rates is the expected recovery in real terms of prices of primary commodities, which account for about half of the export earnings of developing countries.

Export growth in developing countries is expected to rise sharply in this decade, at a rate almost twice as fast as during the two preceding decades and well ahead of the growth of world output. Moreover, the development of strong trading links between developing countries reflect a renewed interest in regional trade arrangements.



Working against higher developing-country growth is the underlying trend of slow productivity growth in the industrial countries.

See PROSPECTS, *page 2*

212

PUBLICATIONS

Economic Growth Projections Vary Across Regions

PROSPECTS, *from page 1*

Additionally, real interest rates are likely to stay higher than the 1960s and 1970s because of the decline in public savings in many countries in the last 20 years, the report maintains. While creditworthy developing countries are likely to find adequate external finance from private sources, the countries without market access will face a limited "aid pie."

World trade faces "an uncertain future," pending completion of the Uruguay Round of international trade negotiations, the report observes and stresses the importance of governments resisting protectionist pressures.

Regional Prospects

East Asia is expected to continue to experience significant rates of growth, though somewhat lower than the past decade. Continued high rates of savings and high levels of foreign direct investment (FDI) will support exporters and make the economies of the region run more efficiently.

Latin America is expected to continue the recovery of 1992. About a 4 percent annual growth rate in gross domestic product (GDP) is achievable over the long-run in the region, provided that improved policies are sustained and that external creditor confidence is maintained.

Increased investment will likely come more from the private sector, which has attracted both local and foreign investors, although public investment in infrastructure is expected to complement private investment.

In sub-Saharan Africa, GDP growth is expected to increase, but not at a rate significantly higher than population growth. The outlook for sub-Saharan Africa is especially fragile, since the region's economic future is dependent upon the end of the decline of real commodity prices, especially for cocoa and coffee, and upon the degree of civil strife affecting a number of countries. This region will continue to depend heavily on credits at concessional terms from official sources.

> While creditworthy developing countries are likely to find adequate external finance from private sources, the countries without market access will face a limited "aid pie."

South Asia's growth is projected to average around 5 percent annually in the 1990s, with faster growth in the second half of the decade as reforms take hold in India, the region's dominant economy. Regulatory reform could expand the relatively slight amount of FDI which the region has been able to attract in the past.

The Middle East and North Africa is expected to experience growth of between 4 percent and 5 percent annually, the region's best performance since the 1970s. Much of this growth will come from exports of oil, real prices for which are expected to rise in the second half of the decade.

In Europe and Central Asia, structural reforms and the shift to market-oriented economies are expected to pay dividends with growth of about 2 percent a year in the 1990s, recovering the sharp decline of recent years. Further reform could boost this growth to the range of 4 percent to 5 percent in the second half of the decade.

Uncertainties Remain

The report stresses that the growth rates in the developing world may fall short of projections for several reasons. First, the pace of recovery in industrial countries—which affects the economies of the developing world—remains very uncertain.

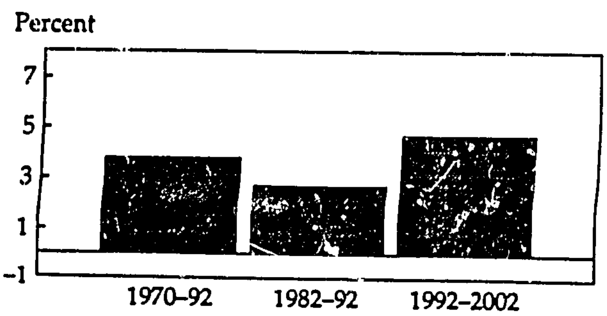
Second, baseline assumptions on changes in world trade may turn out to be too optimistic; there has been little tangible progress recently toward a successful conclusion of the Uruguay Round, and there is a danger that the alternative to an early multilateral agreement may not be a continuation of the status quo but a significant deterioration in international cooperation on trade issues.

Third, there is a risk that real commodity prices may not stabilize as projected. If commodity prices continue to decline as they have during the past two decades, the economic pros-

continued at top of next page

GDP Growth Prospects For Developing Countries

(average annual percentage change)



Source: World Bank projections.

Creditworthiness Gulf Grows Between Countries

continued from previous page

pects for some developing countries, particularly in Africa, may not be bright.

Finally, the baseline projection of rapid economic growth in middle-income developing countries is partly based on sustained growth of private capital flows into the region.

Private External Finance

There has been a radical shift in the pattern of external financial flows to developing countries in the early 1990s, the report notes, "from debt to equity financing and from bank to non-bank sources." Commercial bank loans have been replaced by bond and equity portfolio flows and greater FDI.

Virtually all the growth in financial flows to developing countries in recent years has come from these non-bank private sources. Private companies have had improved access to international equity and bond markets, reversing the proportionate decline in private sector borrowing registered in the 1970s through the mid-1980s.

The report also notes that within the overall pattern of new financing arrangements, there is a growing gulf between those developing countries that are creditworthy, and thus can access the private capital markets, and those that are not, and thus rely primarily on loans and grants from official sources for external finance. Openness to foreign direct investment and trade exposes countries to international competition and can bring such benefits as technology transfer, management know-how, and access to export-marketing services. In the past two years, there has been a big increase in FDI to developing countries (from \$24 billion in 1990 to \$38 billion in 1992), which is serving as an important source of growth even in some countries that may not be able to borrow on global capital markets.

Portfolio flows, which have risen dramatically from \$10 billion in 1990 to \$34 billion in 1992, bring a reduction in the cost of capital and a diversified investor base, the report asserts. The recent growth in equity portfolio flows will prove to be durable, although it is unlikely that Latin America will continue the expansion of the last two years. But at the same time, these new financing opportunities present new challenges to the recipient countries in the areas of macroeconomic and financial management of volatile capital flows.

"The choice for developing countries is not, however, between financial integration and none. Rather, it is between two-way integration that permits capital inflows and private institutional outflows, and one-way integration that consists of capital flight." In relation to GDP, capital flight, once viewed as a problem for a few countries, mainly in Latin America, is a widespread phenomenon, the report illustrates.

Official development assistance, comprising grants and concessional loans, accounted for one-third of all net resource flows to developing countries in 1992 and for nearly twice that share to the low-income countries. Only 60 percent of bilateral official development assistance goes to low-income countries.

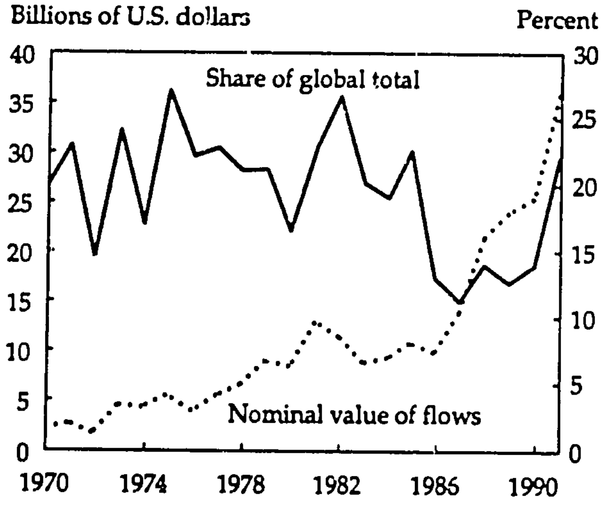
Nearly half of bilateral aid is "tied," with associated direct costs estimated at about 15 percent of the aid provided. On this basis, untying all aid flows would generate economic benefits to developing countries of more than \$4 billion annually.

Rethinking Aid

Aid needs re-thinking, the report contends. Donor countries should further reduce "tying" and need to explore new ways to ensure that what aid is available is concentrated on the poorest countries. Better trade access—particularly for some middle-income countries—to markets in countries belonging to the Organization for Economic Cooperation and Development could do much to free up aid resources for poorer countries.

While aid flows as a share of donors' gross national product have stagnated over the past decade, new claimants have stepped forward to share in what is expected to be a limited aid pie in the 1990s, the report says. For recipient developing countries, the stark message is: show a capacity to use aid effectively or risk losing it. □

FDI Flows to Developing Countries



Note: Net inward FDI. Data exclude Saudi Arabia.
Source: IMF *Balance of Payments Yearbook* and World Bank staff estimates.

Global Economic Prospects and the Developing Countries: 1993 *is priced at \$10.95. Journalists may receive complimentary review copies by writing on company letterhead to the World Bank, Office of the Publisher, Marketing Unit, Room T-8054, Washington, D.C. 20433. Fax (202) 676-0579.*

214

CONGRESSIONAL QUARTERLY
Weekly Report

RECONCILIATION

Clinton's Plan To Cut Deficit Begins Moving in House

Committees approve about $340 billion in savings; House floor action expected by Memorial Day

President Clinton's economic plan got back on track the week of May 10 as 13 House committees turned vague congressional budget instructions into about $340 billion worth of specific deficit reduction that closely tracks Clinton's major economic proposals.

The plan moved with relative ease through the Ways and Means Committee and 12 other panels despite sometimes bitter Republican opposition, especially to the inclusion of more than $240 billion in new taxes. "We've got a president in the White House who's leading, and I think we've got a Congress that's following," said Ways and Means Chairman Dan Rostenkowski, D-Ill.

Clinton needed the lift. Fresh from the defeat of his job stimulus package at the hands of a Republican filibuster in the Senate in April, the president is entering a much more critical phase of the campaign to put his overall fiscal plan in place.

The deficit-reduction package accounts for about two-thirds of the roughly $500 billion Clinton has proposed to shave off the deficit from 1994 through 1998. The savings — which come from tax increases and cutbacks in mandatory spending for entitlement programs such as Medicare and farm price supports — will now be bundled into one huge budget-reconciliation bill.

This measure is by far the largest single expression of Clinton's economic policy, and its progress through Congress over the next several months will be the key test of his plan to change the nation's economic direction.

The other one-third of the proposed deficit savings are supposed to materialize as congressional appropriators put together their annual spending bills over the next five years, constrained by spending caps that essentially freeze overall discretionary spending at 1993 levels through 1998. *(Weekly Report, p. 1126)*

By George Hager

RECONCILIATION COVERAGE

Although much of the hardest work lies ahead, Clinton clearly won this round. From roughly $300 billion in taxes and spending cuts agreed to by the Ways and Means Committee to a relatively tiny $9 million in spending cuts endorsed by Foreign Affairs, the House panels met or exceeded the five-year savings targets set in Congress' budget resolution — a blueprint based on the economic proposals Clinton first made to Congress in February. *(Weekly Report, p. 822)*

The president sought to consolidate his momentum and give himself some cover by endorsing the creation of a "deficit-reduction trust fund" that would devote all net tax increases and spending cuts to deficit reduction instead of new spending. Clinton's aim appeared to be to counter GOP charges that Democrats wanted to increase taxes not to reduce the deficit but to pay for more government spending.

Republicans immediately branded the idea a shameless gimmick designed to lull voters into accepting tax increases.

Even Democrats admitted that the trust fund would not change existing budget policy, which already puts tight limits on appropriated spending and bars the use of taxes to fund more appropriations. Instead, argued one senior House Democratic aide, the proposal would restate existing policy in a way that would "help the public understand this hopeless, convoluted accounting system in the federal government" and add to Clinton's fiscal credibility.

The next step for the reconciliation bill comes the week of May 17 when the Budget Committee is set to formally create the measure by assembling the 13 separate pieces of tax and spending cuts into a single bill. The House is expected to debate the measure the week of May 24, just before it leaves for the Memorial Day recess.

Despite the momentum the Clinton plan appears to have now, there are two clouds on the horizon.

- **Senate GOP challenge.** While Democratic leaders have shown they can steamroll their way through the House without Republican help on even the most contentious tax issues, prospects are far different in the Senate, where the narrower partisan majority means potential trouble for Clinton, especially in the tax-writing Senate Finance Committee.

Democrats have little room for error in the 11-9 panel, where the loss of even one Democrat could subject Democratic amendments to death by tie vote and the loss of two Democrats would give Republicans working control of the underlying measure. Senate Minority Leader Bob Dole, R-Kan., has repeatedly warned that Republicans are targeting the committee for their assault on Clinton's plan, which they complain relies too heavily on tax increases.

- **Drive to cap entitlements.** More immediately, a potential work-

Committees Hit $340 Billion Target . . .

All 13 House committees with "reconciliation instructions" from the Budget Committee completed their responsibilities by the May 14 deadline, approving tax and spending packages that total about $340 billion in five-year savings on the federal deficit.

The Banking Committee finished its work May 6, approving $3.76 billion in savings. Other committees wrapped up work the week of May 10. *(Weekly Report, p. 1130)*

Agriculture

Farm programs. Rejecting the thrust of cost-cutting alternatives suggested by the Clinton administration, the committee on May 13 voted 26-17 for a package that would reduce agricultural spending by about $3 billion over the next five years. Most of the savings would come from expanding the so-called triple-base program, which limits the land on which farmers can grow wheat, corn, cotton and feed grains and qualify for government price supports. *(Story, p. 1223)*

Food stamps. The committee also agreed to increase spending on food stamps by $7.3 billion over five years by expanding eligibility and raising benefits. *(Story, p. 1238)*

Armed Services

Military pay. The committee May 12 agreed on a largely party-line vote of 32-23 to freeze pay for active-duty military in fiscal 1994 and maintain pay increases at 1 percent below inflation for fiscal years 1995-98. The action would save an estimated $11.6 billion over five years.

Members also voted to cut cost of living adjustments (COLAs) for Pentagon retirees to save an estimated $2.36 billion over the next five years.

The panel approved an alternative to the House Budget Committee proposal, which would have cut in half COLAs for military retirees under age 62 and capped COLAs for all military retirees at $400 per person for fiscal 1994.

Instead, members approved a provision by Ike Skelton, D-Mo., that "rolls back" the start of each COLA. For fiscal 1994, COLAs would go into effect May 1, 1994, instead of Jan. 1, 1994. And for fiscal 1995, it would take effect Aug. 1, 1995.

Education and Labor

The committee voted May 12 to replace the guaranteed student loan program with a program that would send loans directly from the government to the students through their colleges, universities and trade schools. The direct loan system, which would eliminate bankers as middlemen, is expected to save $4.3 billion over five years.

The remainder of the committee's $5.8 billion in savings over five years would come from requiring states to share the responsibility for student loan defaults ($300 million) and from amendments to the Employee Retirement Income Security Act, which governs most private pension programs ($1.2 billion). *(Story, p. 1231)*

Energy and Commerce

Medicare/Medicaid. The Energy and Commerce Committee on May 11 approved provisions that would cut $28 billion over five years from the Medicare program, which provides health insurance for the elderly and disabled, and $8.2 billion from Medicaid, the federal-state health insurance program for the poor. The measure would also create a mandatory immunization program for poor and uninsured children. *(Story, p. 1234)*

Spectrum. The committee on May 11 gave bipartisan approval to a five-year, $7.2 billion revenue-raising measure that would put portions of the public radio spectrum on the auction block for commercial users. *(Story, p. 1222)*

NRC user fees. The committee also agreed to extend through 1998 the Nuclear Regulatory Commission's (NRC) ability to charge fees high enough to recover 100 percent of its costs.

Foreign Affairs

The committee came up with $9 million in three-year savings by delaying cost of living adjustments for retired Foreign Service officers. The committee's recommendation is in line with the legislative proposal of the Post Office and Civil Services Committee, which curbed retirement benefits for all federal workers.

Judiciary

Patent fees. Committee members accepted a subcommittee recommendation to extend through fiscal 1998 patent application and maintenance surcharges, raising an estimated $345 million. *(Weekly Report, p. 1131)*

Merchant Marine

Tonnage fees. The committee voted for a stripped-down budget-reconciliation package on May 12, approving $205 million in duties on cargo ships but abandoning amendments that would have boosted the domestic maritime industry and state boating safety programs. *(Story, p. 1222)*

Natural Resources

With major public-land reforms deemed off-limits for now by the Clinton administration, the House Natural Resources Committee met its deficit-reduction goals May 12 mostly by increasing fees to park users, miners and irrigators.

On a 27-14 vote, the committee approved a reconciliation package offered by Chairman George Miller, D-Calif., that achieves $131 million in estimated savings in fiscal 1994 and $2.1 billion over five years.

216

. . . In Deficit-Reduction Packages

R. MICHAEL JENKINS

Chairman Dingell and top Republican Moorhead led the Energy and Commerce markup May 11.

The measure would increase fees for visitors to national parks and forests to collect an additional $41 million in fiscal 1994. Commercial users — such as tour bus operators and broadcasters — would also be required to pay for rights of way and communication sites. The committee approved an amendment by Bruce F. Vento, D-Minn., to charge a one-time administrative fee of $10 on all those with senior citizen passes.

In a step toward changing the 1872 Mining Law, Miller's package would extend permanently the annual $100 holding fee for hardrock mining claims. Miller complained that the committee could not impose royalties on hardrock minerals extraction or increase grazing fees, as President Clinton first proposed in his fiscal 1994 budget, because of an agreement between the president and Western senators to move those proposals on separate legislation. *(Weekly Report, p. 833)*

Post Office and Civil Service

Federal workers. The committee on May 13 approved, 17-5, a package that met its goal of more than $10.6 billion in direct spending cuts and $28.7 billion in limits on federal workers' pay. The largest savings, estimated at $8.6 billion, would come through ending the lump-sum retirement benefit option for most federal workers. An additional $788 million would be saved by a three-month delay in cost of living adjustments in each of the next three years for annuities payable under the federal employee retirement systems. *(Story, p. 1224)*

Public Works

Responding to protests from airplane owners, the committee agreed May 13 to place most of its deficit-reduction burden on the owners of the heaviest planes. The administration had proposed to raise $211 million over five years by charging all airplane owners an annual registration fee. The committee would raise the same amount of money through a sliding scale of fees pegged to the weight of the aircraft. *(Story, p. 1224)*

Ways and Means

Trade. The committee on May 11 approved a series of trade-related provisions recommended by the Trade Subcommittee. They include:

- A two-year extension of Customs Service user fees, which would raise $2.4 billion in fiscal year 1994 and 1995.
- Extension of the Generalized System of Preferences, which allows certain imports from developing countries to enter the country duty-free. The program, which is scheduled to expire July 4, would be continued through Sept. 30, 1994, costing an estimated $791 million.
- A three-year extension of the Trade Adjustment Assistance Program, which assists and retrains workers who lose their jobs as a result of lowered trade barriers with other countries. The cost would be $651 million over three years.

In addition, the bill would grant Clinton authority to enter into an agreement on strengthening the General Agreement on Tariffs and Trade (GATT) through April 16, 1994, as well as extend fast-track procedures governing congressional approval of the GATT agreement for the same period.

Social Security. The committee on May 11 agreed to raise the threshold at which Social Security taxes must be paid for domestic workers. Employers must now pay the taxes if a domestic worker earns more than $50 in a quarter; the committee voted to increase that to $1,750 a year in 1993. *(Story, p. 1236)*

Child welfare. The committee on May 11 approved a new program to help keep children out of foster care. The measure would create a capped entitlement for family preservation services, which would guarantee money to each state up to a limit. Combined with other foster care and adoption provisions, the measure would cost nearly $1.5 billion over five years. Committee staff members said it fell within the Ways and Means overall budget target.

Welfare. The committee also agreed to delay for one year the requirement that states find jobs or training for married welfare recipients. The Clinton administration initially sought a two-year delay.

Unemployment and cost transfers. The committee approved a two-year extension — until 1998 — of the 0.2 percent payroll tax under the Federal Unemployment Tax Act. The tax funds unemployment insurance. The committee also approved certain cost transfers to states, including one that would establish a more uniform 50 percent federal match for administrative expenses for the Aid to Families with Dependent Children program. *(Weekly Report, p. 1088)*

Veterans

The committee on May 11 approved close to $2.6 billion in savings from veterans programs over five years. Provisions include an extension of the Department of Veterans Affairs' (VA) authority to charge veterans for medical care for health problems not connected to their service; a requirement for private insurers to reimburse the VA for treating insured veterans with injuries related to their service; and an increase in fees charged to veterans who take out low-interest home loans guaranteed by the VA. *(Story, p. 1237)* ing majority of Republicans and moderate and conservative Democrats in the House could combine to give Clinton more deficit reduction than he wants by adopting a controversial cap on entitlement programs. If that happens, it could polarize Democrats and threaten final passage of the reconciliation bill itself.

Battle over Caps

Charles W. Stenholm of Texas, the House's key conservative Democrat and the leader of the Conservative Democratic Forum, is pushing the entitlement cap idea as part of a broad budget enforcement package. Some elements of the package — extending through 1998 the current caps on discretionary spending that are set to expire after 1995, for instance — are not expected to be contentious.

But the idea of capping entitlements is a divisive one. Conservatives such as Stenholm back it as the only way to get control of entitlement spending, the one area of the budget that virtually all sides agree is out of control.

Others argue that simply capping entitlements defers the tough, program-by-program cutbacks that would have to be made to live within a cap. And they argue that the ultimate discipline in proposals such as Stenholm's — an across-the-board cut that would fall on all entitlement programs — would punish innocent, slow-growing programs along with guilty, fast-growing ones and potentially harm the elderly, poor and sick beneficiaries who are the targets of many entitlement programs.

"You lock yourself into cuts in the future that can hurt real people," said Henry A. Waxman, D-Calif., at a House Government Operations Committee hearing to discuss budget enforcement proposals.

Stenholm disagrees. "What I want is to get away from this idea that we can't do anything about entitlements," he said in an interview. "If we want to spend this money on entitlements, let's vote to do it."

Stenholm's proposal is designed to force Congress to live within spending limits on entitlements just the way it does for appropriated spending. But because entitlement programs now automatically increase without limit in response to economic downturns (unemployment benefits and food stamps) or factors such as inflation and increases in the eligible population (Medicare and Medicaid in particular), entitlement spending is much more difficult to forecast and control than appropriations.

Stenholm argues that should not excuse Congress from trying, however, and his proposal would adopt as limits the non-binding mandatory spending numbers that Congress wrote into its budget resolution this year. If entitlement spending threatened to exceed those levels, Congress could revisit the programs to cut spending or allow one of two different automatic cuts to take effect.

The most draconian enforcement mechanism would impose across-the-board cuts in all entitlement programs, including Social Security, and also levy automatic tax surcharges and reductions in tax indexation to reduce the surplus. The plan is based on a bill drafted in 1992 by then-House Budget Committee Chairman Leon E. Panetta, D-Calif., who is now Clinton's budget director.

Stenholm said he wants a floor vote on the proposal as part of the reconciliation debate, and he threatened to try to kill the debate rule if such an amendment is barred.

It is not clear at this point that Stenholm can assemble the coalition of Republicans and Democrats he would need to force a vote, but such hardball tactics have worked before. Conservative Democrats joined with Republicans in October 1992 to threaten the debate rule on a 1993 continuing resolution. When the rule appeared doomed, Democratic leaders agreed to give Stenholm the vote he was seeking on an unrelated "expedited rescission" measure, and conservative Democrats switched their votes to support the rule. *(1992 Almanac, p. 114)* ■

A Missed Deadline

House appropriators missed a tentative, self-imposed deadline May 14 when they failed to divide their overall 1994 spending allowance among the panel's 13 subcommittees.

The so-called 602(b) allocation process — named after the section of the Budget Act that describes it — is the first step appropriators must take before they can begin marking up next year's spending bills, which are supposed to clear the House and the Senate before the new fiscal year begins Oct. 1. *(Background, Weekly Report, p. 1126)*

Committee aides had hoped to have the allocations complete by May 14 so that markups could begin. Plans call for all 13 House bills to move through subcommittee, full committee and the House floor before the July Fourth recess, and aides note that there are only 19 legislative days for House floor action between the Memorial Day recess and the Fourth of July break.

Subcommittee chairmen and committee staff insisted the missed deadline did not signal the committee was having any trouble dividing up its spending, which is always a painful duty. Instead, they said, the committee ran out of time in a week that was shortened by several House members' desire to leave town early in the afternoon of May 13 for a special trip to New York City.

The committee's staff has given the 13 subcommittees tentative allocations, which will not become final until all the chairmen agree to them at a meeting now expected the week of May 17.

—George Hager

Reconciliation Facts

Goal: Achieve about $340 billion in deficit reduction through revenue increases and cuts in mandatory spending in fiscal 1994-98.

House status: 13 committees met their May 14 deadline for submitting pieces of the bill.

The Budget Committee is scheduled to package the individual pieces into a single bill the week of May 17 and send the measure to the Rules Committee. Floor debate is scheduled for the week of May 24, immediately before the Memorial Day recess.

Senate status: 12 Senate committees instructed to produce pieces of companion bill by June 18.

21

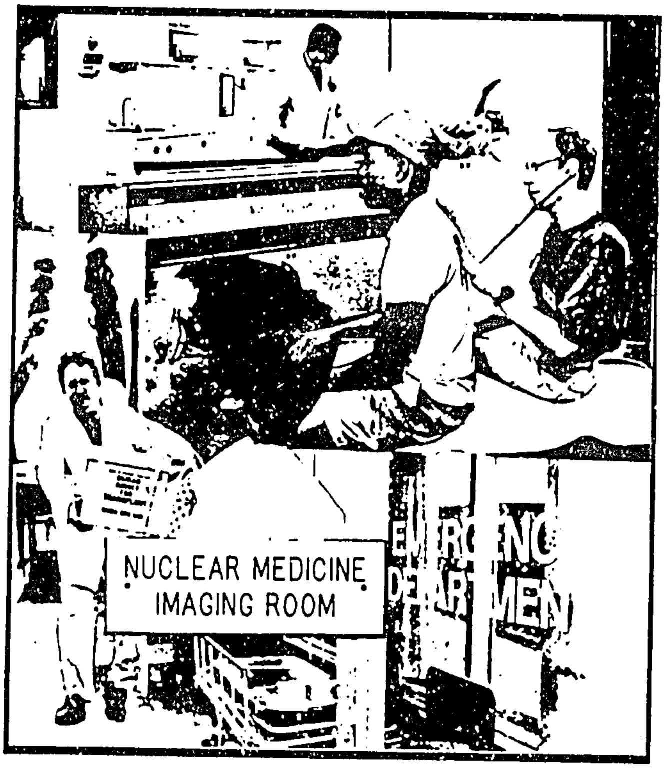
CONGRESSIONAL QUARTERLY
Weekly Report

HEALTH

Are U.S. Taxpayers Ready For Health-Care Reform?

Everyone wants to expand coverage and harness prices, but getting there could cost $90 billion a year

At the heart of President Clinton's effort to remake the American health-care system lies a riddle worthy of the Sphinx: How do you extend health care to more than 35 million uninsured people while also reducing the government's overall health-care spending?



The answer depends on the scope of reform and how fast it happens: The broader and faster the changes, the higher the cost.

"Assuming we're keeping everyone's health care at the level of service it's at now, I don't think we can add 37 million uninsured people without spending more money," said Joseph Newhouse, a health-care economist at Harvard University.

But that spending could add up to between $30 billion and $90 billion a year, depending on how many more people get health-care coverage and how much care is covered in a standard benefits package. And as the dollars increase, so do the political obstacles.

"When you're talking about legislation that has a range of $30 billion to $90 billion ... that's truly terrifying for a lot of congressmen," said Matt James, spokesman for the Kaiser Family Foundation, a health-care policy think tank based in Menlo Park, Calif.

Health reform is supposed to save money in the long run, in part by standardizing benefits, reducing insurance costs and emphasizing preventive care. It is even supposed to help reduce the federal budget deficit. But in the short run, reform means new taxes or spending cuts or both — and lawmakers agree that the prospect is daunting. *(Weekly Report, p. 595)*

By Alissa J. Rubin

"I'm afraid that the public thinks that everybody will have what they have now and they won't have to pay any new taxes," said Rep. Sander M. Levin, D-Mich. "Those mathematics don't work out."

One answer, favored by many in the Clinton administration, is to phase in the health system overhaul over several years. The uninsured would gain access to health care gradually. The hope is that by buying time and putting in place some of the cost-saving measures early on, the government could reduce the amount of money — and new taxes — needed to finance the system.

But a phase-in also has a downside: It will limit the achievements that politicians, including Clinton, will be able to tout in time for the next election cycle.

"There are all kinds of land mines to a phase-in," said Sen. David Pryor, D-Ark., a longtime Clinton ally. "The potential danger in a political environment is that if a new program is not up and running and people are benefiting from it, or if it is burdened with red tape, people may be trying to get the program repealed just as members are up for re-election."

The challenge for Clinton is to find the delicate balance between short-term pain and the long-term benefit of providing Americans with predictable costs and services throughout their lives.

Totaling the Bill

Clinton, Congress and the country face two questions: How much will a health-care overhaul cost and how should it be paid for?

The federal government currently pays 31.3 percent of the nation's $832 billion annual health-care bill. Almost three-fourths of that is spent on Medicare, the national health insurance program for the elderly, and Medicaid, the federal-state health insurance program for the poor. Change unquestionably will cost the government billions of dollars. How many billions? It depends on what Clinton recommends.

By reorganizing the system, Clinton aims to reduce the growth in health spending for both the government and the private sector. But at the same time, he wants to expand the services available and extend them to everyone. While businesses will be asked to shoulder some of the financial burden of providing coverage, the government will continue to subsidize health care for the elderly and the poor — and, under Clinton's plan, those others who are uninsured now and cannot afford private insurance. Clinton also has pledged that the government will subsidize the health coverage that small businesses purchase for their employees.

Economists say that if Clinton recommends a rich package of health-care benefits, government costs could increase substantially, especially at first. White House sources say the plan will cover most of the benefits available through private health insurance plans, plus prescription drugs.

If Clinton also recommends coverage of long-term care, the estimated cost of health reform increases by $30 billion, according to estimates by Clinton's health reform task force, which is drafting his plan.

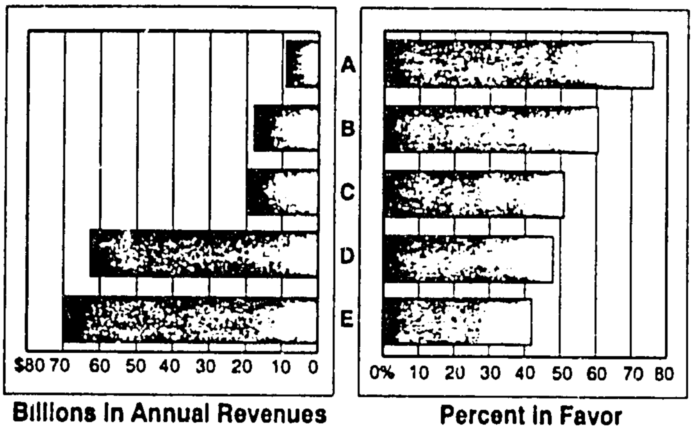
Even stalwart supporters of long-term care, such as Sen. John D. Rockefeller IV, D-W.Va., seem ready to leave comprehensive coverage for another day. But the administration may find that difficult. Last week, Clinton spokesmen said "health-care security" would be a key theme of their program. They announced that every American would receive a "health security card" guaranteeing access to health care. Because "security" in many peoples' minds means coverage of long-term costs, such as those for nursing homes, Clinton may have to include such coverage to sell his package.

But for Republicans and even some Democrats, such a potentially enormous tax hike is insupportable.

"If you take care of all the dental care and the long-term care and the mental health care, you're going to need a lot more revenues," said Sen. Charles E. Grassley, R-Iowa. "So, you're going to see a low-tax boy like me wanting a very basic plan."

Paying for Health Care: Popularity of Various Tax Options

This poll suggests that the most popular taxes would raise the least revenues and that the least popular would raise the most. For example, 3 in 4 Americans favor a cigarette or other "sin" tax, but such a tax would raise only $9 billion a year.



A- Increased tax on cigarettes and alcohol
B- Tax on incomes over $50,000, for health care
C- Tax on employer contributions to insurance premiums
D- Health payroll tax on employers
E- 5% value-added tax (similar to a national sales tax)

SOURCES: Kaiser Harris Election Night Poll and Joint Tax Committee

Note: The poll of 1,149 Americans was taken Nov. 3, 1992. It has a margin of error of 3.5 percentage points.

MARILYN GATES-DAVIS

A further — if little discussed — political consideration is what Clinton will do to offset the job loss that may result from health reform — a loss that opponents are sure to use as ammunition against change. The health-care industry has been one of the leading creators of jobs over the past decade. Drug companies, doctors, hospitals, medical technology manufacturers and health insurers are likely to argue that change will eat into profits and prompt layoffs. If doctors make less money, for example, they may hire fewer assistants.

"Job loss will be the last-ditch argument that the health-care industry will raise to try to stop it," said Matt James of Kaiser. "That resonates very strongly with congressmen."

Another issue that Clinton and Congress will have to confront is that in the short run they are unlikely to reduce the federal deficit through health-care reform. Most proposals, including Clinton's, are based in large part on changes in the private sector's financing and delivery. Overall, spending nationally may decrease in the next four years, but the government's portion of the tab is more likely to increase.

"If health-care reform is successful, we'll bring down overall growth," said Robert D. Reischauer, director of the Congressional Budget Office, which officially estimates the cost of proposed legislation. "But to expect that to result in savings on the federal side in the short term is wishful thinking."

How To Pay for It

The government can pay for reform in two ways: savings and taxes. The more savings that can be achieved by making the health-care system more efficient, the less that will have to be raised in taxes.

Two types of savings are under

The Tax Proposals at Hand

When Clinton administration officials floated the idea of imposing a value-added tax to pay for their health-care initiative, it was a reminder of just how expensive the undertaking will be — and how difficult.

Consider this scenario: Later this year, after Congress sends President Clinton the budget-reconciliation legislation incorporating his plan for the largest tax increase in history — $243 billion over six years — lawmakers on the tax-writing committees will turn to health-care overhaul and immediately face the prospect of voting for another massive tax increase.

Getting Congress to approve more taxes will not be easy, but Clinton has simplified the selling job by placing health-care reform squarely on the national agenda and steadily preparing Congress to expect a large tax increase as part of the plan. Experts say Clinton's plan to provide universal coverage could cost $30 billion to $90 billion annually.

Taxes: Pro and Con

Sin tax: Popular with public and Congress. Regressive. Small revenues.

Tax on incomes over $50,000: Relatively popular with public, despite its visibility. Progressive. Taxes earned and unearned income. Small revenues.

Limiting insurance writeoffs: Opposed by business and labor. Taxes the employed only. Small revenues.

Payroll tax: Regressive if paid by employees but moderately popular. Taxes the employed only. Large revenues.

Value-added tax: Unpopular. Opposed by state and local governments. Regressive. Large revenues.

The following are among the options floated by administration officials:

- **Value-added tax.** This tax, which is used in the European Community, is imposed at each stage of production, unlike a sales tax, which is imposed on goods at the point where they are sold. A VAT is calculated by subtracting the raw materials and other costs from the selling price of the good, so that only the value added at each level of production is taxed. The VAT also would be imposed on most services.

Advocates say the tax, which raises considerable revenue at fairly low rates, would discourage consumption and encourage investment and savings. If proposed as a way to pay for health care, a VAT presumably would be added to the existing corporate income tax, rather than replacing it. That could generate opposition in the business sector, where the tax has been advocated as a replacement for the income tax.

In addition, the administration would have to contend with critics who say a VAT is regressive, falling more heavily on low- and moderate-income earners. The answer could be to exempt certain kinds of goods, such as food, or to offset the effect on lower-income taxpayers through a credit or other means.

The Congressional Budget Office (CBO) calculates that a 5 percent VAT would yield $417 billion over five years ($217 billion if food, housing and medical care were excluded).

- **Sin taxes.** Taxing alcohol and tobacco at higher rates has appeal because it would raise revenue while discouraging drinking, smoking and other pursuits that are believed to cause health problems. Many lawmakers favor this approach, although affected industries have ardent defenders on Capitol Hill who point out that sin taxes are regressive.

There also is debate about how much revenue this option would generate. The alcohol and tobacco industries argue that the revenue take could drop dramatically if taxes are raised high enough to discourage large numbers of people from drinking and smoking. But other experts argue that sin taxes still would bring in some revenue in an easy fashion. According to CBO, raising cigarette taxes from 24 cents per pack to 48 cents would bring in $17.9 billion over the next five years. Increasing the federal tax on alcohol to $16 per proof gallon would raise $22.6 billion over five years.

- **Limiting the writeoff for health insurance expenses.** Currently, businesses can write off the costs of providing health insurance to their employees as a business expense. Some reform advocates argue that subjecting part of those costs to taxation would give companies an incentive to choose lower-cost health plans.

Alternatively, individuals could be taxed on a portion of their employer-paid health insurance, although the administration has appeared to rule this out. Employees do not now pay taxes on income they receive in the form of employer-paid health insurance. Last year, according to CBO, the exemption cost the government $39.8 billion in lost tax revenue.

Both approaches are opposed by organized labor, which argues that lowering the tax benefits available for health care will prompt employers to cut back coverage when negotiating new contracts.

- **Payroll tax.** Another way to raise revenue would be through a new payroll tax that would be deducted from employees' checks every payday. The idea has a certain logic because a payroll tax is the method used to pay for other big government social programs such as Social Security and Medicare. And payroll taxes are relatively popular with the public, despite being regressive. One problem: Wealthy individuals who do not receive regular paychecks would be outside the system.

- **Income tax.** The most direct way to finance health-care reforms — increasing the individual income tax — seems unlikely, since Clinton has proposed rate increases as part of his economic plan.

- **Other.** Other taxes under consideration include an income tax on health-care providers and a tax on health-care insurance premiums. Both would be targeted specifically at health care but would not raise much money. The intent of both taxes is for the government to capture some of the private savings expected from the health-care overhaul.

—David S. Cloud

consideration: interim price controls on doctor and hospital bills, and more permanent savings from a systemic health-care overhaul. Both sound logical, until politicians consider that such changes will touch the entire health-care industry, which encompasses one-seventh of the nation's economy and affects about 10 million jobs.

Price Controls

While the White House has sent mixed messages about the likelihood of price controls, few doubt that some limit on the rise in health-care costs will be part of Clinton's proposal for the transition period to a new system.

Past efforts to hold down spending have focused on reducing the amount the government pays doctors and hospitals through Medicaid and Medicare. The controls now under discussion would be aimed at health services in the private sector as well, said a spokesman for Clinton's health-care task force. Among the costs that would be controlled would be physician and hospital reimbursement rates and drug prices, which might be frozen or allowed to increase only as much as inflation.

Price controls, however — especially on health care — can be extremely difficult to enact, let alone administer.

Unlike the price of gasoline or clothes, prices for health care vary widely from state to state and even within a hospital, depending on whether the government or a private insurer is paying. "There is no single price for an operation — it's like the seats on an airplane," said CBO Director Reischauer. "Everyone has paid a different amount for a seat. It's horrendously complex administratively to impose price controls."

Business groups are dubious; most say they will oppose any rigid controls that freeze medical prices. They say the current health system often encourages unnecessary surgery and expensive tests — and a price freeze would not address those inefficiencies.

"What's the point of controlling the price of an unnecessary surgery?" said Sean Sullivan, president of the National Business Coalition Forum on Health, a group that represents 50 consortia of businesses, health-care providers and insurers. Sullivan said his members support gradual cost reduction but want the freedom to decide how to make the savings.

Leaders at a task-force hearing March 29 included Vice President and Mrs. Gore and Attorney General Reno, in rear.

Virginia Trotter Betts and Dr. Jack Harris were two of the health-care providers who testified at the hearing.

Don Young, who runs the Prospective Payment Commission, which sets Medicare reimbursement rates for hospitals, agrees. "If you put a freeze on prices, it freezes prices that are too high but also those that are too low, so there's an issue of fairness," he said. He also said cost controls could affect jobs. Hospitals under pressure to reduce costs probably would try to hold down wages and hire more low-paid workers.

Long-Term Savings

Marilyn Moon of the Urban Institute, a Washington think tank, said there are only two ways to reduce costs: "You can pay less to the people who provide health care, or you can give patients less in terms of service." She said a combination of the two will save money, but she added that people will have to get used to the idea of fewer services. Other academics say that profits in some areas of the health-care industry — such as drugs and medical technology — may diminish as well.

Those changes are likely to slow spending and federal costs, but they will take at least five years to put in place, said CBO's Reischauer. "And it is highly likely that fundamental health-care reform will take longer than that," he said.

Politicians' most fervent hope is that by reinventing the health-care system, they will save so much money that the overall package could offer insurance for everyone while reducing the deficit — before the next election. That is a pipe dream, most economists say, but dispelling it is surprisingly difficult.

It seems every lawmaker has a favorite silver bullet for cutting health costs: Reduce paper work; impose price controls; reduce malpractice insurance costs by limiting plaintiffs' awards; impose wider use of managed care, such as health maintenance organizations (HMOs).

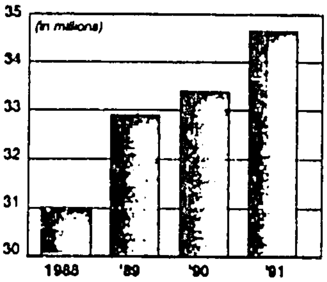
"You still have people around here who think savings will come from cutting down fraud and abuse or from malpractice reform," said Rep. Fred Grandy, R-Iowa, a member of the Ways and Means Subcommittee on Health.

Each silver bullet, however, is likely to yield far less in savings than politicians believe, according to academics and the CBO. Putting all Americans into an HMO-like system initially would reduce national health-care spending by as much as 10 percent — but after that, costs would contin[ue] to rise at their current rate. And anything less than a strictly run system would not achieve the same savings, Reischauer said.

Moreover, wider use of managed care, a key component of proposals from both Clinton and Congress, is a potential political lightning rod. Managed-care savings come from assigning each patient to a primary physician who acts as a gatekeeper, signing off on every test and referral to a specialist. Managed-care physicians are given incentives to limit tests and referrals. That could severely restrict the access many middle-class Americans now feel they have to highly trained specialists and sophisticated medical tests.

How Many Are Uninsured

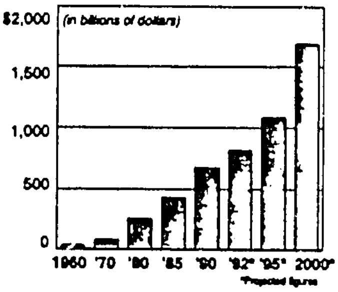
The number of Americans who are uninsured reached about 35 million in 1991.



SOURCE: Health Care Financing Administration

What America Spends

Total health-care spending has skyrocketed and is expected to hit $1.6 trillion in 2000.



SOURCE: Congressional Budget Office

MARILYN GATES-DAVIS

"Under managed care, you won't be able to say, 'I want an MRI test because my friend Joe had one last year'.... It will be up to the doctor," said Moon of the Urban Institute.

Clinton emphasizes that Americans will continue to be able to choose their doctor. However, most doctors will go into managed care groups, which are proliferating across the country, according to the American Medical Association. Thus, a patient might follow a doctor by subscribing to the health plan offered by the doctor's HMO.

Cutting waste and duplication may reduce overall spending, CBO said, but even under the most efficient option — in which the government became the single payer or health-care insurer — only $30 billion to $35 billion would be saved, far less than the $100 billion that proponents project. And Clinton has all but ruled out a single payer system, except as a state option. Most doctors and hospitals will continue to fill out numerous claims forms from government programs, HMOs and insurance companies.

Malpractice reform is crucial to the passage of health-care reform, say many politicians. But CBO estimates that malpractice premiums represent 1 percent of health-care costs. So-called defensive medicine, which prompts physicians to order unnecessary tests, would theoretically be reduced with malpractice reform. But physicians and ethicists point out that while some tests are clearly either necessary or extraneous, there is a vast gray area in which good practitioners might reach different conclusions.

Taxes

In a sharp reversal from the anti-tax sentiments of recent years, polls find that a majority of Americans are willing to pay more taxes if the money is used to overhaul the health-care system. In a New York Times survey in late March, 58 percent of those polled said they would be willing to pay higher taxes.

However, when Americans are asked what taxes they would be willing to pay, they generally pick those that raise the least money. Examples are increased taxes on cigarettes or alcohol ("sin" taxes) or an increase in the income tax on those who earn $50,000 or more. Support for an income tax drops from 61 percent to 29 percent when the increase is on those who earn $25,000 or more. *(Chart, p. 956)*

Many people would like to rely on sin taxes, including an increase in the taxes on tobacco, alcohol, guns and pollutants. But from a political standpoint, lawmakers say, the tax should be tied to a health problem — the way smoking is tied to lung cancer.

"I think it gets difficult the further you get from tobacco," Levin said. "You really have to be able to make the connection to health care." But sin taxes do not raise much money. Doubling the tax on cigarettes would bring in only $17.9 billion over five years, according to the CBO. Said a Senate aide: "If they want to pay for this with sin taxes, they are going to have to invent a few more sins."

Several politicians feel they must find a single tax mechanism that people can view as their contribution to solving the health-care crisis. "Philosophically, I've always felt that a dedicated health care tax would work," Pryor said.

It could be a national sales tax earmarked for health care or an additional payroll tax, similar to the one already in place that collects money for Medicare. Or a "value-added" tax of the type proposed by Rep. John D. Dingell, D-Mich., and others. Recently the administration has begun to consider a tax on health-care providers or on health insurance premiums. *(Story, p. 957)*

However, every tax comes with political baggage that may make it difficult for Congress to enact. The sales tax typically has been a revenue raiser for state and local governments, which do not want to compete with a similar federal value-added tax.

Similarly, only moderate support can be found for taxing health benefits for which employers and employees pay. Currently, employers can deduct the full amount they spend on health care as a business expense, and employees pay no taxes on their health-care benefits. This year the government will exempt from taxes $48 billion that businesses spend on health benefits. Proponents of this tax say limiting deductibility would encourage employers to buy less expensive health plans. But labor unions, which won generous health-care benefits in the 1930s in lieu of wage increases, oppose the tax because they do not want to see those benefits eroded.

"It's very difficult to devise a tax package that meets all the criteria of a reasonable or a good tax," said Moon. "The Clinton administration needs to make the point that even if you don't help the deficit, you do society a lot of good by slowing the growth in health-care spending. But none of this is easy." ■

ENVIRONMENT

Statement of Korinna Horta, Staff Economist, Environmental Defense Fund, before the Committee on Banking, Finance and Urban Affairs/Subcommittee on International Development, Finance, Trade and Monetary Policy, U.S. House of Representatives, May 5, 1993.

"Development Experts Uphold Focus on Environment," Press Release of the Overseas Development Council (ODC), May 25, 1993.

Von Praag, Nicholas. "Governments Push Ahead with the GEF," The Independent Sectors' Network, The Centre for Our Common Future, March 1993.

Mitchell, James A. "Toward a New International Environmental Order, or the North-South Stalemate Revisited?" Development, Society for International Development (SID), 1993.

Daly, Herman and Robert Goodland. "Poverty Alleviation is Essential for Environmental Sustainability," Environment Department, The World Bank, February 11, 1993.

Rich, Bruce. "The World Bank After Rio: A Need for Institutional Reform," EDF Letter, Environmental Defense Fund, March 1993.

Rosen, Gerald R., Ed. "Seminar Explores Links Between Macro Policy and the Environment," IMF Survey, The International Monetary Fund, June 14, 1993.

Loughran, Kim. "Reforming the Corporation," Tomorrow, April-June 1993.

Bishop, Brian. "Transport Industry's Role in Deforestation," World Rainforest Review, Rainforest Action Network, April-June 1993.

Banks, R. Darryl. "The Heat is On," Tomorrow, April-June 1993.

Vaughan, Scott. "About Those Accounts: Reforming the Masquerade of Progress," Our Planet, United Nations Environment Programme (UNEP), 1993.

Agarwal, Anil. "The Land of Milk From Water," Our Planet, United Nations Environment Programme (UNEP), 1993.

Berndt, Jane. "Book Review: Earth in the Balance," Presidential Studies Quarterly, Center for the Study of the Presidency, Spring 1993.

Appendix I

Statement by Korinna Horta
Staff Economist
Environmental Defense Fund
May 5,1993

Concerning FY 1994 Authorization
for the Global Environment Facility (GEF)

In FY 1993 the U.S. Congress passed legislation which makes a U.S. contribution to the GEF core fund dependent on the GEF's ability to meet three basic conditions. In a nutshell, these concern the public's right to obtain information on the GEF projects and related activities of the GEF implementing agencies; the participation of affected people throughout the life of the project; and the highest standards for the quality control of GEF projects. These conditions do not represent unrealistic expectations. On the contrary, the issues of transparency and participatory processes, which the conditions promote, lie at the very heart of the concept of sustainable development that has been embraced by the largest gathering of heads of state at the Rio Earth Summit last year.

We strongly urge the Congress to continue this conditionality on authorizations for the Global Environment Facility. There are both substantive and strategic reasons which argue against a lifting of the conditions at this critical stage in the restructuring of the GEF. Here we will briefly describe evidence gathered on three GEF projects in three different continents. We will also refer to a GEF project in Egypt which highlights the overarching need to integrate environmental concerns into the development process itself. Furthermore, we will briefly examine the counter-argument being made, which is to go ahead with a U.S. contribution to the core fund with no conditions attached, and examine its implications.

I. GEF PROJECTS

(1) Ecuador. After over a year of intense project preparation, the GEF decided to withdraw financing for the Ecuador GEF project in April 1993. The GEF Ecuador project was intended to be a model for private sector participation in carbon sequestration through the establishment of forest plantations for a large Ecuadorean timber company. The $ 2.5 million GEF grant was a component of a $ 12.8 million project investment project prepared by the International Finance Corporation, the World Bank's private sector financing arm. An environmental organization in Ecuador, Accion Ecologica, sounded the alarm about the environmental and social impact of the project. The GEF started by stonewalling any public discussion of the project. However, international environmental organizations supported the Ecuadorean NGO request for a careful reexamination of the project. As a result, the GEF commissioned an independent review of the project which confirmed the NGO concerns:

a) The scientific basis for the project to store carbon in a plantation forest to global warming is doubtful;

b) The project, by indirectly supporting logging in natural forest, would lead to the loss of globally important biodiversity;

c) Part of the project's logging activities would occur in indigenous peoples' forest lands, yet the affected Chachi Indians were not represented in the project;

d) The future livelihoods of the small farming communities now occupying the land to be converted to plantations during the project would be uncertain. There is the danger of the smallholders selling their plots to the timber company and resettling in other forested areas.

The GEF deserves to be congratulated for having commissioned an independent review and for holding public discussions about the project. Yet important questions still need to be examined. How could this project ever have been approved as part of a work program by the GEF Participants' Assembly and gotten past the scrutiny of the GEF's Scientific and Technical Advisory Panel (STAP)? If the conditions of public access to information, local participation and high standards for project quality control, as mandated by U.S. law, had been met, a whole year of project preparation, including staff time and project preparation costs, would not have been wasted and Ecuador might now benefit from a much needed project to help stem the country's rapid deforestation.

(2) Kenya. The Tana River Primate Reserve GEF project plans to set up a protected area in the riverine forest ecosystem of the Tana River in northeastern Kenya. The Kenya GEF project is among the first tranche of GEF projects and has been in preparation since the fall of 1991. The area to be protected is home to an indigenous human population, the Pokomo, and to two endangered primate species, the red colobus and the crested mangabey. According to the East African Wildlife Society, a Kenyan NGO which has worked in the Tana Region since 1975, the design of the GEF project is based

229

on the disturbing assumption that protection of the primates can only be achieved if the human population in the reserve is resettled elsewhere.

Resettlement for the sake of conservation - and it remains unclear how the proposed resettlement would be voluntary and at what point it would become involuntary - seems to be a fundamentally flawed approach. The fact that there is no social science expertise on the GEF's Scientific and Technical Advisory Panel has led to the complete lack of guidelines on resettlement and the GEF's relationship to indigenous communities. In February 1992, the United Nations Development Program (UNDP) wrote to the World Bank requesting that the GEF Participants Assembly or the GEF Implementation Committee (which has representation from the three implementing agencies) decide whether resettlement costs can be paid with GEF funds. UNDP believed that this issue was too important to be left to any of the implementing agencies by themselves and refused to participate in financing studies related to the resettlement in the Tana region without a prior policy decision. The Bank simply responded that it did not need UNDP participation in financing the studies. The way the World Bank has handled the issue is deeply disturbing, especially in light of the fact that official Bank policy recognizes that involuntary resettlement may "cause severe long-term hardship, impoverishment and environmental damage" and advises that "involuntary resettlement should be avoided or minimized where feasible, exploring all alternative project designs" (OD 4.30).

The East African Wildlife Society, which has sponsored research in the Tana River area for many years, opposes the resettlement of local people and is convinced that only a collaborative community approach where local people are full partners in the conservation efforts can be successful. Recent studies have found that there were more endangered colobus groups (one of the endangered primate species) living in places inhabited by the Pokomo than in abandoned forest lands. Also, it was only due to the knowledge of local people that new populations of red colobus monkey were discovered in a recent survey. According to the East African Wildlife Society, the upstream construction of dams and of irrigation schemes, some of which financed by the World Bank, has contributed to the degradation of the riverine ecosystem and the habitat of the endangered primate species.

The Kenya GEF project will be a grant component of a larger World Bank loan. Initially, the GEF project was to be attached to a $ 60 million project entitled "Protected Areas and Wildlife Services". Current plans call for the GEF project to be attached to a larger World Bank agriculture sector loan. What is the logic behind the shift and what is being done to ensure that activities funded under the sector loan will not undermine the goals of the GEF project (for example by increasing irrigated areas upstream, use of pesticides and fertilizers, etc.) ?

According to the East African Wildlife Society, the World Bank has scheduled

226

its first consultation with NGOs in Kenya for May 3, 1993, which is rather late in the process of project development. The invitation was sent out by the World Bank four days prior to the meeting without any accompanying documentation on the issues to be discussed. At this stage it is critical to ensure that the project will not proceed any further without first undertaking a thorough participatory review of the project with the affected communities in the project area.

(3) Laos. Towards the end of May 1993, the World Bank's Board of Executive Directors will be asked to approve a GEF biodiversity protection project and an associated World Bank forestry loan for Laos. The main objective of the project is to promote the restructuring of forest management and conservation in Laos by effectively regulating access to forest resources and logging in the country. The World Rainforest Movement, a Malaysia-based international environmental organization, has monitored this project closely since early 1992 and come to disturbing conclusions: The project will unduly restrict traditional forest uses by local communities and thereby affect about 50% of the Laotian people whose livelihoods depend on their forests. At the same time, the World Bank's forestry loan is likely to promote commercial logging in primary forest, contrary to the Bank's Forest Policy.

No environmental impact assessment was carried out for the forestry project although its focus includes tropical forests and indigenous peoples. There are signs that the project may also include the resettlement of forest dwellers. There has been no adequate consultation with NGOs, local communities and local authorities. The latter finding was corroborated by an internal World Bank report which found that no provisions were made for a participatory development process in and around the areas to be protected under the GEF component of the project, although local community involvement is essential to any long-term conservation success.

The World Rainforest Movement and other environmental NGOs are calling for a revision of the project, including a full environmental impact assessment and consultations with affected communities.

(4) Egypt. It is widely recognized today that global environmental concerns need to be integrated into the development process itself. However, the fact that a vast majority of GEF investment projects is attached to larger, regular World Bank loans raises questions questions whether environmental standards and criteria are fully integrated into activities funded under the World Bank's regular programs. Indeed, there are indications that the GEF in its current form may have a perverse effect by marginalizing environmental concerns and treating them as add-ons to regular development projects.

The Swiss NGO, Berne Declaration, has documented the case of the GEF's coral reef protection project for Egypt. The World Bank approved the $ 4.75 million GEF project as an attachment to a $ 130 million dollar loan to promote the tourism industry along Egypt's Red Sea. In view of the fact that the main threat to the coral reefs is tourism development, the larger World Bank loan should have internalized any costs associated with protection of the coral reefs. The GEF's Scientific and Technical Advisory Panel (STAP) did not have access to documentation on the associated tourism development project when it was asked to examine the proposal for the GEF project. According to the chairman of the STAP, a much better analysis of the GEF project could have been done if documentation on its larger context would have been made available.

****

In conclusion, these brief descriptions of four GEF projects demonstrate that removing the conditionality on an U.S. contribution to the GEF core fund would have serious consequences for the quality of future GEF projects. Given the lack of public access to information, it is unclear how many more problem projects similar to the four above are currently being prepared in the name of protecting the global environment. Only if the U.S. maintains the conditionality and actively requests the support of other countries for the U.S. position, will it be possible to weed out projects that are environmentally and socially harmful at the earliest stage before large investments for project preparation are made. This would certainly be one of the most cost-effective ways to protect the global environment. It would also assist the GEF in becoming the open, accountable and transparent entity that it aspires to be.

II. STRATEGIC CONSIDERATIONS

The argument has been made that the U.S. will only be able to press for fundamental changes in the way the GEF conducts its business, if a U.S. contribution is made to the GEF core fund. There is little evidence to support the assumption that U.S. leverage to achieve reform increases once a U.S. payment has actually been made. To the contrary, continued U.S. conditions on a contribution to the GEF core fund coupled with the commitment that the U.S. is willing to contribute its fair share to the GEF or any other financial mechanism that will support global environmental goals, offer incentives that are more likely to bring about the needed reforms.

Removing last year's conditions on a U.S. contribution to the GEF core fund would send the wrong messages:

a) It would signal to other countries that the U.S. is not committed to the principles of openness, participation and quality control, which are reflected in the conditions, and therefore doom any chances of putting them in practice:

b) It would signal to the GEF that a restructuring process that is merely a cosmetic exercise is acceptable.

U.S. participation in the GEF is indispensable if the GEF is to be a <u>global</u> mechanism. This provides the U.S. with an unprecedented opportunity to demonstrate international leadership on global environmental matters.

Finally, in addition to ensuring that the U.S. conditions will be met, the ongoing restructuring of the GEF does require some immediate attention concerning the following issues:

(a) Completion of an independent evaluation of the GEF pilot phase;

(b) Making GEF Governance more effective by ensuring the independence of the
GEF secretariat from the three implementing agencies;

(c) Examination of possible alternative funding mechanisms for the Climate Change and Biodiversity Conventions.

Important opportunities for U.S. diplomatic initiatives to gain support for the U.S. position will be the GEF Participants' Assembly meeting in Beijing in May 1993 and the G 7 summit in Tokyo in June 1993.

231

1875 CONNECTICUT AVENUE, NW WASHINGTON, DC 20009 TELEPHONE (202) 234-8701 FACSIMILE (202) 745-0067

PRESS RELEASE
May 25, 1993

CONTACT: Courtenay Singer
202/234-8701

DEVELOPMENT EXPERTS UPHOLD FOCUS ON ENVIRONMENT

Washington, D.C. -- "The 1992 Earth Summit at Rio championed a new era of sustainable development. A year later we are still grappling with the international institutional implications of stimulating economic growth and development while protecting the earth," state Maurice Williams and Patti Petesch in Global Governance and Aid After the Earth Summit, available later this summer. This advance copy of their summary of recommendations focuses on the roles of the United Nations Commission for Sustainable Development (UNCSD), the United Nations Development Programme (UNDP), the United Nations Environment Programme (UNEP), the Global Environment Fund (GEF), and the World Bank in moving toward sustainable development.

The recommendations, released on the eve of the first anniversary of the United Nations Conference on Environment and Development (UNCED) and the first session of the United Nations Commission for Sustainable Development (UNCSD), focus on enhancing the ability of the key multilateral agencies to take the lead in the transition to sustainable development.

* * *

The Overseas Development Council is a private, non-profit institution that provides comprehensive analyses of the economic and political issues of U.S. developing country relations. The Council's program is funded by foundations, corporations, and private individuals. Stephen J. Friedman is Chairman of ODC. John W. Sewell is the Council's President.

THE INDEPENDENT SECTORS' NETWORK

NUMBER 24
March 1993

Published by
The Centre For Our Common Future
Palais Wilson
52 Rue des Pâquis
CH-1201 Geneva
(Switzerland)
Tel (4122) 732 71 17
Tlx 412 436 csen ch
Fax (4122) 738 50 46
E-mail commcnfuture
(Green Net)

Governments Push Ahead with the GEF

By Nicholas van Praag

Representatives of 46 governments gathered in Rome on 4-5 March to push ahead on the restructuring and replenishment of the GEF that must be accomplished by the end of 1993.

The meeting, held at the UN Food and Agriculture Organisation (FAO) headquarters, focused on the decision making system and saw the adoption of arrangements for an independent evaluation of the Pilot Phase.

GEF Replenishment Discussed

Rome also saw the first round of discussions on the replenishment of the Facility. At the half-day session on March 3 - the day before the main Participants Meeting - representatives of the 28 countries that contributed to the GEF during the Pilot Phase agreed that the replenishment of the GEF would go ahead in parallel with, but separate from, negotiations on restructuring the Facility.

It was decided that only those countries that intend to make a contribution to the fund could participate in the replenishment discussions. However, other countries participating in the GEF may each designate an observer to attend the replenishment meetings.

Participating governments also agreed that the replenishment process should be completed by December 1993. To meet this timetable, they decided to hold four more meetings on replenishment - in May, September, November and December. Agreement must be reached on a series of issues ranging from decision making and constituency arrangements, to the legal status of the GEF, the links between the GEF and the Conventions, the role of the Scientific and Technical Advisory Panel and the role of the GEF Secretariat.

Voting Mechanisms

Participating governments agreed that decisions should be taken on the basis of consensus wherever possible. When it is not, a voting system will be used that respects the interests of both beneficiaries and contributors. At the meeting, there was a frank exchange of views on the merits of various voting mechanisms to use if consensus is not possible, but no final decision was taken and the matter will be on the table again when Participants meet in Beijing in May 1993.

However, it has already been agreed that members will group themselves into 25-30 constituencies, each with a single spokesperson. This is being done to prevent the deliberations in the Participants' Assembly from becoming unwieldy once membership increases. Precise arrangements for its formation have yet to be worked out.

GEF Evaluation Continues

While each of the three GEF implementing agencies is evaluating its own performance, governments also agreed on arrangements for an independent evaluation of the Pilot Phase.

An independent panel will guide the evaluation. It will include representatives of at least two participating countries (one developing and one industrialised), the heads of the implementing agencies' evaluation teams and three to five high level experts. The panel will be chaired by one of the outside experts. The evaluation will be completed in November 1993. Given the relative youth of the GEF, the evaluation will focus more on process (how projects are identified and prepared, etc) than on project accomplishments (because relatively few projects are yet being implemented)

What Costs Can the GEF Cover?

While most of the attention is on the restructuring and replenishment process, other investigations are under way to establish just what costs the GEF can cover. Both the biodiversity and the climate change conventions call for the provision of financial resources for the 'incremental costs involved in implementing measures to meet the objectives of the conventions.

These costs are easier to define in the energy sector (where GEF intervention may involve switching from a traditional technology to a more expensive but globally benign variant) than in a biodiversity project (where the incremental costs may be 100 per cent of project costs, because nothing might be done without GEF support).

To shed some light on this conundrum, a research programme has been launched by the Administrator of the GEF to determine how to measure these costs. Its implementation will require analytical rigour mixed with reasonableness in interpreting what constitute incremental costs in a particular case.

The GEF and NGO Input

NGOs have contributed a lot to the GEF. And there has been a considerable effort from the beginning to involve them in both project work and the broader policy and programme issues, such as those linked to the restructuring of the Facility. The small grants programme for local and grass roots NGOs is now active in more than 20 countries - with more to follow over the coming months.

A special NGO Consultation precedes each biannual meeting of governments, and a number of regional meetings have been held with NGOs. Information on the GEF is made available on ECONET (an electronic data base) and more than 500 NGO representatives are on the GEF's mailing list. NGOs have not, however, been accorded observer status at GEF meetings, as they have long requested. To address this issue, member governments have asked the GEF to study how NGOs might participate in the future. The study will go to governments in Beijing in late May. It is to be preceded on 24-25 May by an NGO consultation.

Nicholas van Praag is an Adviser to the GEF.

Contact: Global Environment Facility (GEF), World Bank, 1818 H Street NW Washington, DC 20433, USA. Tel (1 202) 473 5102; Fax: 477 0551

BACKGROUND ON GEF

The GEF was set up at the end of 1990 as a three year experiment to provide grants to developing countries for projects aimed at protecting the global environment in ways that are in harmony with their development goals. GEF resources are available for projects that deal with global warming, pollution of international waters, the destruction of biological diversity and depletion of the ozone layer. The GEF is implemented by the United Nations Development Programme, the World Bank and UNEP.

The three year pilot phase will be completed at the end of 1993 by which time the resources contributed during the pilot phase (some US$1.3 billion) will have been committed.

About 25 projects worth $150 million had been approved by early 1993. But there are another 45 projects, worth some $580 million that have been endorsed by member governments and are in various stages of preparation. Some 43 per cent of the projects in the GEF work programme are for projects aimed at conserving biodiversity, 40 per cent for combating global warming, 16 per cent for protecting international waters and one per cent for controlling emissions of ozone depleting substances

DEVELOPMENT
JOURNAL OF THE SOCIETY FOR INTERNATIONAL DEVELOPMENT 1993:1

Toward a New International Environmental Order, or the North-South Stalemate Revisited?

James A. Mitchell

The statesmen meeting in New York at the 47th session of the United Nations General Assembly under the auspices of the UN Environment Programme (UNEP) are being confronted with a daunting challenge. Their task is to craft a comprehensive environmental accord, a goal that eluded the states men and women who met at the June 1992 Earth Summit Rio de Janeiro.

With the elimination of East-West belligerencies, the dominant rivalry in the international system plays itself out along the North-South axis, pitting the advanced industrialized countries (AICs) against the less developed (LDCs). The North-South schism that materialized in Rio, the principal obstacle to an accord, has appeared before during the course of global negotiations. The stakes are higher today than ever before. A bleak forecast has been proffered by a host of observers regarding the ecological future of the Earth. The luxury of mortgaging the earth resources is not one that will be afforded for an indefinite period. Clearly the quality of life of future generations is being imperiled as long as attempts to devise a new international environmental order are forestalled.

An endangered planet

Early threats to the ecological well being of the planet that included a rapidly diminishing nonrenewable resource base, exponential population growth and environmental pollution, resulted in the convening of a United Nations Conference on the Human Environment, or Earth Summit I, in 1972. (Caldwell, Winter 1991, p. 5)

In subsequent years substantial progress was made globally in alerting citizens about the dangers inherent in environmental degradation. A number of global and regional meeting were held in an effort to identify common problems and for the crafting of strategies for solving them. Despite these developments new and more ominous threats to the ecosystem became increasingly evident.

The linkage between economic development and environmental deterioration was made explicit in "Our Common Future", a report issued in 1987 by the World Commission on Environment and Development, or Brundtland Commission. The Brundtland Commission, in citing the tradeoff between economic development and environmental preservation, called for an international commitment to the achievement of "sustainable development". Sustainable development involves "meeting the needs of the present without compromising the ability of future generations to meet their own needs."

The problem with actually reaching a global accord regarding the pursuit of sustainable development is in its implicit notion that resource utilization and, consequently, economic development, must be inhibited by AICs and LDCs. This would require that the AICs contain their heretofore unbridled pursuit of economic growth, flying in the face of the precepts of classical economic theory. The South would not only have to follow a similar course, but also accept a freezing in time of the historically disproportionate exploitation of the earth's resources by the North, and a "ratification of the unequal economic relations between the two groups. (Hecht and Cockburn, June 22, 1992, p. 849)

Flying down to Rio

Optimism was high among the cogniscenti regarding the prospects for the signing of a comprehensive Earth Charter in Rio. The successful record of the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer was viewed as a precursor to what might be expected for the Earth Summit. (Our Planet, 1992, p. 9) Additionally, the simultaneous appearance of several developments yielded high hopes. Among them were: the end of the cold war; the planetary scope of the impending ecological catastrophe; the activism and influence of environmental nongovernmental organizations (NGOs); an expressed resolve on the part of the United States to stimulate progress in addressing environmental issues. Each of these prospects were revealed as illusory. Consider them in turn.

End of the Cold War — The cessation of East-West tensions has been advanced as a panacea for virtually every international malady. Peeling away the skin of East-West conflict from the global body politic revealed even more complicated and vexing AIC-LDC conflicts festering underneath.

Ecological Catastrophe — The threat that continued environmental degradation poses for the Earth's future has been detailed exhaustively elsewhere. Suffice it to say that the natural lifespan of the planet has been severely truncated by the machinations of its human inhabitants. It was anticipated or, more likely hoped, that the indiscriminate impact of ecological malaise would compel the summiteers in Rio to hasten toward an agreement. Instead, as has frequently been the case for world order issues, political cleavages intruded.

NGO Activism — The failure of environmental nongovernmental organizations to sustain their push for a meaningful and comprehensive agreement at Earth Summit II was perhaps the most surprising and disconcerting development of all. The global environmental movement, which began to pick up the steam in the 1970s, had been successful in several respects. The measurable dissipation of atmospheric and ground water pollution, along with the addition of millions of acres to the wilderness system, were among the victories won by the

23

environmental movement since its inception. (Dovie, Winter 1991/92, p. 70) Perhaps most importantly, NGO activism was critical in raising the consciousness level of the planet's citizens regarding the prospect of environmental peril.

U.S Leadership — The essential ingredient in any recipe for achieving a comprehensive environmental accord is support by the United States government for the endeavor. With the "environmental president" George Bush in the White House, and an environmentalist in the cabinet, hopes were never higher for the United States' exchanging its fealty to business interests for the needs of the Earth Summit. Such a policy change would not be in the offing. Indeed, President Bush was loathe to even attend the meeting in Rio. He did not commit to appearing at the summit until the month before. The White House by that time had concluded that during the election year of 1992, not attending the summit would alienate environmental advocates among the electorate. Withholding agreement to anything of substance after he reached the meeting would enable him to placate foes of the conclave.

In the end the achievements of Earth Summit II fell far short of what was anticipated and, perhaps tragically, what might be necessary for the continued sustainability of the resources of the planet. Representatives of the 178 governments in attendance at the summit signed a Rio Declaration. The essence of the non-binding 800-page document was a commitment by the signatories to accept the legitimacy of a number of environmental principles. They also passed on the work of making the aforementioned Agenda 21 to the ensuing UN session. A climate convention obliging signatories to reveal their plans for how they intended to stabilize their emission of GHGs was signed. A Commission for Sustainable Development was established. Still, this is a far cry from the anticipated Earth Charter.

The principal conventions, addressing biodiversity and forestry did not achieve a consensus, rendering them nonstarters.

Further legitimacy was accorded the Global Environmental Facility (GEF) as the principal funding apparatus for handling environmental issues.The GEF is principally operated by the World Bank, with nominal participation by the UNEP and the United Nations Development Program, further cementing northern dominance. Implicit in the ethos of the GEF is southern complicity in global environmental degradation.

In the end, the United Nations Conference on Environment and Development was far from a watershed event. In a fashion identical to most other multilateral negotiations, the Earth Summit evinced an exacerbation of global political cleavages shortchanging the have-nots.

Will Rio be like NIEO?

The negotiation involved in hammering out the New International Economic Order (NIEO) in the 1970s were similar in many respects to those that transpired during the course of the Rio deliberations over a new international environmental order. In April 1974, at the 6th Special Session of the UN General Assembly a NIEO was declared by the developing national coalition. Both instances, the South was endeavoring to gain northern acceptance for its culpability for the principal item on the agenda. Earlier, it was southern economic deprivation. Subsequently, the issue was the imperiled global environment. On both occasions, the South wanted resource transfers from the North to enable them to address the respective problems. Out of both Rio and NIEO, the South expected to gain decision making authority commensurate with that of the North. The northern nations initially agreed to the need for a NIEO "in principle". Subsequent discussions became sufficiently protracted that the North was able to render the entire dialogue stalemated.

NIEO is now moribund, a dead issue. The fate of the earth depends on the present North-South environmental dialogue avoiding a similar destiny. The prospects for North-South movement on an environmental accord that will not exploit the have-nots might depend on the appearance of a recurrence of the structural changes in the international system that spurred the North accede to NIEO initially. These structural changes would be tantamount a paradigmatic shift in the global regime. It would amount to a fundamental transformation in outlook, certainly, and perhaps authority relations in the global dialogue. Consider the changes and likelihood of their recurrence.

Southern Power — With the oil embargo and the quadrupling of petroleum prices in 1973-74 in the wake of the Yom Kippur War, the South mobilized an element of power that was instrumental in compelling the North to listen to NIEO. The South cannot presently, nor is it likely in the short to medium term, wield power in a way commensurate with its success in the heady days of the 1970s. The collapse of OPEC unity, conservation on the part of oil consuming countries, and the exploitation of nonpetroleum energy sources, are among the developments that neutralized the oil weapon. A resurgence of southern countries power should not be counted on.

Southern Unity — The combination of third world nations melding their identities, interests and strategies under the auspices of such institutions as the Non-Aligned Movement and UNCTAD resulted in unprecedented southern unity. It is quite unlikely that southern unity will ever ascend to the commanding heights that is had attained by the time of the NIEO declaration. The multilateral southern bloc was divided in the aftermath of NIEO through a northern strategy of cutting bilateral deals with southern states in order to satisfy their immediate developmental and security requirements. In succeeding years their disparate developmental paths, along with their pursuit of divergent objectives in other issues areas, have further served to drive a wedge between them in subsequent attempts to unify. The unity of the 1970s is unlikely to be duplicated henceforth.

American Acquiescence — The leader of the northern bloc, the United States, was foremost among the advanced industrialized countries that initially acquiesced to the need for a NIEO. The vulnerability of the United States and its allies to impact of southern power and unity compelled it to throw its support behind the NIEO in the early stages of negotiations. With the collapse of the Eastern Bloc and the end of the Cold

War, the United States, is the undisputed leader of the international system to an extent approaching hegemony. That development, combined with the aforementioned dissipation of southern power and unity, insulates the United States from the prospect of being brought forcibly to a position of accommodation for the foreseeable future.

Crisis — The energy crisis of the 1970s was the event that imbued the need for North-South economic accommodation with a sense of urgency. The deprivation of northern economies from energy resources that were formerly plentiful, cheap and in southern possession facilitated the early NIEO agreement. The energy consuming nations have taken steps to mitigate the recurrence of an energy crisis of the magnitude that beset them in the earlier. The possibility has not been entirely eliminated. Its likelihood, however, has diminished considerably.

Regrettably, of the four developments noted above that came together to bring about an initial NIEO accommodation, the one most likely to recur is the incidence of a crisis. An environmental crisis promises to have an impact on the planet considerably more calamitous and indiscriminate than that of the energy variety nearly two decades ago. American acquiescence to the crafting of an environmental accord that will both address global problems and apportion the adjustment burden in a fashion commensurate with respective AIC-LDC responsibility will is difficult to imagine. Still, it is the only development short of a crisis that stands as a necessary and sufficient condition for the attainment of a North-South agreement during the course of the 47th Session and beyond. It will require vision and farsightedness on the part of the American leadership to enable them to transcend the economic interests have thwarted environmental accommodation in the past. For every day that that vision is not forthcoming, we move closer to the day when the sun's rays, unmuted by a protective ozone layer, might make us truly blind.

James A. Mitchell *works at the California State University, Northridge, USA.*

References

Caldwell, L.K., "International Response to Environmental Issues: Retrospect and Prospect. *International Studies Notes*, (Winter 1991).

Dowie, M., "American Environmentalism: A Movement Courting Irrelevance", "Everybody's Atmosphere". *The Economist*, (May 30 ,1992).

Hecht, S. and Cockburn, A., "Rhetoric and Reality in Rio", *The Nation*, (June 22, 1992).

McCoy, M., "New York Dress Rehearsal for Rio", *Development Forum*, (February 1992).

Our Planet, (1992).

The State of the Global Environment", *Our Planet* (1992).

Poverty Alleviation is Essential for Environmental Sustainability

Recommendations

1. **How the North can help the South:**

First, by getting its own (Northern) house in order, (Weiszacker, 1992) by transforming today's Northern consumerism and borrowing economy into a more sustainable model. This implies more saving. An accelerated transition to renewable energy for a stable population (zero growth rate) is the major element. Internalizing environmental costs in energy prices would be a powerful start. This transition has to be faster than what would be suggested by the market at present. OECD countries are unilaterally phasing in carbon- or non-renewable energy taxes. The implications of such taxes for the Southern development should be discussed. Part of Northern energy taxes could be allocated to promote Southern sustainable development, especially direct alleviation of poverty. Such national taxes may later become global, as proposed by UNCED in 1991, or become tradeable pollution permits (perhaps with futures and options), as proposed by UNCTAD in 1992. Such arrangements would help alleviate poverty and protect global life-support systems.

Second, the North should internalize the costs of disposal of its toxic and other wastes within its own national borders, rather than exporting it in the name of "comparative advantage" to low wage countries. There it may harm the poor and may increase poverty and disease. Internalization of costs to the nation of origin, as well as to the firm, gives a stronger incentive to minimize toxic waste generation. This dynamic benefit is more important than the static allocation cost of neglecting "comparative advantage".

Third, the North should halt harm to the South perpetuated by present policies. This includes underpricing of Southern exports, armaments sales, warfare, proxy wars, and global pollution. Of course, the South has a bigger role to play in solving its own problems as outlined below. GATT should be improved accordingly.

Fourth, Northern governments, the private sector and development agencies are involved in creating much Southern debt; much of which is unrepayable. The North should address the current imbalance between commercial rate loans, subsidized investments, and grants to the South. The relative proportions of Northern transfers as loans *versus* subsidized, almost concessionary, IDA-type arrangements, or essentially as grants such as by free access by the South to the North's socially and ecologically beneficial technologies, should be improved. Reparations for historic pre-emption of global sink capacity are mentioned above. Questionable loans, those accelerating liquidation of natural capital, loans failing to internalize full costs, unrepayable loans, and loans clearly for unsustainable purposes should be halted or canceled. Global sustainability, poverty, equity and security would be improved if debts in severely indebted countries were conditionally written off commensurate with progress towards reduction in income inequality and environmental sustainability. Improvements in enabling conditions in the South would accelerate net investment flows there.

221

Fifth, as economic justification for foreign exchange loans for many environmental investments is difficult, conventional cost-benefit analysis needs to be broadened to internalize more environmental costs and benefits. Where international assistance is required for the South's global or transnational environmental priorities, it should be grant funded. Recent World Bank improvements in this respect are encouraging and need to be accelerated. Economists should begin to consider environmental investments as extended infrastructure investments: in other words, those investments in the maintenance of the biophysical infrastructure that supports all economic activity, both public and private (eg: regeneration of natural resources, rehabilitation of over-exploited land, restoration of environmental services impaired). Where conventional cost/benefit analysis is difficult to apply, as in some conventional infrastructure investments, the World Bank, UNDP and UNEP can now make grants for global environmental benefits through the pilot Global Environmental Facility. This important facility urgently needs to be complemented with an "Earth Increment" to bolster national development lending towards their environmental priorities, if it is to help the South to approach sustainability.

Sixth, the North should focus on direct help to the South, and steer away from indirect "trickle down" help. Investments should focus more directly on the poor countries, and on the poor strata of society in those countries. More ODA should be on softer and untied terms, and should help finance only the most essential projects, emphasizing domestic needs more than the export market. Suggestions to finance such investments have included reparations, conditioned debt relief (eg: Brady Plan), subsidized loans, and especially grants. The investments are to accelerate needed growth and employment-creation in small Southern economies. International assistance is needed to facilitate and possibly to help purchase rights to environmentally beneficial technologies for the South. This will include improving the policy framework for commercial transfer of technology, and training and institution strengthening to improve absorptive capacities.

Seventh, as old Northern assets depreciate, some may better be replaced in the South -- with appropriate technology. Thus, the North should accelerate export of advanced but appropriate technology, plus skills, for Southern processing of their own raw materials. If the North finds cleaner technology easier to espouse than reducing population or overconsumption, then the North ought to be more willing to transfer technology on easier terms, even at the expense of other ODA. The traditional view would argue for more Northern growth in order to increase ODA. GATT needs to start addressing the environmental implications of trade and needs to take on board the concept of sustainable development.

Robert Goodland and Herman Daly
S-5035
Environment Department
The World Bank
Washington DC 20433 USA
Fax: 202/477-0565

725

EDF Letter

CELEBRATING 25 YEARS OF RESULTS

A REPORT TO MEMBERS OF THE ENVIRONMENTAL DEFENSE FUND VOL XXIV, NO.2 MARCH 1993

The World Bank After Rio: A Need for Institutional Reform

By Bruce Rich, an attorney in the Washington office, who directs EDF's International Project. His new book, "Mortgaging the Earth: The World Bank, Environmental Impoverishment, and the Crisis of Development," will be available this fall from Beacon Press.

The World Bank, already the world's leading international development agency, emerged from the Earth Summit with a major new role. It will be a key institution—perhaps *the* key institution—for financing and implementing much of what was agreed upon last June in Rio.

Bruce Rich

The industrialized nations at the Earth Summit endorsed the Bank as the preferred means of financing projects in developing nations to protect the global environment. The Bank-dominated Global Environment Facility (GEF) was chosen as the interim funding mechanism for the Biodiversity and Climate Change treaties signed in Rio. The Bank may also play a key role in Agenda 21—a 700-page document endorsed by 171 nations in Rio that outlines investments needed for sustainable development into the next century.

Unfortunately, the Earth Summit focused almost exclusively on increasing funding to international aid institutions such as the World Bank, rather than on using existing aid to developing nations—already some $55 billion annually—in environmentally and socially acceptable ways.

Years of advocacy by EDF and other environmental groups around the world led the World Bank and other multilateral development banks to commit to major environmental reforms in the late 1980's. The Bank, for example, has stopped funding some of its most destructive programs, such as tropical forest colonization schemes, and greatly enlarged its environmental staff. But other pressures to move money and meet lending targets appear to be forcing the Bank to violate its own environmental policies and to continue massive funding of environmentally unsustainable and economically dubious programs.

A disturbing picture of an institution that has lost direction emerged from two unprecedented reports in 1992. Responding to growing international criticism of the Bank-financed Sardar Sarovar dam on India's Narmada River, former World Bank President Barber Conable asked a special Independent Commission to review the dam. In addition, World Bank Vice President Willi Wappenhans headed an internal review of the Bank's entire loan portfolio.

A Notorious Example

Indian communities affected by the Sardar Sarovar dam, and non-governmental organizations (NGO's) in India and around the world, argue that the project would be an environmental and social disaster. EDF attorney Lori Udall has played a central role with Indian NGO's in a campaign to convince the Bank to stop supporting the dam; this effort has produced several U.S. Congressional hearings, as well as resolutions by the Japanese Diet and the European, Swedish, and Finnish Parliaments, all urging the Bank to reconsider its position.

Most information on World Bank projects is not publicly available, even to those affected.

The Commission's report confirmed virtually all the charges made by EDF and Indian NGO's. It found that the dam and its canals would likely displace 240,000 people—not 90,000 or 100,000 as originally envisaged—and it warned that humane resettlement for most of these people is simply impossible. The Commission urged the Bank and the Indian Government to "step back" and undertake the fundamental environmental and human impact assessment studies that should have been completed before the project was begun nearly a decade before.

Regrettably, despite the Commission's conclusions and the strong objections of several major donor nations, the Bank continues to fund the dam.

Flawed Projects Have Increased

But Sardar Sarovar is just the tip of the iceberg. The Wappenhans report found that the Bank's own staff judged nearly 39% of completed projects to be failures in 1991, up from 15% in 1981. The report makes it clear that meeting lending targets has taken precedence over the environmental, social, and economic quality of projects. EDF is convinced that the World Bank should receive no further funding until its priorities are radically changed.

The Sardar Sarovar dam, called "India's greatest planned environmental disaster," would create a lake 125 miles long and displace nearly a quarter of a million people.

EDF will raise the issue of World Bank reform both in Earth Summit follow-up negotiations at the U.N. and at the meeting in July in Tokyo of the Group of Seven (G7) most industrialized nations. Ultimately, reforms will only succeed if they are promoted by the G7, who control over half the Bank's voting shares.

Leading the list of needed reforms is getting the G7 and the U.N. to press the Bank to make project quality and environmental sustainability its top priorities. Critical to this effort is promoting more openness and freedom of information on World Bank activities for the public and NGO's in developing and donor nations. As in the past, most information on World Bank projects is not publicly available, even to those who are affected.

The 50th Anniversary of the Bretton Woods Conference, which saw the founding of the World Bank, the International Monetary Fund, and the entire post-World War II global economic order, will occur in 1994, and 1995 will mark the 50th Anniversary of the United Nations. A major part of EDF's international efforts in the near future will aim to make these two dates occasions to reform and reinvent international institutions to meet a post cold-war, post-Rio Summit world in which environmental security has become a global priority.

239

IMF
SURVEY
A PUBLICATION OF THE INTERNATIONAL MONETARY FUND

Seminar Explores Links Between Macro Policy and the Environment

The relationship between macroeconomic policies and the environment was the subject of a seminar—the first of its kind hosted by the IMF—held on May 12–14. Twenty leading environmentalists from around the world joined 15 staff members from the IMF and 2 from the World Bank in an informal discussion on how macroeconomic and structural adjustment policies, with which the IMF is concerned, interact with environmental issues. The seminar followed up on an informal meeting that IMF Managing Director Michel Camdessus had with environmentalists at the June 1992 Rio de Janeiro Earth Summit, and was part of a continuing dialogue between the IMF and nongovernmental organizations (NGOs).

Sessions at the seminar were moderated, alternately, by Margaret Kelly, Deputy Director of the IMF's External Relations Department, and Robert Repetto, Vice President of the World Resources Institute.

The seminar featured brief, informal presentations by IMF staff and environmentalists that were followed by discussions. While there were several areas of agreement, views differed, as expected, on the importance of macroeconomic policies for environmental issues. Environmentalists stressed the *fundamental* importance of the environment to economic activity, which could not be sustained over the long haul, they maintained, if environmental degradation were to proceed unchecked. They wanted the IMF to change its approach to make environmental concerns a *(Please turn to page 187)*

fiscal imbalances, redress structural weaknesses, and strengthen institution building. In the fiscal field, the Government's medium-term objectives include attaining an overall budget deficit, excluding grants, of 8 percent of GDP by 1995. On the revenue side, the authorities aim at increasing the tax-to-GDP ratio by about 3 percentage points through tax measures and intensified collection efforts. They will pursue cautious monetary policies, with greater reliance on indirect policy instruments. Structural policies will include an acceleration of privatization, trade and tariff reform, and strengthening the banking sector.

The program for 1993, supported by the first annual ESAF loan, aims at maintaining real GDP growth of 7 percent, limiting the inflation rate to an annual average of 7 percent, and holding the external current account deficit, excluding official transfers, to about 10 percent of GDP. To achieve these objectives, the budget deficit will be reduced through significant new revenue measures. Monetary policy is designed to support the program's overall objectives, while allowing a significant expansion of credit to the private sector.

Structural policies under the program include the privatization of at least 25 enterprises in 1993, the removal of quantitative restrictions on imports, and completion of the recapitalization of state banks.

The program is also expected to have a beneficial impact on the poor by facilitating broadly based economic growth. The Government aims to minimize any short-term adverse effects through severance payments to mitigate the impact of planned civil service retrenchment. At the same time, the authorities attach high priority to environmental protection and appropriate natural resource management.

Erb: macroeconomic stabilization is necessary for environmental protection.

The Lao P.D.R. joined the IMF on July 5, 1961. Its quota is SDR 39.1 million (about $56 million), and its outstanding financial obligations to the IMF currently total the equivalent of SDR 20.5 million (about $29 million).

Press Release No 93/22, June 4

240

TOMORROW

GLOBAL ENVIRONMENT BUSINESS

BY KIM LOUGHRAN

Reforming the CORPORATION

The energy industry's restructuring and a generational shift among CEOs signal a potential gear change for environmental progress, says Christopher Flavin in a TOMORROW interview.

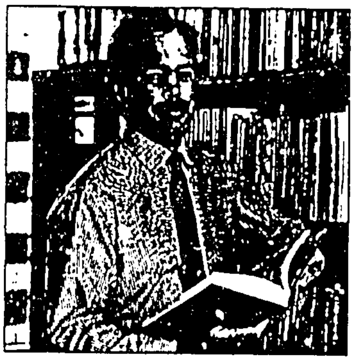
The Market Works—that is, with a great many controls. That's what Christopher Flavin is saying, backed up with arguments and the anecdotal evidence he loves compiling. This heartening message is in the latest edition of the Worldwatch Institute's *State of the World*, perhaps the most thorough and accessible annual review of the world environment. Worldwatch vice president Flavin and fellow researcher John E. Young have contributed a chapter entitled "Shaping the Next Industrial Revolution," investigating the progress being made by industry towards a future that works for us all.

At our meeting in Stockholm recently, Flavin admitted that the main burden of changing industry is still being carried by a very few: not very many industrialists are ready for change, or even dialogue. The sections in *State of the World* dealing with business indicate, however, that there is no question that corporations are starting to change their strategies in the way they give awards within the company and in the way they respond to environmental situations. There is also an obvious new competition dynamic.

What is triggering this change? And why has it not occurred earlier?

Answering the second question first, Flavin states what might be obvious: that a generational change was required before company CEOs began to see environmental compliance as anything but a cost issue.

As to the trigger: governments are increasingly aware of environmental needs and are instrumental to change. Plus, the economic implications of environmentalism are tremendous. The chemical industry, for example, could easily spend 50 percent of its budget meeting environmental demands, so changing practices to



Worldwatch vice president Christopher Flavin notes that activists are starting to consider deals with industry. At the same time, business is widely beginning to incorporate environmentalism into its strategy.

avoid problems makes eminent sense. The human factor might also have been underrated—we know that decisions are made not only by spread sheet. Executives sometimes report that criticism over the dinner table from spouses and children has spurred them to action. We all know what fun sassy children can be.

Christopher Flavin has toiled under the Worldwatch Institute banner since 1978. That's before a good many of today's thinking adults even realized the earth had its own agenda and that it didn't look good; certainly before more than a tiny handful of industrial executives could say the words "sustainable development" without gagging.

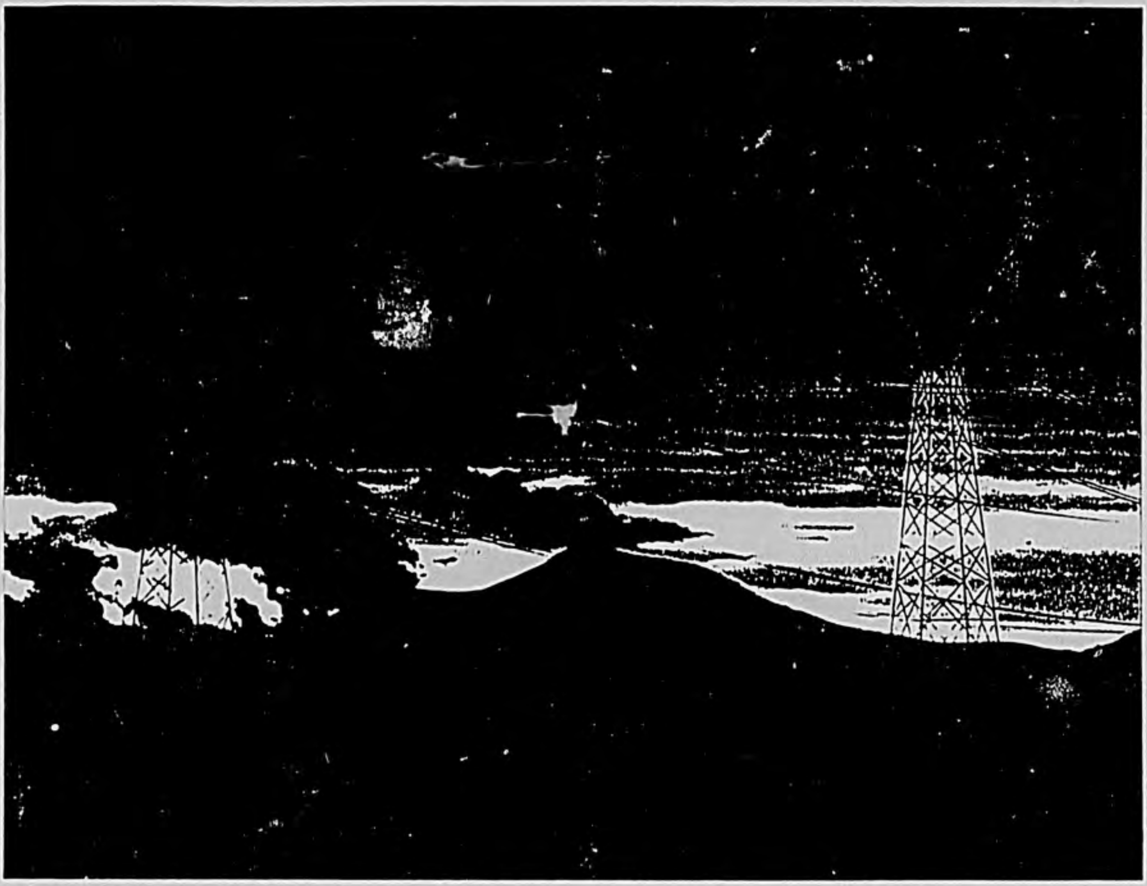
Flavin attacks his Stockholm hotel breakfast with the air of a seasoned traveler; he'll eat what's provided, even if it's pickled salt herring as this morning. In one of his clear moments, Lenin once said, "There is not a minute to lose; therefore we must act as if we have 50 years." Flavin, too, projects an almost insouciant approach, never raising his voice, never condemning obtuse industrialists other than with a rich laugh. The effect is that you take what he is saying very seriously.

Flavin's major is energy and he has a few suggestions for alleviating the current and coming crises. "Combined cycle technology is the intermediate answer; natural gas will be the dominant energy source for the next half century—it's the most significant field of development in energy today," he offers. "There's a new political dynamic emerging in energy, particularly in the U.S., where gas companies are separating from the oil industry. Gas companies are working much more closely with the environmental community than the oil industry ever did. Some gas people even say they've got more in common with environmentalists than with the oil, electricity or coal industries.

"Private investors in industry are pulling their money out from nuclear power and putting it into renewable schemes, even those as unlikely as wave power. If major corporations with R&D resources are not putting their money into renewables now, they're likely to miss the boat."

A quick tour of Europe, visiting with industrialists and activists alike, leaves Flavin with some unexpected impressions. He says he found suprisingly little awareness of the various market trends, even among multinationals in the energy field. For example, some European companies seemed unaware of how decentralized the power industry is becoming in North America. "In the U.S., the days of selling facilities of 1,000 MW might well be over; 50 to 100 kW is going to be more common in the near future."

2 41



he says, "but a lot of people don't seem to be aware of this. For example, some of the world's dominant electric power and transmission corporations, seem to be acting much as computer giant IBM did ten years ago. IBM saw that they dominated the mainframe computer market and decided to consolidate that market." Today, PCs are so flexible and so powerful that alone or linked, they're often all that most companies need. The market has developed away from the mainframe. In the energy sector, the difference in scale and economy is, if anything, even more dramatic. "There is almost a physical rule in manufacturing that price is determined by an equation involving the size of the market and manufacturing capacity," notes Flavin, "but the energy economy goes by other rules."

He returns to his original point: "To say that 'the Market works' is oversimplified. The market can work positively for the environment if government policy first sets up the right conditions to allow markets to work." Some markets are too constrained, such as in the Scandinavian countries, where energy is a state monopoly. In cases like that, the best way to get a market to work is not through more regulation but by breaking up utility monopolies and rewriting the regulations.

Virtually all power plants used to be built by large utility companies either owned by governments or granted a regional monopoly by them. Now, an aggressive independent power industry is building over half the new generating plants in the U.S.

Will business's environmental ethos always be regulatory-driven?

"No," says Flavin. "In the future, there'll be a tendency to look ahead, to go beyond the requirements of legislation. Smart businesses will always want to anticipate legislation, not just adhere to it. There will be a stronger sense of values—it will become impossible to behave as though CO_2 does not exist. But no one expects business to take responsibility for global welfare. Conditions and parameters must be set by government." Taxes will become a driving force, if not the major tool, he believes.

"Smart businesses will always want to anticipate legislation, not just adhere to it."

It's been a relaxed but lengthy breakfast and Flavin has a ten-thirty appointment. It's nearby but he doesn't realize how near and has not once looked at his watch during our interview. We wrap up by taking a look at the newspaper. Scandinavia's biggest morning paper has devoted its main editorial to the new *State of the World* report. The editorial notes that the previous day's press launch, chaired by Sweden's Environment Minister, was almost disrupted by journalists demanding confirmation that the government intends to disseminate the report. I translate and a smile lifts Flavin's ample moustache. It's not a satisfied smile; he's been around too long to be satisfied at any single sign of progress. But he's pleased. ●

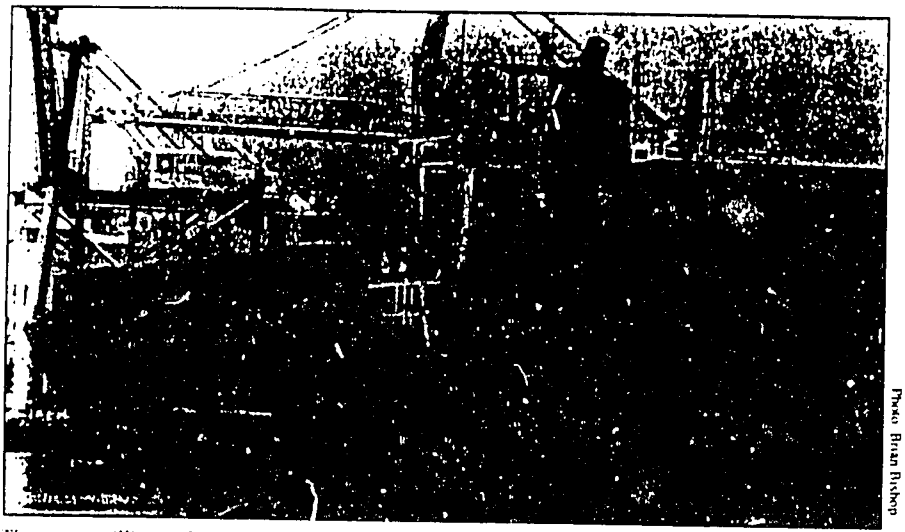
Kim Loughran is Editor of TOMORROW.

242

WORLD RAINFOREST REPORT

April-June 1993 Vol IX, No 2

A Publication of the World Rainforest Movement



There are millions of intermodal containers (pictured above) scattered around every major port in the world. 95% of them have thick multi-layer floors made exclusively of tropical timber.

Photo: Brian Bishop

Transport Industry's Role in Deforestation

Over ninety-five percent of all intermodal containers have floors made of tropical timber which is harvested primarily from the lush forests of Southeast Asia. Intermodal containers, used for the transport of consumer goods, are large, metal-sided containers manufactured by companies like Hyundai and leased by companies like General Electric's Genstar division. They are seen towed by Mack trucks, loaded onto trains, stacked on decks of huge ocean liners and scattered about every port in the world. Although there are millions of them, few people are aware of their devastating effect on the rainforest.

Why use a wood floor in a metal container? Because, according to industry officials, tropical hardwood floors are stronger than steel but lighter, cheaper and easier to repair. But what does this industry cost rainforests?

Over seventy percent of inter-modal container manufacturers are in Pacific Rim nations. South Korea is the home of the two largest manufacturers. Wood is supplied from nearby Malaysian and Indonesian rainforests to make container floor plywood. In the past century, Southeast Asian rainforests have been reduced by 75%, making them some of the most devastated forests on the planet. Because of extensive logging in peninsular Malaysia and around-the-clock logging operations in Sarawak, hundreds of plant and animal species unique to Sarawak have become extinct and many forest dwelling cultures such as the Penan and other Dyak tribes of Malaysia are being robbed of their way of life.

While other industries are often monitored by independent agencies, the inter-modal container industry has been left to monitor itself. The Institute of International Container Lessors (IICL) is an industry coalition formed to share technology and business information and represents the only significant

Continued on Page 5

authoritative body in this industry.

Although it is the manufacturers who make the containers, it is the container lessors who buy, rent and control them. Therefore the container lessors are in a position to apply pressure on manufacturers to change patterns of wood consumption.

IICL member, Dieter Heckler, the Vice President of Operations at General Electric's Genstar Corporation, claims he has personally requested his manufacturers to begin using rubber wood. Genstar's chief manufacturer is Hyundai Precision, the largest manufacturer of containers in the world. Hyundai, facing severe criticism for their intended logging operations in Siberia, has stated they are in the "final stage" of adopting rubber wood in their floors and are "well aware of...the importance of this environmental matter."

While lip service is being paid to this issue, and progress has been reported by some involved, Edward Wooley, the head of the IILC admitted that they "may not move as fast as some would like us to...and there are no deadlines." Indeed, little is happening from the environmental standpoint.

Members of the IICL have shown little interest in alternatives. Those being tested range from recycled plastic/synthetic materials to a U.S. alternative wood such as Sweet Gum. However, this industry continues to support the incalculable environmental cost of clear-cutting tropical hardwood over the higher monetary costs of domestic or recycled alternatives. The industry defends their position by claiming that if an alternative wood (Sweet Gum) floor is used and proves to have a shorter life span, this would demand more repairs resulting in higher wood consumption and money spent in the long run. But with the use of any alternative, consumption of tropical hardwood would be minimized, thus reducing the costs to the rainforest where half of the planet's species exist, and raising hopes for survival of indigenous cultures like the Penan.

— Brian Bishop

249

BY R. DARRYL BANKS,
WORLD RESOURCES INSTITUTE

The HEAT IS ON

Environmental technologies may well be the key to edging out global competitors—at least that's what U.S. strategists are banking on.

Governments around the world have come to see the appeal of environmental technologies in an ever more intense global economic competition. Europe and Japan have led the way while the U.S. has lagged behind. But that picture may be changing under a new, environmentally minded American administration. Consider these facts:

By midcentury, the world may be twice as populous as it is now and have an economy five times as large. Today's 5.4 billion people and US $15 trillon global economy are already taxing the global environment, so unprecedented environmental pressures are certain unless societies everywhere find ways to meet human needs without doing so much incidental damage.

In Japan, Germany, the Netherlands, Italy and Canada, government and industry have for many years been working together to develop technologies that create high-paying jobs and bolster economic strength. Italy, for instance, requires that every publicly funded R&D project consider possible spin-off technologies that might be environmentally useful. These countries' long tradition of funding technological advances—in computers, software, electronics, aerospace and biotechnology—makes it easy for them to add environmental equipment and techniques to the list.

How does the U.S. environmental record compare? Historically, the United States led the attack against environmental problems, mostly through regulation. Private and public institutions have committed significant resources to environmental research and many of the country's national technical institutions, labs and universities are increasingly riveted on environmental issues. But federal support for environmental technologies is meager and federal priorities are skewed. In 1991, fully 92 percent of all public R&D funding was spent on defense, health, space, general science and energy. R&D budgets relevant to environmental needs had shifted away from applied research. Unlike Japan, where MITI coordinates all public R&D funding, the United States spreads its environmental R&D funding across ten agencies and programs, making it difficult to impose a coherent overarching strategy.

This year, though, new ways of thinking look possible, judging from the technology initiative announced by U.S. President Bill Clinton in February. Clinton pledged to spend $17 billion over four years on everything from "environmentally clean" cars and "smart highways" to a national "information superhighway" that can transmit vocal and video information. The new plan proposes to shift funding from defense to civilian technology, expanding the civilian share of public R&D spending from today's 41 percent to more than 50 percent by 1998. It requires the 700-plus national laboratories to increase what they spend on jointly funded projects with private industry by up to fourfold from today's 5 percent. The Commerce Department's National Institute for Standards and Technology will get an added $1.3 billion to invest in emerging technologies and to create a network of technology extension centers. Clinton has striken "Defense" from the Defense Advanced Research Projects Agency (DARPA), given ARPA more latitude to pursue commercial R&D and pledged funds to help the troubled aerospace industry pursue civilian technologies.

The Clinton initiative also calls for a four-year $272 million increase in money for the Environmental Protection Agency for private-industry

Henning Christoph/Das Fotoarchiv

A researcher experimenting with transmission technology at the FHG Institute for Solar Energy Systems. Germany is increasing its R&D budget for environmental technology.

244

development of environmental technology.

It will take a concerted effort to catch up with Japan. Its Ministry of International Trade and Industry (MITI) is launching a research program into far-from-commercial realms of materials science, optics and biology. MITI is also pursuing "ecofactory" technology—ways to design energy efficiency and controls on pollution and waste into factories from the outset. As part of this program, MITI's "New Sunshine Program," an ambitious drive to develop renewable energy sources and other "environment-friendly" technologies, is getting under way and so is its "Ultimate Manipulation of Atoms and Molecules" program, aimed at developing such technologies as the scanning tunnelling microscope and ways to manipulate atoms and molecules on a surface or in space.

German firms have already pulled even with their U.S. counterparts in solar photovoltaics and German turbines produce electricity more efficiently—and with less pollution—than those made by the world's leading manufacturers. Germany is also cutting into Japanese domination of the world market for add-on devices to reduce power plant pollution. German technology is at the cutting edge in many things the world needs: "direct" steel making, emission-free electricity generation, hydrogen-powered motor vehicles, efficient household appliances and light bulbs and the recycling of everything from junked cars to solvents to CFCs.

Now the Bündesministerium für Forschung und Technologie (BMFT)—MITI's German counterpart—is shifting its focus from physics to biology and downplaying such big-ticket items as accelerators, according to the British journal *Nature*. As a percentage of GNP, German research spending is among the world's highest, with 40 percent of the total devoted to basic research—up from 26 percent in 1982. The funding shift from physical to biological sciences suggests that Germany aims to make its mark in biotech, a field in which U.S. researchers now have a commanding lead, especially in molecular biology. Germany is also investing more of its R&D budget in ecology and climate research, partly in response to agreements made last summer at the Earth Summit in Rio.

The U.S. is now poised to muscle in on its competition. Step one in designing a strategy for technical transformation is deciding which areas hold the most promise. Some governments and agencies in Europe have ranked "green" technologies in this way and the World Resources Institute in Washington, D.C., has developed a strategic list of advanced technologies critical to environmental sustainability. In the Institute's search for "environmentally critical" technologies that warrant U.S. government support, we used four criteria to screen candidates. Can this technology reduce large risks at the lowest possible cost? Does it represent a significant advance in knowledge? Can it benefit a wide swath of industries, not just a few? And finally, does society as whole stand to gain more from this technology than private interests do?

The list concentrates on areas where breakthroughs can lead to systemic changes that prevent environmental problems before they arise. Similar lists have been prepared without an eye to environmental problems, which demonstrates an important point: Environmental concerns are part of the mainstream, not the periphery, of industrial technology development.

There are twelve fields where technological advances are critical to environmental sustainability.

1 **RENEWABLE ENERGY.** Fossil fuels are the major cause of both air pollution and climate change, so finding alternatives that can help fuel a growing world economy is imperative. Major research targets should include technologies for producing and using such energy sources as photovoltaics, geothermal, solar thermal electricity and nuclear fission.

2 **ENERGY STORAGE.** Many "green" energy technologies won't make much headway until there are better ways to store, transport and use the energy they produce. Batteries, superconductors, storage of hydrogen and heat, and fuel cells should be major research priorities.

3 **ENERGY END-USES.** Cars and buildings are the most promising targets here. Ceramic engines, better electronic controls and continuously variable transmissions can make motor vehicles cleaner and more efficient, while "smart highway" systems streamline travel. With alternative refrigeration cycles and refrigerants, improved controls, capacity-modulating systems and thermally activated heat pumps, buildings too could use energy much more efficiently.

4 **AGRICULTURAL BIOTECHNOLOGY.** An intensified "green revolution" is needed to feed a doubled world population while holding the line on environmental damage. Better gene-transfer techniques, genetic engineering of plants and new approaches to animal breeding and bioprocessing are needed along with advances in biological pest control and ways to step up plants' nitrogen fixation capacities and photosynthetic efficiency.

5 **IMPROVED AGRICULTURAL TECHNIQUES.** The two most pressing needs here are "precision" farming (in which monitoring and information technologies target inputs of fertilizer, pesticide, or water) and "alternative" agriculture (in which the best use is made of natural cycles, ranging from crop rotation to integrated pest management). Electronic, chemical and biological sensors number among the most promising lines of inquiry.

6 **MANUFACTURING MONITORING, MODELING AND CONTROL.** Materials science and engineering, electronics, information, chemistry and biology are already amid a technological revolution that can make industry cleaner and more efficient. Sensors, process models and controlled actuators (pumps, valves, robots and numerically controlled machine tools) are key components of emerging "intelligent manufacturing systems" that can optimize productivity and decrease waste. Particularly promising are new methods of analyzing signals from complex chemical mixtures.

7 **CATALYSIS.** Catalysts can prevent pollution, improve product yield, permit the use of more benign feedstocks and remove undesirable by-products. New developments in chemistry, materials science and biotechnology are already pushing the field forward but chemical engineers need to know more about chemical reaction mechanisms and material surface phenomena and about the protein structure and functions of organic catalysts. Fabricating highly ordered supramolecular structures may open doors to new catalysts.

8 **SEPARATION OPERATIONS.** Distillation, drying, cleaning, degreasing and evaporation can all play a role in pollution prevention. Better membrane systems could eventually replace conventional distillation

245

and evaporation processes. Super-critical fluid extraction could replace organic solvents and help clean up contaminated soil and water. "Affinity separation" could conceivably be used to purify dilute products or remove dilute pollutants.

9 PRECISION FABRICATION. Computer controls and miniaturization, which make it possible to manipulate matter precisely, could greatly reduce industrial natural resource use and emissions. With increasing precision, nanolithography (x-ray, electron beam and ion-beam techniques for etching features on chips) can improve chip capacity and quality. Thin films or precision coating techniques can lower the cost of photovoltaic cells, improve the performance of electronic components, increase a material's resistance to wear and corrosion and make "smart" building components more widely available.

10 MATERIALS DESIGN AND PROCESSING. The revolution in this field centers on developing superior metals, polymers, ceramics and composites—and radically new ways to produce them. "Direct" steelmaking, electrochemical processing of metals and chlorine and microbial mineral processing could dramatically diminish pollution and energy requirements.

11 INFORMATION, COMMUNICATIONS AND COMPUTING. Advances here promise many indirect environmental benefits. "Dematerialization"—the tendency among highly developed societies to use fewer material inputs for a given level of output—is a matter of substituting information for natural resources. But advances in a vast range of information technologies are needed to understand and manage complex global problems such as climate change.

12 CONTRACEPTION. Complex social, cultural, economic and political factors have more impact on birth rates than technology does. But such emerging technologies as reversible and less invasive surgical techniques or vaccines and implants could radically expand contraceptive options. Contraceptive R&D has slackened in the United States, the victim of high liability risks and political pressures. But the inverse relationship between population growth and environmental sustainability puts a premium on advances in this field.

Change is afoot in Washington but one vital question remains: What's most needed now is the understanding that the U.S.'s major competitors have been acting on for some time—that "green" technical advances can protect the global environment and guarantee their own economic future. If this perception gains enough adherents in Washington, the United States too can do well while doing good. ●

Dr. Darryl Banks, World Resources Institute, Washington, D.C.

COUNTRY	INSTITUTION	FOCUS	BUDGET
JAPAN	RITE (Research Institute of Innovative Technology for the Earth)	Founded 1990. MITI-sponsored research institute; greenhouse warming main initial target.	> $ 1 billion cooperative national, local, private funding
	NEDO (New Energy & Industrial Technology Development Organization)	MITI-origin. Environmental technology one of four areas of R&D support.	$ 1.8 billion ([illegible])
GERMANY	BMFT (Ministry for Research and Technology)	4 programs; Environmental technology; R&D funding and demonstration.	$ 470 million (5 % R&D budget)
	STATES	Similar to national.	23 % national R&D total
THE NETHERLANDS	TNO (longstanding technical research, technology transfer organization)	Contract research and technical assistance to industry.	Environmental technology approximately 10 % portfolio.
ITALY	TIF (Technological Innovation Fund)	Established 1990. Research and precommercial development loans. Environment priority sector. Projects in all other areas require assessment of potential environmental benefit.	Before 1990 5 % environmental, will now increase
CANADA	Technology for Environmental Solutions (combines Science and Environment Ministries)	Established 1991. Three components: demonstration, technology transfer and information network.	$ 100 million

246

Volume 5, Number 2 1993

OUR PLANET

THE MAGAZINE OF THE UNITED NATIONS ENVIRONMENT PROGRAMME

ABOUT THOSE ACCOUNTS: reforming the masquerade of progress

SCOTT VAUGHAN

argues that current accounting procedures ignore environmental sensitivity and disguise as prosperity the poverty that 'economic success' will bring to the planet.

It is dusk in Alaska's Prince William Sound, the scene of the *Exxon Valdez* oil spill. The lone call of a distant bald eagle kindles hope that the birdlife has finally returned to this northern wilderness. But the sound soon fades.

Visitors are hard pressed to conjure up images of the catastrophe that engulfed this area four years ago. If you look closely, though, you can still see lumps of hardened tar wedged between polished and shampooed rocks. In addition to the devastating spill itself, scientists now believe that the scramble to minimize the damage by dousing the rocky shoreline with chemicals and steam may have destroyed micro-organisms that play an important, if unknown, role in this fragile ecology.

Ron Giling/Panos Pictures

Four years after the worst oil spill in US history, the name *Exxon Valdez* has become etched on the world's conscience—a legacy to humanity's unrelenting assault upon Nature. In the aftermath of the March 1989 spill of 38.5 million litres of oil into the cold Alaskan waters, an estimated 435 000 birds have died, together with 1000 sea otters, and untold numbers of fish and marine plant life.

Under the current system of measuring today's icons of national wealth, natural resources and a clean environment ... have no economic value because they are not 'exchanged' in the market-place.

More baffling than the destruction itself has been the response of conventional accounting practices, not only to this disaster, but to accelerating natural resource degradation, spiralling pollution, and the proliferation of hazardous and toxic wastes in general. Under the current system of measuring today's icons of national wealth, Gross National Product (GNP) and Gross Domestic Product (GDP), natural resources and a clean environment—including a healthy marine ecosystem, and fresh air and water—have no economic value because they are not 'exchanged' in the market-place. By the same logic, pollution is ignored in calculations of a nation's wealth because it is outside, or 'external' to, market activity.

Although incapable of attaching a price to blackened beaches and the appalling carnage of wildlife, accounts have been quite adept at tallying up the economic activity sparked by the spill. Thus far, the *Exxon Valdez* disaster has contributed more than US$2 billion to Alaska's economy—by creating jobs to clean up shores, filling hotel rooms, cramming airplane seats with experts and media, and purchasing and transporting clean-up equipment. As the Washington-based World Resources Institute has noted, 'Economic disaster masquerades as progress'.

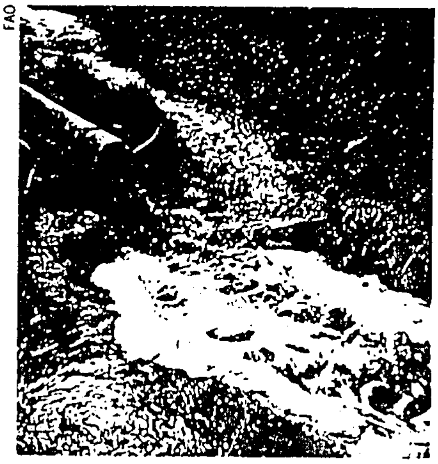
Despite the obvious flaws of such a system, any economist can tell you that GNP was not created as a measure of social welfare, including environmental protection, but as a barometer of economic activity. GNP measures transactions that occur in the market-place, and includes some capital assets.

That the environment is basically ignored in today's system of national accounts is hardly surprising, since the system grew out of the preoccupations of the 1930s. At that time, the prices of raw materials were at an all-time low. Pollution was barely a concern. The issues that preoccupied those who launched national income accounts—including noted British economist John Maynard Keynes—were unemployment, the balance of payments and economic cycles. Issues that preoccupy policy makers and the general public today—the depletion of the ozone layer, the threat of climate change and global warming, and the mass extinction of biological diversity—would have been regarded half a century ago as beyond the realm of even science fiction.

But in light of the now evident environmental crisis, there is a growing recognition among economists, non-governmental organizations, international organizations such as the United Nations, and national governments that our ability to respond to environmental problems is constrained. The problem lies in our preoccupation with economic indicators that are incapable of measuring ecological destruction.

The system we have inherited looks solely to exchange as representing a contribution to income. Under these assumptions, a tree has no intrinsic worth unless it is felled. Minerals and other stock resources have no economic value unless they are mined or earmarked for future exploitation. Intact marine environments, such as Prince William Sound just before the *Exxon Valdez* accident on a cold March night, have no economic value unless exploited for commercial use.

The current UN System of National Accounts (SNA) represents the standard benchmark used to measure economic performance. The backbone of SNAs are human-made assets and capital formation used in production: tangible assets such as buildings, machinery and equipment used in production, as well as inventories and consumer durables. One exception that gives some hope to ecological considerations is what is loosely termed 'land'. However, land is valued only insofar as it contributes to market exchange and income generation, through timber production, agricultural output and so on. Basic environmental and natural resources are not measured, because they are not valued.


FAO

Conventional accounting practices ignore the value of a clean environment. 'Green' accounting aims to put a monetary value on the 'free' resources—such as clean air and water—which we so easily take for granted.

This fundamental contradiction has provoked a growing number of experts to push for reforms in how we, as individuals and societies, regard wealth. According to Kirk Hamilton of Statistics Canada, 'What is unsatisfactory in this treatment of wealth is that it puts the calculation of the net worth of Canada on the same footing as that of Hong Kong, for example, almost completely ignoring resource endowments [such as standing forests, clean water, minerals, groundwater aquifers and healthy soils]'.

Although some 'deep ecologists' may have difficulty tagging 'the environment' with a commercial price, evidence suggests that, without a specific monetary value, resources that have erroneously been regarded as 'free'—such as clean air and water, standing forests and schools of fish—have not been conserved. Rather, the lack of a price gives the illusion of infinite reserves, inviting reckless behaviour. Like it or not, more often than not, we waste that which we do not value. By contrast we cherish, and use wisely and efficiently, that which we view as being scarce and precious. That is the basic logic behind the current push to reform national accounts. Unless a symmetry is struck between environmental goods and services and their value as reflected in market prices, then basic principles such as resource scarcity, conservation and increased efficiency will not be applied.

However, moving from general consensus to bottom-line reforms is very


Ron Giling/Panos Pictures

Heavy industry surrounding the Mexican town of Minatitlan may have created wealth and employment, but not without the cost of severe air pollution and the health hazards that go with it. Yet how can these things be valued in monetary terms?

difficult. Like the global environmental agenda itself, progress requires consensus. But the difficulties are enormous on questions of pricing policies. What price are people willing to pay to conserve and sustainably manage tropical forests teeming with undiscovered species—species which may hold clues to curing cancer or solving the AIDS crisis? What value do people attach to a predictable climate, an intact ozone layer, and clean air and drinking water? How do we go about attaching a price tag to a tree that stands untouched in a deep forest, or to marine mammals that are rarely seen?

These are absolutely critical issues if the goals of environmentally sound and sustainable development are to transformed from vague goals into hard-nosed, clear and concrete policy reforms. As Agenda 21 of the Earth Summit recognized, reforms are needed in our basic economic assumptions, tools and indicators, so that markets move from ignoring environmental considerations to placing environmental considerations at the centre of decision making. That, after all, is the goal of sustainable development: the integration of economic and ecological goals.

There is, however, some progress in a number of countries—including Canada, Germany, The Netherlands, Norway and the United States—towards the 'greening' of national accounts. At the international level, the UN Statistical Office, the World Bank,

One sign of hope is a system known as 'satellite accounts', which will subtract the costs of 'defensive expenses'—such as the clean-up of the Exxon Valdez accident—from national income.

It is traditional to assume that a tree has no intrinsic worth unless it is felled. But the long-term environmental cost of deforestation is far greater than the commercial value of the timber it provides.

UNEP and others are working on environmental and natural resource accounting procedures.

One sign of hope is a system known as 'satellite accounts'. Currently designed to sit alongside conventional systems, satellite accounts encompass a myriad of environmental and natural resource considerations. For example, these new systems will value stocks of natural resources. They will include not merely manufactured products, but also untraded by-products, notably pollution damages, or so-called 'defensive expenditures'. By this reckoning, costs such as the clean-up of the *Exxon Valdez* accident would be subtracted from national income. Satellite account systems will also adjust discount rates, so that the rights of future generations are brought forward. And they will introduce depreciation rates for environmental assets and natural resources.

Progress has already been made in the area of treating natural resource depletion as equal to the depreciation of capital and other equipment. Recent research by the World Resources Institute in Washington, DC (see *Wasting assets: natural resources in the national accounts*, December 1991) has recommended deducting natural resource depletion from conventional GNP calculations. This approach springs from two basic assumptions: one, that natural resource stocks ought to be regarded as national assets in roughly the same manner as reproducible assets such as equipment; and two, that the basis of valuation for natural assets should be what is called the 'net price method', that is, the net price of resources equals the market price of the resource minus the average cost of production.

Such approaches are helping to expose countries—especially developing countries whose economies are resource-intensive—to the economic, as well as the environmental, folly of short-term, fast-track development. *Wasting assets*, for example, concluded that the GNP rate for Indonesia, conventionally measured at a 7.1 percent increase in GNP, shrank to 4.0 percent because of deforestation and other resource extraction practices.

The 'greening' of income calculations offers the hope that a healthy environment will become as important as conventional preoccupations with maximizing GNP. While reforming national accounts might not help the wildlife of Prince William Sound to recover, it will make us all value healthy ecosystems far more.

For the bald eagle circling alone above Prince William Sound, that just might mean that sustainable development will not rest solely on a wing and a prayer.

Volume 5 Number 2 1993

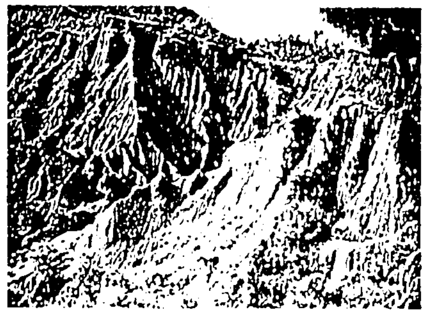
OUR PLANET

THE MAGAZINE OF THE UNITED NATIONS ENVIRONMENT PROGRAMME

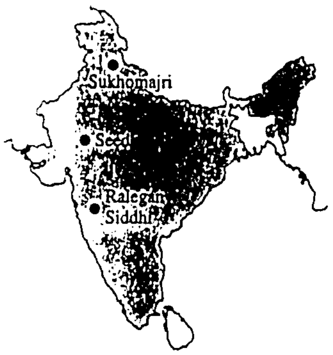
THE LAND OF MILK FROM WATER

Destitute villagers put their environment first and find it pays.

ANIL AGARWAL *reports from India.*



Sukhomajri village had a highly degraded watershed with soil erosion rates reaching 900 tonnes of soil per hectare of land ...



Environmentally, the 1980s were a dismal decade. We became more aware of land degradation, desertification, deforestation, and air and water pollution, and by the end of the decade, we had added destruction of the Earth's ozone shield and climate change to a list seemingly set to plunge us into an ecological Armageddon.

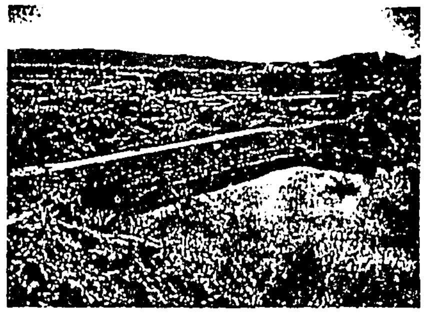
But if humanity took two steps backward in its efforts to combat the environmental crisis, it also took a few steps forward. The most heartening response in India came from rural communities, many of which took their future in their hands and made their degraded land green, showing that sustainable development can be an ordinary, everyday reality.

In the early 1980s, international experts were still discussing the conflict between the environment and development, and which comes first. But grassroots movements, such as the famous Chipko Movement in which Himalayan women threatened to hug trees in danger of being felled, had already begun to show that it is the poor who suffer the most when the environment is degraded. And, therefore, the poor have a vested interest in the sustainable management of their natural resource base, both for survival and for growth. Soon, development experts began to accept that any development that degrades the environment degrades the people who live in it and exacerbates poverty, and so obviously cannot be called development.

Nearly one-third of India's land area is today considered a wasteland. Both agricultural productivity and production from grasslands and forests in these areas are very low. As a result, there is an acute shortage of food, fuel, fodder and daily water. Soon after the monsoon, the streams run dry and groundwater levels fall dramatically. A woman's life is one long trek to collect basic needs such as water and fuel.

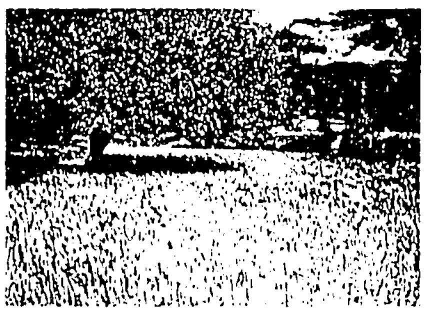
But that is no longer the case in Sukhomajri village in the sub-Himalayan Shivalik hills. Over-grazing and deforestation had left the village environment badly degraded, with extremely high rates of erosion, able only to support a destitute people. Crop lands produced a few tonnes of grains for food. The deficit was made up with purchases from the local town with the help of earnings sent back to the village by migrant workers.

In 1977, soil conservationist Priya Ratna Mishra tried to dissuade the villagers from uncontrolled grazing in their watershed. The village stream was carrying thousands of tonnes of silt to a large reservoir which supplied water to the state capital, Chandigarh, and was reducing its water-holding capacity. But Mishra's pleas fell on deaf ears. Sukhomajri's shepherds had their own problems of daily survival. Their goats at least gave them some income and support.



... but Sukhomajri's villagers united to build an earthen dam on the local stream to irrigate their fields. The dam changed everything: ...

... grass and trees returned to the watershed; fodder and firewood became abundant; and milk production increased dramatically ...



... and with irrigation from the small dam, villagers began to harvest three assured crops, instead of just one risky crop, a year.

But things began to change when a village elder suggested to Mishra that he should bring the villagers water. So Mishra built a small earthen dam to hold back the monsoon rain. Villagers immediately asked Mishra for the water and, in return, promised to protect the watershed, especially as the silt would now accumulate in their own reservoir. The forest department also took a daring step to let the villagers manage the watershed. The villagers, in turn, banned all grazing in it and levied a charge on every family collecting fodder from it. In five years, the irrigation helped the villagers to double their grain production, turning the village from a food importing one to a food exporting one. As the grass and trees regenerated in the watershed, the villagers began to get more fodder. They sold off their goats and bought high-yielding buffaloes. Today, the village sells more than US$10 000 worth of milk a year.

Hunger and destitution have disappeared. The village collective sells the extra grass from the watershed; in 1989, the village became the first in India to be levied income tax on its earnings from a regenerated forest. The average earnings of a household in the village have increased by about US$200 a year, and all on a sustainable basis. Mishra estimates that if the forest department allows the villagers to harvest the wood in the watershed, they could net at least US$100 000.

During a television interview with an elder from the village, he suddenly asked me: 'Tell me, sir, what do you see in this reservoir?'

I hesitantly replied, because my answer seemed so obvious: 'Water.'

'No,' he said, 'I see milk in it. It is this water which gives us milk and honey.'

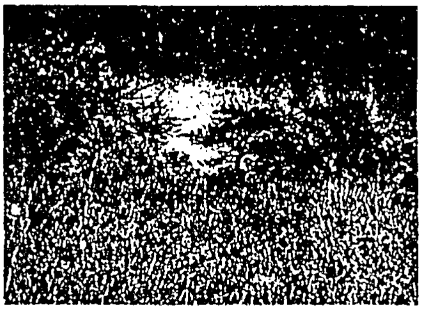
In Ralegan Siddhi, the use of dams has increased groundwater supplies, enabling villagers to cultivate crops in even the worst droughts. Crops which consume high levels of water are forbidden, so that water can be shared equitably.

Sukhomajri is not the only village in India where the people have responded to the ecological crisis. In Ralegan Siddhi, in the drought-prone district of Ahmednagar, Krishna Bhaurao Hazare has achieved a miracle that has turned the village into a Mecca for the environmentally concerned. Hazare, a jeep driver in the Indian army, returned to his village in the mid-1970s to find the environment extremely degraded, the villagers extremely poor, liquor brewing the sole occupation, and heavy male migration. Hazare slowly mustered support for a campaign against liquor brewing and turned the community's attention to its environment.

Taking advantage of the government's rural employment programmes, Hazare mobilized them to build earthen dams across every drainage channel cutting across the village, and to plant and protect trees on all the hills around. With the monsoon water arrested, groundwater levels started to rise and stabilize. The village community then unanimously agreed to share the groundwater equitably. The result is that, today, no villager has to migrate and, even in the worst of droughts, as in 1992, the villagers have enough water to cultivate their crops. The village now has a small branch of a national bank and a very high level of savings.

Yet another example of a village managing its resources comes from Seed, a village in the heavily deforested hills of the Aravalli range, which buttresses the arid desert of Rajasthan. For miles and miles, there is no tree in sight. Except in Seed, which was registered under the Gramdan Act promoted by Gandhian activist Rameshwar Das to allow villagers to manage their own environment. Under the law, the assembly of village adults is empowered to take all decisions about the village environment, and has the right to penalize and prosecute like a village court.

The Aravalis are today one of the most degraded hill ranges in India ...



... but the forests of Seed village, protected by the villagers themselves, give them grass year after year.

Seed has a well-thought-out land-use plan: it has a village forest, where no grazing is allowed, and villagers gather once a year, on an agreed day after the monsoon season, to collect grass from this forest. In other areas, villagers can graze their animals, but they cannot break even a leaf from the trees. Even private trees cannot be felled without the permission of the village assembly, which is granted only in case of dire need.

Environmentalists across India are clearly excited that sustainable development is indeed possible. Sukhomajri, Seed and Ralegan Siddhi are just three outstanding examples. There are hundreds of others, which are also responding to the ecological crisis. But they need a nudge from the government, which must enact laws to create democratic village institutions that have legal control over their environment. Sukhomajri, Seed and Ralegan Siddhi show that self-governance in ecological self-interest promises a very green future.

VOLUME XXIII • NUMBER 2 • SPRING 1993

PRESIDENTIAL STUDIES QUARTERLY

CENTER FOR THE STUDY OF THE PRESIDENCY

GORE, AL: *Earth in the Balance* (New York: Houghton Mifflin Company, 1992) 407 pp. (ISBN 0-395-57821-3).

With an international movement toward concern for preservation of the environment, America should seriously scan the future. Fortunately, one key leader in this grand country has evoked the ecological commitment of many Americans. This leader and author, Al Gore, has virtually encapsulated the environmental concern in his recent publication, *Earth in the Balance*.

Via a journalistic style, Gore takes the reader through eco-issues regarding the reality of current environmental risks, causes of climate change, the seriousness of global warming, disequilibrium in the water cycle, threats of soil erosion compounded by desalinization, and precariousness of the food supply. The author leads the reader into some self examination through change in political attitudes, empowerment in political leadership, through regaining the sense of faith in self determination.

Gore cites additional environmental disequilibrium as arising from covert economical influences. He assesses the imbalance of cost-benefit analysis with the example of excessive pesticide use to achieve short term gain profits for the tradeoff of ground water poisoning, etc. This pervasive sense of short term viewpoints coupled with damage to relevant thought through the technology information age, or more correctly misinformation, has power to manipulate impulsive ideas. However, with Gore's wisdom springs the imperativeness to return to whole earth ecology through consolidation, protection and conservation of things people should care about.

Gore cites errors in some deep ecologists' thinking concerning the analogy of comparing the earth to a diseased organism. In this scenario, humans become the pathogens diseasing the earth with rashes and fevers. This deep ecological scenario relegates humankind to that of the most destructive force this earth knows. In the chapter entitled "Dysfunctional Civilization" the *eminent* author identifies Arne Naess' (initial proponent of Deep Ecology, 1973) perspective of seeing humankind as an alien presence pervading this earth. This acceptance and trend may be a symptom of man's spiritual desertification. According to this author, man has become disembodied from characteristics of feeling, mind and body, with nature becoming shackled to the addiction of consumption of the earth. A schism between feeling and thought distorts actions of people, thus thwarting an ecological approach to living. Gore recommends a solution for man confronting through understanding his vital role as steward of the earth.

Earth in the Balance encapsulates a spiritual aura as the later chapters move from concrete fact of the ecological to the spiritual ethics of harmony. As man recaptures his spiritualism, the wellspring of earth's life leaps forward. Additionally, Gore cites the importance of world religions, which perpetuate thoughts concerning the relationship between mankind and the earth. Mohammed instructed his followers: "Whoever plants a tree and diligently looks after it until it matures and bears fruit is rewarded." By reflecting the image of God, man grows closer to the essence of this stewardship.

Gore's final section, "Striking the Balance," addresses the global human conflict problems coupled with possibilities for future plans. Though sometimes bleak, history indeed portends a picture for the future. More frequently than not, humankind's squabbles have added to the earth's equilibrium's downward spiral. The author weighs the importance of designing a Global Marshall Plan in which each country heightens its awareness of the stage of development discovering the individual self. Hence, each new eco-agreement must become cognizant of the extreme chasms among involved countries considering all stages of political, cultural and economic development.

Recommendations for the "Marshall Plan" are many and incorporate the following highlights: stabilization of world population, creation of environmentally developed appropriate technologies, decision making for environmental changes, new international negotiations with controls to facilitate the plan, global educational planning geared to environmentally sound programs, and applications of such knowledge (social and political) conducive to a perpetuation of sustainable societies. Numerous recommendations incorporating U.S. involvement follow the original guidelines. Actuation of the plan, according to Gore, could be accentuated through a global summit.

The last chapter of Section III, "Striking the Balance," indicates that change becomes the essence of actualizing true balance. The author emphasizes the predictability of change for moving forth in the personal realm, as well as actuating new roads to environmental accomplishments. Gore concludes that we must join individual concerns and commitment to community, love of natural world and love for civilization. The answers lie within ourselves.

Earth in the Balance is indeed a thoughtful treatise, weaving a tapestry of facts, hopes, and plans into a bit of an ethereal prayer for mankind. The reality of the book encapsulates the breadth of recent environmental examples and their denouement while addressing the spiritual goodness of all men. Gore intertwines early philosophies, religions, and cultures to demonstrate some current and aberrant mind-sets resistant to ecological change.

This book is meant to be perused with a reflective mind. It is a book to be sampled in several readings. The confrontations with ecological realities and philosophical reflections will touch the reader. Indeed, *Earth in the Balance* is designed for change.

JANE BERNDT

The George Washington University

ASIA

"East Asia: Regional Economic Integration and Implications for the United States" (Executive Summary), United States International Trade Commission (USITC), May 1993.

Gleason, Paul. "Asia-Pacific Region's Growth Remained Strong in 1992, Says ADB Report," IMF Survey, The International Monetary Fund, June 28, 1993.

Statement of Ambassador Charlene Barshefsky, Deputy United States Trade Representative on Trade Policy toward China before the Ways and Means Committee/Subcommittee on Trade, U.S House of Representatives, 1993.

Findlay, Christopher, Will Martin and Andrew Watson. Policy Reform, Economic Growth and China's Agriculture (Executive Summary), Development Centre Studies, Organization for Economic Cooperation and Development (OECD), 1993.

"Economic Prospects for China in 1993 - Predictions of Oxford Analytica," Transition, The World Bank, March 1993.

Bell, Michael and Simon M'guiamba. "China's Open Economic Zones Are Speeding Its Transformation to a Market Economy," IMF Survey, The International Monetary Fund, April 19, 1993.

Fan-zhang, Huang. "China's Economic Reforms," ODI Briefing Paper, Overseas Development Institute, February 1993.

Lei, Xiong. "China's War on Waste and Pollution," People and the Planet, Planet 21, United Nations Population Fund (UNFPA), the World Conservation Union and the International Planned Parenthood Federation, Vol. 2, No. 2, 1993.

Carter, Holly Ornstein. "A Field of Dreams in Northeast Asia," Choices, United Nations Development Programme (UNDP), Vol. 2, No. 2, 1993.

Brown, Frederick Z. "The Persistence of a Bitter Past: Impediments to U.S.-Vietnam Normalization," The Challenge of Indochina: An Examination of the U.S Role, Congressional Staff Conference, The Aspen Institute, April 30 - May 2, 1993.

Snodgrass, Donald R. "Malaysia: The Next NIC?" International Economic Insights, Institute for International Economics, May/June 1993.

"Former Soviet Republic has 'Great' Potential," World Bank News, The World Bank, May 20, 1993.

Horiuchi, Shiro. "World Population Growth Rate: Why Declines Stalled in the 1980s," Population Today, Population Reference Bureau, Inc., June 1993.

"95 Percent of Population Growth is in Third World," Population Reference Bureau, Inc., May 12, 1993.

EAST ASIA:
REGIONAL ECONOMIC INTEGRATION AND IMPLICATIONS FOR THE UNITED STATES

UNITED STATES
INTERNATIONAL
TRADE COMMISSION

EXECUTIVE SUMMARY

Flows of trade, investment, and aid among the rapidly growing economies of East Asia, and between these economies and Japan, have increased substantially in recent years. As a result, the region's economies have pursued more vigorous efforts to promote economic cooperation through both formal institutions and more informal arrangements.

In May 1992, the House Committee on Ways and Means asked the U.S. International Trade Commission (Commission) to investigate the "causes and implications for the United States of . . . economic integration in East Asia." Some analysts suggest that closer economic ties among East Asian countries could be harmful to U.S. trade interests and policies. Among other things, these analysts argue that U.S. suppliers could lose ground in this fast-growing part of the world through a combination of deliberate policy measures, natural market forces, and benign neglect.

The Commission examined trade, investment, and other economic data, as well as commercial and development policies of East Asian countries and their major trading partners—Japan and the United States—to determine whether recent economic changes and policy measures are effectively merging East Asia's markets for goods, services, capital, and labor. Case studies on three industrial sectors and the energy and environmental sectors were also undertaken to identify factors favoring or standing in the way of economic integration in the region. Finally, the Commission sought the views of people experienced in regional economic and business affairs about the implications of recent trends in East Asia for U.S. trade interests and policy. Following are highlights of the Commission's report.

Country Profiles

- The countries of East Asia—defined for this report as Brunei, China, Hong Kong, South Korea (Korea), Indonesia, Malaysia, the Philippines, Singapore, Taiwan, and Thailand—have recorded significant rates of economic growth for much of the past two decades, and the region currently hosts some of the world's most dynamic economies. Trade and foreign direct investment have often played a key role in this growth.

- Many East Asian nations are seeking to attract foreign investment and secure aid, both to invigorate their export-oriented industrial structures and to finance needed improvements in infrastructure and environmental protection. Among other things, they have eased restrictions on foreign goods and investment and have taken steps to improve political relations.

- Barriers to trade and investment still remain, however, particularly in the less developed but resource-rich countries of the region. The continued presence of state-owned corporations is a major obstacle to further reform in several countries.

Subregional Integration

- The newly industrializing economies (NIEs) of Taiwan, Korea, Hong Kong, and Singapore are becoming more active as investors in the up-and-coming economies of the region, as they search for ways to maintain competitiveness in the face of appreciating currencies, higher wages, and rising land costs.

- Transfer of less competitive, labor-intensive industries to China and other developing countries in East Asia has been a key competitive strategy and has given rise to patterns of subregional integration. The emergence of "mini-blocs" such as the Singapore growth triangle (consisting of parts of Singapore, Indonesia, and Malaysia) are evidence of this mostly market-driven phenomenon. The extensive network of ethnic Chinese throughout the region has also played a key role in fostering greater integration within East Asia.

Regional Institutional Arrangements

- East Asian nations have revived efforts to establish regional institutional arrangements, both to encourage greater cooperation in areas such as transportation and to develop market information. Several production rationalization schemes have recently started to attract interest, and a regional trade preference program among the six members of the Association of Southeast Asian Nations (ASEAN) is to be implemented over the coming 15 years.

- Part of this drive is based on a perceived need for institutions to manage the already substantial economic ties among these countries. However, stymied efforts to strengthen world trade rules and movement toward regional trading arrangements in Europe and the United States reportedly have been an added impetus.

- The more inclusive and loosely structured regional institution—Asia-Pacific Economic Cooperation (APEC)—appears to be the most widely accepted forum for regional economic dialog, although proposals for a more insular group that excludes the United States and other non-Asian nations have been advanced.

- The U.S. Government has been taking a more active role in efforts to frame future regional institutional arrangements, but their purposes, goals, and agendas are still very much in flux. Japan has been a leading proponent of greater institutional ties among the nations of East Asia.

Trade

- The dollar value of total East Asian trade tripled during the 1980s, and growth was particularly rapid after 1985. By 1991, East Asia's exports totaled $477.8 billion and its imports $490.2 billion. East Asia's share of global commerce also grew substantially, from 7.5 percent of total world trade in 1980 to nearly 14 percent by 1991.

- Trade among the East Asian countries has risen rapidly in recent years, particularly after 1985. By 1991, intraregional trade accounted for 35 percent of total East Asian exports, up from 22 percent of the total in 1980, driven in part by rising incomes and increased domestic consumption.

- The relative importance of the United States as a market for East Asian countries has declined over the past 5 years, as intraregional trade has grown. Nonetheless, the United States is still a major market for East Asian goods, and accounted for 20 percent of the region's exports in 1980, 30 percent in 1986, and 21 percent in 1991. Japan's importance as an export market declined steadily over the decade, accounting for 22 percent of the region's exports in 1980, 15 percent in 1985, and 14 percent in 1991.

- Notwithstanding Japan's relative decline as a market for East Asian goods, Japan's imports from the region doubled in value between 1980 and 1991, totaling $69.9 billion. In 1991, 30 percent of Japan's imports originated in East Asia, up from 25 percent in 1980. The largest increase was recorded in miscellaneous manufactured goods, with clothing accounting for about half of imports in this category.

- East Asia has been an important market for U.S. goods, and an increasingly important source of U.S. imports. The value of U.S. exports to East Asia in 1991 was 2.6 times the

1980 level, totaling $64 billion. U.S. export growth was particularly strong after 1985. U.S. imports from East Asia, meanwhile, rose steadily during the 1980s, totaling $102 billion in 1991, or 3.3 times their 1980 value.

- East Asia has been an even more significant trading partner for Japan than it has been for the United States, and its importance grew over the past decade. By 1991, about a third (32 percent) of Japan's exports were destined for East Asia, up from 26 percent in 1980. The dollar value of Japan's exports to the region in 1991 was $101 billion in 1991, about 3 times the 1980 level. Electrical and nonelectrical machinery led the rise.

Investment

- Large increases in net foreign direct investment (FDI) inflows were registered in several East Asian countries over the past decade, especially in China, Indonesia, Malaysia, Thailand, and Singapore, which is by the far the most dependent on foreign direct investment.

- In recent years Japan's importance as a source of FDI has increased relative to that of the United States, though the United States remains an important investor. Japan's direct investment flow to East Asia in 1989 stood at 3.3 times its 1982 level in yen terms. Indonesia, Hong Kong, and Malaysia were the top three recipients. Electrical machinery, chemicals, and metals industries were the top manufacturing sectors in terms of cumulative flows.

- U.S. direct investment in East Asia doubled in value from 1982 to 1991. Much of the growth can be attributed to reinvested earnings. Hong Kong, Singapore, and Indonesia were the top locations, and oil the dominant sector.

- The most remarkable phenomenon of FDI in East Asia is the rise of the NIEs as major investors in other East Asian countries. Notable among these economies is Taiwan, which has become the top source of FDI in Malaysia and Indonesia, and the number two source in China. Hong Kong is the top investor in China, and Korea has also begun to export capital in significant amounts.

- East Asia's trade and investment patterns over the past decade appear to be largely explained by economic factors: the overall rise in Japanese (and later Taiwan, Korean, and Hong Kong) outward investment flows, the rapid growth of East Asian economies and their increasing share of global imports and exports, changes in exchange rates, and rising wages and land costs in the more developed economies of the region. More recently, investment in East Asia is being driven by the desire to serve booming regional and domestic markets, particularly in Southeast Asia.

Foreign Aid

- Foreign aid in the form of official development assistance (ODA) has been a vital supplement to direct investment flows. In 1991, ODA accounted for about one-third of the total net resource flows to Asia (including East Asia), and Asia received some 30 percent of the ODA provided by developed countries in the year.

- Japan emerged as a major aid donor during the 1980s, and its total aid level now approximates that of the United States. Asia has been the primary focus of Japan's aid efforts, accounting for nearly half—$3.5 billion—of Japan's bilateral aid in 1990. Over the past 5 years Indonesia, China, the Philippines, Thailand, and Malaysia have consistently ranked among Japan's top 10 foreign aid recipients.

- Most Japanese aid has been concentrated in large-scale capital-intensive projects that call for substantial imports of capital goods, as well as for extensive use of engineering, consulting, and construction services. Traditionally, most ODA contracts were awarded to Japanese firms.

- Recently, Japan has reduced the share of ODA contracts officially tied to the purchase of Japanese goods and services and increased efforts to include non-nationals in design and subcontracting procurement. Nevertheless, a variety of factors appear to give Japanese firms an advantage in winning prime contracts.

- The Japanese Government has also encouraged movement of industrial facilities to other parts of Asia as part of its overall economic restructuring effort. These policies supplement Japan's longstanding strategy of securing access to the region's natural resources and raw materials through comprehensive trade, aid, and investment ties. Active Government-business cooperation characterizes the Japanese effort.

- The high level of Japanese direct and indirect aid and its comprehensive nature stands in stark contrast to the U.S. experience. U.S. aid to countries in the region accounted for 6 percent of total U.S. foreign aid, or $560 million in 1990. Only two East Asian countries—the Philippines and Indonesia—were among the top 25 U.S. aid recipients, and their selection seems more related to security than to economic considerations.

- U.S. Government aid and export promotion efforts are reported to lack focus and coordination. Business-government cooperation has also been poor. The recent jointly sponsored U.S. Ambassadors' Tour of member countries of ASEAN has been lauded as a step in the right direction.

Case Studies

- The five case studies undertaken by the Commission to illustrate trends in East Asia present a varied picture of the region's integration prospects and the participation by U.S. and Japanese firms in East Asian markets. Three deal with industrial sectors in which U.S. trade and investment activity is substantial. Two respond to the Committee's request for an examination of energy needs and resources in the region and environmental conditions, consequences, and opportunities for local and U.S. interests.

- Japanese-based firms have long dominated *automobile and auto parts* production in East Asia and are now taking some steps to integrate production facilities there. U.S. firms play much more limited roles as investors and producers, and there is concern that this role may not provide a sufficient foothold for pursuing growing demand in the region or for capitalizing on East Asia's production potential as part of an overall global business strategy.

- U.S.-based companies have a strong foothold in the East Asian *computer* market and play an important role in the region's computer production. East Asia continues to be an important manufacturing base for many U.S. computer companies. Whereas Japanese-affiliated producers tend to produce component products in East Asia for export outside the region, U.S.-based companies manufacture many finished products in the region, along with some components. These products are sold in East Asia and other markets. Investment within the region by computer firms from the more developed East Asian countries—Taiwan, Korea, and Singapore—is on the rise, as are their imports from elsewhere in the region.

- U.S. firms are major investors in the development of East Asia's *refining and petrochemical* industries. Total U.S. refining and petrochemical investment in 1991 was estimated at $5 billion, compared with Japanese investment of $1 billion. Current and future expansion plans are aimed at meeting the region's growing demand for fuels and chemicals. Asia's demand for chemicals is now expanding twice as fast as demand in North America and Western Europe. By the year 2000, Asia's market for chemicals is expected to surpass that of North America in size. A desire to retain control over utilization of domestic energy supplies has, however, discouraged integration among East Asian countries.

- The *energy and environmental technology* sectors have been characterized by heavy governmental involvement in the form of ownership, regulation, and subsidies. Both Japanese and U.S. firms offer competitive products in these fields. High levels of growth in East Asia have been accompanied by greater energy demand and environmental degradation. U.S. firms retain the lead in a number of energy and environmental technologies that are of vital interest to the countries of East Asia, although competition from Japanese companies is strong. Unlike the U.S. case, however, firms in Japan, Germany, France, Italy, and the United Kingdom all have access to significant Government-backed financing programs, and these programs are decisive in some contracts. Price, after-sales service, design flexibility, and local market presence are also reported to be advantages offered by U.S. competitors.

Implications for U.S. Trade Interests and Policy

- Many analysts observe that a combination of macroeconomic forces, strategic business decisions, governmental policies, political realism, and other factors are pulling the economies of East Asia closer together. The primary concern expressed by U.S. and Asian business, government, and academic leaders about this phenomenon is that the United States is not participating fully in the region's bustling economic activity.

- Most experts find that a large portion of the increased interdependence occurring in East Asia is driven by market forces and the private sector. Many believe that the need to remain competitive by drawing upon different countries' comparative advantages explains much of the recent expansion in intraregional business activity during the past decade

- Nearly all experts believe that the region is, and will continue to be, dynamic, export-oriented, and fairly open to inflows of foreign investment and goods. Japan and the United States are seen as likely to play major roles in the region's future.

- Given its continued reliance on the United States and on other non-Asian markets, the region is seen as having a major stake in the multilateral trading system and in liberalizing trade and investment generally.

- At the same time, as they grow in size and confidence, the countries in the region can be expected to become more active in trade and economic forums, making it necessary for the United States to adjust negotiating strategies. The blurring of boundaries within East Asia, and between it and Japan, may make bilateral trade a less appropriate focus of U.S. negotiating efforts and render administration of U.S. trade laws more difficult, the experts observe.

- Numerous analysts say that it is vital to the long-term competitiveness of U.S. industry as well as to U.S. commercial interests and policy for the United States to play an active role in the continued transformation of the fastest growing and most populous region of the world. Analysts note that Asia is now the hub of key industries such as electronics and is an increasingly important source of new technologies and products.

- Many regional experts caution that fighting the region's integration is neither necessary nor possible. Rather, active U.S. participation in shaping regional institutional arrangements, more coherent and substantial efforts to promote U.S. business, and sustained efforts to prevent or remove discriminatory barriers may be warranted, the experts suggest, especially in areas where Japan's official policies and more substantial on-the-ground presence could foreclose future U.S. opportunities.

- Lack of familiarity by U.S. business and preoccupation with opportunities closer to home receive much of the blame for the untapped U.S. potential in Asian markets. A number of business representatives who are already doing business in East Asia called for more vigorous pursuit of market opportunities in the region by their U.S. colleagues.

Asia-Pacific Region's Growth Remained Strong in 1992, Says ADB Report

Despite the recession in much of the industrial world, the economies of the Asia-Pacific region continued to grow vigorously in 1992, according to the Asian Development Bank's *Asian Development Outlook 1993*.

The report, which was published in early May, notes that average GDP growth for the region increased to 7 percent in 1992 from 6.1 percent in 1991, with its average inflation rate decreasing to 6.7 percent from 8.4 percent during the same period. It projects that the region will average economic growth of over 7 percent annually, with inflation abating slightly, during 1993 and 1994.

The *Asian Development Outlook* states that the region's 1992 growth "was characterized by a sharp acceleration in China's economy, a significant slowdown in newly industrializing economies (NIEs), and creditable progress in the transitional economies of Asia." The strong economic performance of the ADB's developing member countries (DMCs), the report points out, reflected strong domestic demand and export growth in their economies, as well as the favorable effects of policy reforms they had undertaken in recent years.

Although the growth in DMCs' exports was somewhat slower than in 1991, it remained robust. Their total exports increased by about 13 percent to $555.1 billion, or 15 percent of world trade, more than twice as fast as world exports. Moreover, the report notes, exports from the NIEs, China, and Southeast Asia each increased at double-digit rates. At the same time, though, the region's balance of payments deficit increased to $8.9 billion in 1992 from $5.2 billion in 1991, as the current account surpluses of the NIEs and China narrowed, and South Asia's deficit widened.

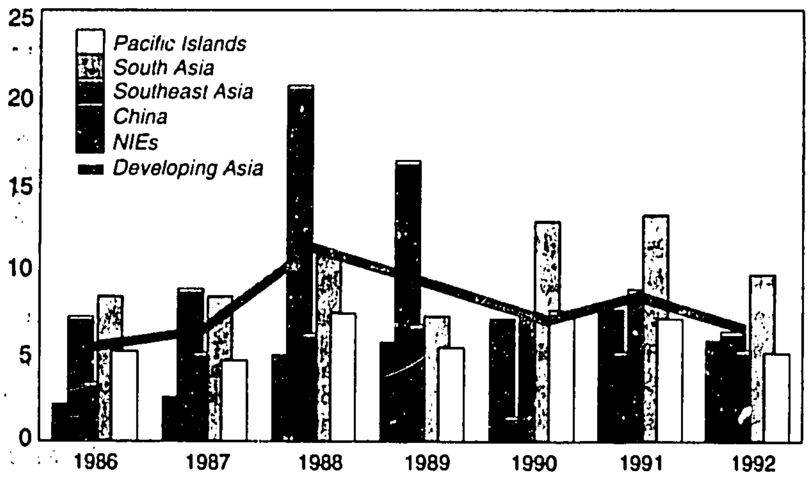
The report observes that "the dynamism of international trade played a key role in helping to shelter the economies of the region from slow growth in the world economy." It notes that intraregional trade currently accounts for about 35 percent of DMCs' total exports, adding that trade among DMCs increased by 23 percent in 1991, while their exports to the rest of the world grew by 14.8 percent. Data for the first half of 1992 indicate, the report states, that intraregional trade continued to expand rapidly.

The *Asian Development Outlook* observes that the rapid expansion of China's economy has been a major source of intraregional trade growth. It notes that the DMCs' exports to China increased by more than 30 percent in 1991 and that Asia, including Japan, accounted for 61 percent of China's imports in that year.

Large inflows of foreign direct investment (FDI) have contributed to the region's rapid economic growth. For the 16 DMCs shown in the accompanying table on page 202, inflows of FDI increased by 11.8 percent in 1991, down from a 17.5 percent increase the previous year. Total FDI for these 16 countries amounted to $18.4 billion, about a fourth of which went to China. The report notes that most of the increase in these flows went to China, India, and Malaysia.

The report also expresses some concern about declining FDI commitments in 1991, especially in Southeast Asian countries except Vietnam. Commitments from traditional sources, such as Japan and the NIEs,

Inflation in Developing Asia, 1986–92
(percent)



Data: Asian Development Bank, Economics and Development Resource Center fell significantly—by 20–60 percent—in 1991. The report states that "part of the explanation for the decline in intra-Asian foreign investment commitments is that the labor-intensive industries of the investor countries have now largely been relocated or phased out." It adds that "the slowdown in Japan's economy and balance sheet adjustments in financial institutions have been limiting outward lending by Japanese banks."

Recent Developments in Country Subgroups

Newly Industrializing Economies. The report states that growth for the NIEs as a whole decreased to 5.3 percent in 1992 from 7.3 percent in 1991. Economic growth in real GDP (net of inflation) in Korea fell to 4.5 percent from 8.4 percent during the same period, but the economic slowdown was relatively mild in Singapore and Taiwan Province of China. Hong Kong's economic growth rate increased to 5 percent in 1992 from 4.2 percent in 1991, as China's strong economy boosted both Hong Kong's direct and indirect (transshipped) exports. Growth in exports from Singapore, Taiwan Province of China, and—to a lesser extent—Korea slowed markedly as a result of both their rising production costs and weak demand in their major markets, including the European Community, Japan, and the United States. As their economies slowed and their macroeconomic policies were kept tight, the NIEs' average rate of inflation decreased to 5.9 percent in 1992 from 7.6 percent in 1991.

China and Mongolia. China's economic growth rate accelerated to 12.8 percent in 1992 from 7.5 percent in 1991. The report notes that in 1992 China's industrial sector grew by 20 percent, its services sector by 9 percent, and its exports by roughly 16 percent (compared with 14 percent in 1991). It comments that "the continued robust growth of China's exports derived mainly from the favorable impact of trade reforms, a rapidly expanding export production base resulting from large FDI inflows over the past few years and some gains in competitiveness because of currency depreciation."

China's domestic demand, the report states, increased by more than 30 percent in 1992. This demand, especially the sharp increase in demand for capital goods created by an investment boom, brought about an increase of 26 percent in China's imports during 1992. Although China's current account balance decreased by more than $3 billion in 1992, it showed another large surplus—of an estimated $10.4 billion—for the year. The report also observes, however, that inflationary pressure has been building rapidly over the past two years, with the annual inflation rate increasing from 1.3 percent in 1990 to 5.1 percent in 1991 and 6.4 percent in 1992. It also estimates that the current urban inflation rate was nearly twice the national inflation rate.

In contrast to China's rapid growth, Mongolia's economy continued to worsen in 1992. Real GDP, which had fallen 19 percent in 1991, fell a further 7.6 percent. The sharpest declines in output occurred in the industrial sector, where, the report states, "lack of ready access to foreign exchange led to serious shortages of raw materials and spare parts." Owing to price deregulation—which has been an important element of the reform process as Mongolia has sought to transform its economy—and the rapid rise in its domestic credit, the

Selected Developing Countries in the Asia-Pacific Region: Foreign Direct Investment, 1986–91

(million U.S. dollars)

	1986	1987	1988	1989	1990	1991	1986–91
Newly industrializing economies	2,471	4,152	5,485	5,132	5,906	5,971	29,117
Korea	435	601	871	758	715	1,116	1,116
Singapore	1,710	2,836	3,655	2,770	3,861	3,584	18,416
Taiwan Province of China	326	715	959	1,604	1,330	1,271	6,205
China	1,875	2,314	3,194	3,393	3,489	4,366	18,631
Southeast Asia	1,137	1,467	3,336	4,688	6,581	7,494	24,703
Indonesia	258	385	576	682	1,093	1,482	4,476
Malaysia	489	423	719	1,668	2,514	3,454	9,267
Philippines	127	307	936	563	530	544	3,007
Thailand	263	352	1,105	1,775	2,444	2,014	7,953
South Asia	345	373	521	580	402	556	2,777
Bangladesh	2	3	2	...	3	1	11
India[1]	208	181	287	350	112	200	1,338
Pakistan	105	129	186	210	244	257	1,131
Sri Lanka	30	60	46	20	43	98	297
Pacific Islands	100	103	190	231	101	44	769
Fiji	8	(11)	23	13	75	7	115
Papua New Guinea	91	93	153	203	...	...	540
Solomon Islands	(1)	8	3	6	13	19	48
Vanuatu	2	13	11	9	13	18	66
Total	**5,928**	**8,409**	**12,726**	**14,024**	**16,479**	**18,431**	**75,997**

[1]Data refer to net foreign direct investment.

Data: IMF, *Balance of Payments Statistics Yearbook*, Vol. 43, Part 2 (Washington, 1992); Central Bank of China, *Balance of Payments* (Taipei, September 1992) inflation rate ballooned from 120 percent in 1991 to 321 percent in 1992.

Southeast Asia. As a consequence of slow growth in industrial countries and tight monetary policies in some of this subregion's countries, the average growth rate of its real GDP decreased slightly to 5.8 percent in 1992 from 6.3 percent in 1991. In 1992, Indonesia's growth rate declined slightly, to 5.9 percent, while Malaysia and Thailand posted strong growth rates of 8 percent and 7.5 percent, respectively. The former planned economies in the subregion—the Lao People's Democratic Republic, Viet Nam, and Cambodia—also experienced solid economic growth during the year, but the Philippine economy stagnated.

Exports from the subregion doubled between 1987 and 1992. Export growth in 1992 remained quite strong, at a rate of 13.8 percent, which was only about 1 percentage point lower than in 1991. The exports of Indonesia, the Lao People's Democratic Republic, and Viet Nam grew significantly faster in 1992 than they had in 1991. Import growth in Southeast Asia decreased to an average rate of 10.3 percent in 1992 from 15.4 percent in 1991 as a result of which the balance of payments deficit narrowed to $14.2 billion in 1992 from $17.4 billion in 1991.

South Asia. The economies of this region recovered strongly, averaging 4.7 percent in 1992, compared with 2.1 percent in 1991. For 1992, Pakistan's economy grew 7.8 percent, reflecting the improved output of its agricultural and manufacturing sectors, with all of the other countries in the region posting growth rates of less than 5 percent. India's economy saw improvements in many sectors, as the growth rate climbed to 4.2 percent in 1992 from 1.2 percent in the crisis year of 1991. The *Asian Development Outlook* comments that India's sharply improved growth "was attributable partly to increased agricultural production because of a normal monsoon and partly to the reform measures adopted to increase the international competitiveness of the economy." The average inflation rate in South Asian countries declined significantly during 1992.

The region's nominal export growth picked up significantly, moving to an average rate of 8.5 percent in 1992 compared with 3.8 percent in 1991, although it remained below that of both the NIEs and the countries of Southeast Asia. Imports also picked up, with the result that the region's current account deficit increased to $11 billion in 1992 from $8 billion in 1991 (after having fallen to this level from $13 billion in 1990). India's current account deficit, which had fallen to about $4 billion in 1991 from a peak of $8.8 billion in 1990, rose to $6.7 million in 1992. Pakistan's current account deficit increased slightly in 1992, while the deficits of Myanmar and Nepal decreased somewhat, and Sri Lanka's deficit nearly doubled.

Pacific Island DMCs. The average economic growth rate for the Asian Development Bank's developing member countries in the Pacific islands remained unchanged at 6.7 percent in 1992. Papua New Guinea's growth rate of 9 percent was the highest, primarily reflecting output growth in its mining and petroleum sector of more than 30 percent. The Fiji economy recovered considerably in 1992, as its earnings from tourism climbed sharply. The Solomon Islands economy also grew faster, owing mostly to its strong production of primary commodities. During 1992, however, Tonga's growth rate declined sharply to 1.9 percent; Vanuatu's economy stagnated; and Western Samoa's economy contracted by 5 percent as a result of severe cyclone damage to both its export crops and physical infrastructure.

The average rate of inflation in these countries decreased to 5.1 percent in 1992 from 7.1 percent in 1991. Their export growth accelerated substantially in 1992, and, given their economies' heavy dependence on imports, their current account deficits remained large.

Outlook for Country Subgroups

The *Asian Development Outlook* comments that "the speed of world economic recovery is particularly important for the economies in the Asia-Pacific region, while the progress of market-oriented policy reforms, developments in industrial relations, political stability, and weather conditions will also have a significant bearing on economic prospects." It also noted that economic growth in the region will continue to be hindered by infrastructure bottlenecks and, in some countries, by labor shortages. Interestingly, it states that "export demand in the North American markets, which will gather strength over the next two years, is not likely to be adversely affected by the formation of NAFTA [the North American Free Trade Agreement] in the short run." It also expresses the view that European markets for the region's output are likely to remain weak, especially in 1993.

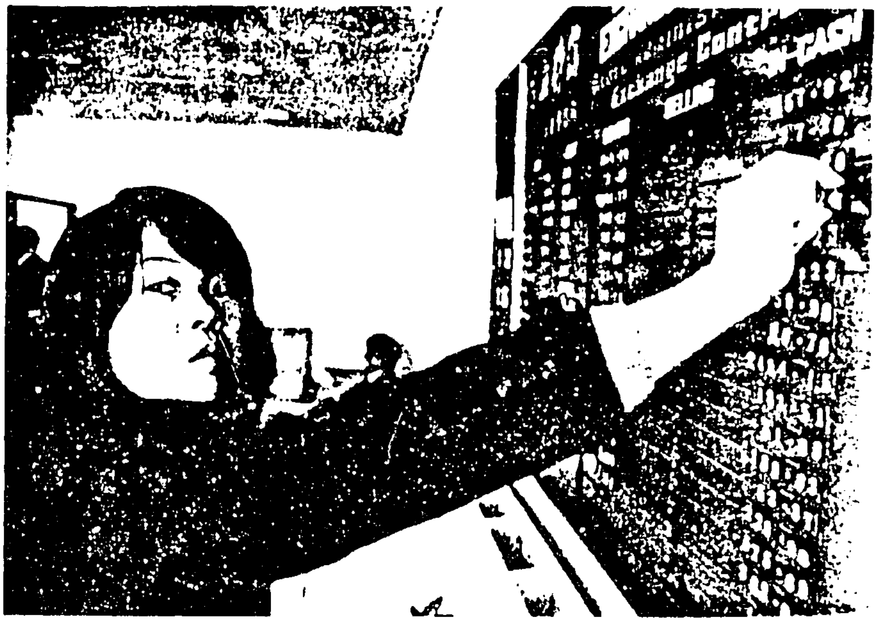
The report projects economic growth for the Asia-Pacific region averaging 7 percent during 1993–94. It estimates that the region's exports will increase by 12.8 percent in 1993 and by 13.3 percent in 1994, and that import growth will increase considerably in most DMCs during 1993–94 owing to their trade liberalization and large investments in infrastructure. It also predicts that the current account positions of most DMCs in the region will change very little during the next two years, except for China, whose 1992 surplus of $10.4 billion is projected to change to a deficit of $437 million in 1994. The report also projects relatively rapid FDI inflows during 1993–94 into China, Indonesia, Singapore, Sri Lanka, and Viet Nam, with "some leveling off in inflows to traditional large recipients such as Malaysia and Thailand."

Newly Industrializing Economies

The report predicts that "a recovery in exports and the continued strong growth in both public and private investment should enable all NIEs to enjoy accelerated growth in the next two years." It projects that the growth rate of NIEs will average 6 percent a year during 1993–94, adding that their exports to China are expected to remain strong because of that country's continued high growth. Export growth of the NIEs, it states, should improve moderately in 1993. Hong Kong's exports are expected to increase by 18 percent annually during 1993–94, reflecting continued strong demand from China, while exports of the other NIEs are expected to increase by 9 percent annually during the same period.

***China and Mongolia*.** The *Asian Development Outlook* predicts that China's economic boom will continue in 1993 and 1994 "as the reform process continues in enterprises, public finance, labor, social security, and the financial sector." Economic growth rates are expected to remain at double-digit levels during the period, although they will fall somewhat below current levels because of emerging bottlenecks in transportation, energy, and raw materials production, as well as higher rates of inflation. The report states that China's exports are projected to grow at annual rates of 15–16 percent during 1993–94, while its imports—owing to the continuation of strong domestic demand and to trade liberalization measures related to China's application to join the General Agreement on Tariffs and Trade (GATT)—are expected to increase by 20–25 percent annually. Consequently, China's current account surplus is expected to be almost halved to $5.7 billion in 1993 and then to be further reduced to roughly $0.4 billion in 1994. In contrast, Mongolia's economy "is likely to experience negative growth in 1993, and economic recovery is not expected until 1995."

***Southeast Asia*.** Economic growth in Southeast Asia as a whole is expected to accelerate during 1993–94, helped by higher exports and active public and private investment. Malaysia and Thailand are expected to have the fastest growth rates, of about 8 percent a year, while Indonesia is expected to grow somewhat more slowly. The Philippines is expected to recover to 3–4 percent annual growth, while Cambodia, Viet Nam, and the Lao People's Democratic Republic are expected to grow at annual rates of 6–8 percent. The report projects that exports from these countries will "remain relatively buoyant over the next two years as demand in major markets improves somewhat and intraregional trade continues to expand."



Posting an exchange rate change at a Beijing bank.

***South Asia*.** The *Asian Development Outlook* cautiously states that "if political stability and normal weather conditions are maintained in the region, economic growth in South Asia is projected to increase slightly, to an average of 5.6 percent annually for the next two years." It projects annual growth of 5.5–6 percent for India and a decreased average annual growth rate of 6 percent for Pakistan. The report estimates that economic growth in Sri Lanka will average 5.6 percent during 1993–94. It predicts that except for India, whose exports are expected to recover during 1993 and 1994 and to average 15–18 percent annual growth, "no significant improvement in export performance is projected in South Asia."

Paul Gleason,
Assistant Editor, *IMF Survey*

Copies of the *Asian Development Outlook 1993* are available for US$[illegible] plus a postage-and-handling charge from the publisher, Oxford University Press, 2001 Evans Road, Cary, NC 2751[illegible] U.S.A. (Telephone (800) 451-7556; fax (919) 677-1303.)

STATEMENT OF

AMBASSADOR CHARLENE BARSHEFSKY

DEPUTY UNITED STATES TRADE REPRESENTATIVE

ON TRADE POLICY TOWARD CHINA

BEFORE THE

HOUSE WAYS AND MEANS

SUBCOMMITTEE ON TRADE

This Administration has clear goals that it wishes to achieve on trade with China. First and foremost, we intend to pursue market opening initiatives for U.S. goods and services. U.S. business should have access to the Chinese market comparable to that available to China and our trading partners in the United States. Second, as a result of greater comparability in market access, we would expect more rapid growth in our exports to China, greater than with the growth of U.S. imports from China in recent years. Finally, and perhaps most important, we must work to ensure to the maximum extent possible that China accepts the rule of law as it applies to trade -- that is, that China's trade and economic policies are consonant with international norms.

China's Market Potential

China is now the fastest growing major economy in the world. In 1992, its economy grew at an official rate of 12.8 percent, with growth in the booming cities along the east coast at even higher rates.

Over the past decade, China's global trade has grown on average by more than 11 percent annually -- twice the rate of world trade growth -- increasing from less than $40 billion in 1980 to $165 billion in 1992. While changes in accounting methods have reduced the ostensible size of China's foreign reserves, they are still formidable. In trade terms, China is no longer a poor nation.

The growth of our bilateral trade relationship with China over the past decade and a half has been dramatic. Our two-way trade has grown from $2.3 billion in 1979 to more than $33 billion in 1992. The United States is now China's largest export market, with more than 30 percent of China's exports going to the United States. Americans imported more than $25 billion of Chinese goods in 1992.

Our trade relationship, however, is badly out of balance. The bilateral trade deficit stood at $18.2 billion in 1992, up 43 percent over 1991. The deficit reached $4.2 billion in the first three months of 1993 -- up 23 percent over the same period last year. In light of the lack of comparability of market access between our two countries, we cannot abide China's huge and growing trade surplus with the United States, now second only to that of Japan.

China's planners import proportionately more from the European Community and Japan than from the United States. According to former trade minister and current Vice Premier Li Lanqing, in 1992 China's imports from the European Community and

Japan grew at a rate approximately double that of imports from the United States. Not only is our deficit with China unacceptable, but our trade pattern vis-a-vis our foreign competitors is disturbing and must be reversed.

China needs the products and services that U.S. companies are the best in the world at providing. In addition to supplying China with wheat, fertilizer, and wood -- products that we have long sold to China -- the mix of products that we now export is dominated by the high-technology sectors in which we excel. Thus, the United States exported $273 million in wheat and $629 million in fertilizer in 1992, but over $2 billion in aircraft and parts and over $1 billion in computers and power generation equipment, along with substantial sales of electrical machinery, telecommunications equipment, and scientific and control instruments.

In addition, U.S. investment in China -- which in many respects augurs an increase in trade -- reached record levels last year, totalling over $1.5 billion, with total pledged investment above $6 billion. More than 550 companies now have offices in China.

Opportunities for enormous expansion of U.S. exports -- and thus for creation of high-wage export jobs -- are plentiful, provided that market access barriers are reduced and eliminated. China estimates that it will require more than $350 billion in imports over the course of its Eighth Five Year Plan, which will be completed in 1995. For its part, the U.S.-China Business

Council estimates that the market for power generation equipment in China over the next 25 years is $40 to $100 billion, for aircraft and aerospace over $40 billion over the next 20 years, for telecommunications about $30 billion over the next five years, and for auto parts, $29 billion over the next three years.

In short, the boom in China's economy, support for change within China's leadership, and the enormous potential of China's market for U.S. companies provide the United States with a rare opportunity to press for open and fair markets in China. If we wait, we may find that our industries are placed at a permanent disadvantage relative to those of our trading partners.

MFN FOR CHINA

The President's decision on Most Favored Nation (MFN) trade status for China firmly expresses the Administration's resolve that China must take essential steps toward improving its human rights policy and complying with the prison labor Agreement. The Administration is committed to elimination of human rights abuses in China.

At the same time, the President's decision recognizes the accelerating importance of China's market to the United States, and, more broadly, the importance that the success of China's effort to modernize holds for our domestic and global interests. The Executive Order of May 28 thus stipulates that the President will renew China's MFN status on the basis of explicit human rights criteria, and will use all legal tools to resolve issues

262

of weapons proliferation and trade. With respect to the latter, the President committed his Administration to "pursue resolutely" all legislative and executive actions available to ensure that China follows fair and nondiscriminatory trade practices.

POLICY ON TRADE WITH CHINA

China maintains one of the most protectionist trade regimes in the world. It has put in place multiple, overlapping non-tariff barriers to imports and maintains prohibitively high tariffs. While China's export regime has undergone a remarkable transformation over the past decade, turning China into one of the world's most formidable export engines, China's import regime remains the creature of central planners and state bureaucrats. And China's market for services remains closed to all but a few companies that are allowed in only on an "experimental" basis.

Strong, pent-up demand in China for advanced and other products on the one hand, and China's restrictive import regime on the other, has led to the creation of a large and growing grey market for goods. That grey market, access to which is often determined by illicit business practices, remains largely off-limits to U.S. companies. For many sectors, the grey market for goods is substantially larger than the officially-sanctioned market.

China's rapid growth has thus spawned a "wild west" mentality on trade that often has little respect for rules or international norms. Growing corruption have made that situation

worse. A fundamental tenet of our trade policy toward China, therefore, is the establishment of a solid framework that makes the rule of law a basis for China's conduct of trade. A second and equally important tenet is that U.S. companies must have access to China's markets comparable to that afforded China's exports to the United States. If Chinese business has the ability to trade and invest freely in the United States, then U.S. business should have the same rights in China. That, after all, is the "equality and mutual benefit" that girds our bilateral trade Agreement.

Trade Agreements. The trade agreements that we have signed with China represent important steps toward creation of a solid framework for the U.S.-China trade relationship. The intellectual property rights Memorandum of Understanding (MOU), signed in January 1992, commits China to the establishment of a world-class legal structure for the protection of intellectual property. The market access MOU, signed on October 10, 1992, is based on GATT rules and disciplines. It commits China to make sweeping changes in its import administration over a five year period. We intend to negotiate further agreements that broaden and strengthen the market access framework reflected in the initial agreement. Let me take each of these agreements in turn:

Intellectual Property Rights. Protecting intellectual property is vitally important if U.S. industries are to maintain their comparative advantage in the high-technology sectors they dominate. At the same time, Chinese leaders have recognized the importance of protecting intellectual property. Deng Xiaoping, in the spring of 1992, made that point succinctly when, in a statement that was published in the People's Daily, he declared that China should "abide by international rules on intellectual property."

In the IPR Agreement, China made bold commitments to bring its hitherto poor intellectual property rights regime to world class standards. For example:

- On copyrights, China has joined the Berne Convention on Copyrights and the Geneva Phonogram Convention, issued regulations implementing the Berne Convention in China, and promised to protect existing copyrighted works.
- China has raised the level of protection for computer software. China now protects computer software as a literary work as defined by the Berne Convention.
- On patents, China has taken significant steps to redress weaknesses in its patent regime, including amendment of its patent law to extend protection beyond processes to agricultural chemical and pharmaceutical products.

While we have made a good start, many problems remain. Piracy of copyrighted works and patented products is still endemic in China and the Chinese government has done little to bring it under control much less eliminate it. China does not

have an effective IPR enforcement agency and Chinese law offers no criminal penalties for offenders. Clearly, on enforcement, China lags well behind most countries in the region.

The International Intellectual Property Alliance notes that piracy in China of software, books, audio records, and music and motion pictures remains serious. They estimate that, in 1992 alone, U.S. industries lost upwards of $415 million to copyright piracy alone last year. In addition to market barriers, the absence of effective IPR protection is the greatest hindrance to access to China's market by the recording, motion picture, computer software, and other industries.

We have informed officials of China's trade ministry -- the Ministry of Foreign Trade and Economic Cooperation -- that we expect China to enforce strictly IPR laws and regulations. We intend to hold consultations on enforcement of intellectual property rights, with the aim of reaching agreement on a strict enforcement regime.

Market Access Agreement. China's commitments here are sweeping. But the Chinese government has not lived up to some important obligations under the Agreement. China has missed some important deadlines. It has not opened its markets to key U.S. exports as substantially as promised in the Agreement. We are now holding discussions with China to ensure full implementation of the Agreement. If China does not fulfill its commitments, we will act decisively.

The market access MOU, signed on October 10, 1992, commits China to wide-ranging liberalization of its import regime. That commitment, made at the highest levels of the Chinese government, if completely fulfilled, contemplates unprecedented access for U.S. companies to China's market in virtually all of our key export sectors.

Under the Agreement, onerous import licensing requirements and administrative barriers such as "controls," "restrictions," and quotas will be phased out for computers, telecommunications equipment, heavy machinery and electronics products, instant cameras and instant print film, agricultural goods, wood products, steel, and many other goods. China has already reduced some prohibitively high tariffs, effective December 31, 1992; further significant tariff reductions are to be implemented by year-end 1993.

Equally important, the Chinese government has acknowledged that it has for many years used restricted "internal" or neibu trade regulations or secret directives to make commercial decisions. In the Agreement, China has promised to make its trade regime transparent by publishing all trade laws, rules, and regulations, and by issuing rules that forbid enforcement of non-published regulations. China will also make its obscure but extremely important import approval process open and transparent.

China has also agreed that it will not use standards and certification requirements as barriers to trade, particularly in agriculture. It has promised to base sanitary and phytosanitary

standards on sound science -- the principles of which will be negotiated with the United States -- which should clear the way for U.S. exports of fruit, vegetables and other agricultural products. For wood products, China confirmed that domestic regulations banning the use of wood in domestic construction and other projects does not apply to imported wood -- thus opening up a potential $1 billion market to U.S. firms.

With these and other commitments, China has pledged to open its doors to U.S. exports over the next five years. We will take all necessary steps to ensure that China fulfills its obligations under this Agreement and opens these markets.

Accession to the GATT. The United States is committed to "staunchly support" China's accession to the GATT and to work constructively with China and other GATT contracting parties to achieve an "acceptable protocol" of accession. Under the condition that China's protocol of accession must be a strict and detailed one that further opens its markets and commits it to significant reform of its trade regime, the Administration regards China's eventual accession to the GATT as an important step toward further opening China's markets and holding China to international norms.

In the past year, U.S. negotiators have participated in four meetings of the Working Party for China in Geneva in concert with many other nations. They have also held a round of bilateral discussions with the Chinese in Beijing. While the Chinese have expressed interest in reaching agreement on an acceptable protocol, to date there has not been significant progress in that direction. China cannot enter the GATT on its own terms but must subscribe to GATT norms -- something China has not yet been willing to do.

Textile Transshipments. Textile transshipments, estimated by the U.S. Customs Service to be $2 billion annually, violate China's bilateral textiles Agreement and are a major threat to the integrity of the international regime governing textile trade.

The Administration is committed to combatting Chinese textile transshipments. In the last several months, China has adopted several measures, some at our insistence, to stem transshipments. They have proven ineffective. Unfortunately, no noticeable reduction in transshipments has occurred.

The Administration insists that China eliminate illegal textile transshipments. The ultimate responsibility lies with the Chinese government. For our part, the U.S. Customs Service will continue to monitor transshipments. If China is unable or unwilling to accept its obligations to trade fairly in this important sector, substantial alterations in the manner in which this trade is conducted will be made by the United States.

SERVICES

U.S. companies that have entered China's market are severely

limited in their ability to expand and to provide the full range of products and services available to Chinese customers. In most instances, U.S. companies cannot offer after-sales service, do not have direct access to sales and distribution networks, cannot own or manage their own retail outlets, cannot operate leasing companies or holding companies in China, and are otherwise restricted in their access to a vast array of business and local customers. If U.S. industries are going to establish a long term and successful presence in China's markets, they will need to be able to draw on a highly articulated services sector.

The market access Agreement sets the stage for the opening of China's potentially extensive market for services. We have asked the Chinese formally to begin negotiations on services that would lead to an Agreement opening China's market to U.S. companies. We are now awaiting a positive response.

Complementary Issues

If our market opening initiatives are to be fully effective, other complementary efforts to expand U.S. exports to China will be required. Expanded trade promotion activities in China are one necessary component. Through active trade promotion activities sponsored by the Department of Commerce we can take better advantage of the market opening measures that we have achieved.

Similarly, the Administration must review the effect of export controls on our high-technology exports. Generally speaking, controls are the strictest in areas where the United States is most competitive. The rapidity with which technological advance occurs often means that our export control policy lags woefully behind commercial reality, draining the U.S. of substantial export opportunities.

We sometimes require export licenses on products that the Chinese are now producing themselves -- and that our competitors in Asia are exporting freely into China. It is not surprising that many companies have told us that export controls are among the most important barriers to expanding trade with China. Export opportunities will be achieved not only in negotiations with the Chinese, but also in a review of those barriers to U.S. exports imposed by our own country. The Administration will consider steps to ensure that the export control system continues to maintain the integrity of our national security and foreign policy, yet functions in a fashion that does not unnecessarily encumber our commercial goals.

Conclusion

We have an historic opportunity to expand our trade relations with China and to help create hundreds of thousands of high wage jobs here in the United States through increased exports. We have a great stake, not only from a global, strategic perspective, but also from a domestic perspective, in opening China's markets and ensuring that China plays by the rules. We will make every effort to see that this happens.

DEVELOPMENT CENTRE STUDIES

POLICY REFORM, ECONOMIC GROWTH AND CHINA'S AGRICULTURE

by
Christopher Findlay, Will Martin
and
Andrew Watson

DEVELOPMENT CENTRE
OF THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Executive Summary

The Spread of Reform

The major elements of the post-1978 rural reforms were the reintroduction of household farming and free markets in the Chinese countryside, and the implications of these changes for rural investment and non-agricultural enterprises. Our analysis of the evolution of household farming and the free retail and wholesale markets demonstrates how each phase of economic development after the original changes of 1978 created strong pressures for further reform. What started out as a reform of the system of labour management and of agricultural prices led to the collapse of collective farming as managerial decisions were decentralized to the household. This, in turn, stimulated the growth of free markets which challenged both the state price structure and state controls over the distribution of agricultural products. The influence of the free markets fed back into production by encouraging specialization, and forward into distribution by generating wholesale trade. This also began to affect urban-rural exchange. The economic forces generated in this way then proceeded to change the structure of rural investment and led to a new phase of rural economic growth based on the development of rural enterprises. The process of agricultural reform thus developed according to its own economic logic and could not be kept within discrete areas.

Reform Cycles: the Market vs. Administrative Control

Such changes heralded a change in China's rural development strategy away from the former preoccupation with pure agriculture and local self-sufficiency towards a diversification of production based on regional comparative advantage and an integrated approach, involving all sectors and relying on the market as a resource allocation mechanism. Needless to say, this has entailed major political and institutional adjustments. The subordination of economic activity to governmental administration has begun to give way to a pattern where economic linkages no longer coincide with the pattern of administrative control. The bureaucratic system is thereby losing its ability to play a direct role in controlling economic flows. Inevitably, this is a political issue. While administrative obstacles to economic movement across boundaries remain, and while local officials remain unwilling to relinquish all of their economic powers (or retain those powers disguised as new forms of ownership, licensing and taxation), the free market system is not yet fully free to follow its own logic of development. In effect, both the party and government hierarchies have to change their structures and adjust to using indirect methods of influencing market systems without preventing the markets from performing the functions now required of them. Where the markets began both to challenge the economic and political authority of the party, the authorities have felt compelled to reassert greater administrative controls. This led to cycles in the process of reform over the decade.

Reform is Incomplete

Common aspects of the process of reform were cycles of deregulation and the reinstatement of controls, and the 'balkanisation' of many agricultural markets. This problem of barriers to inter-regional trade tends to exaggerate the instability in urban markets, reinforcing the cycles of reform and re-regulation. The origins of the barriers to inter-regional trade lie in the partial nature of the reforms. One example is the different rates of deregulation in various markets which leads to a continued bias against raw materials production compared to processing, and the incentives this creates for local governments to intervene in order to protect local interests. Another example is the devolution of power in an international trade system which retains the administrative mechanism of quantity targets.

The reform process is far from complete. Further reforms include:

- the removal of internal barriers to trade, associated with various commodity wars, which will promote the pursuit of regional comparative advantage;
- the development of marketing institutions which will also promote the development of national markets for agricultural products;
- access to new varieties of grains and other technical inputs which will raise yields;
- more secure land tenure and land transfer arrangements which will facilitate the structural adjustments in agriculture following the rural industrial boom.

There is scope for substantial increases in productivity associated with further agricultural reforms in China. Agricultural product prices were low (in the second half of the 1980s) compared to world prices. Price reforms would therefore have also added to growth in agricultural output. Reforms up to the mid 1980s had certainly generated an impressive growth in agricultural output. Those growth rates slumped in subsequent years, recovering again in the late 1980s and early 1990s. The recovery this time was due to a combination of policy changes (higher prices) and good luck (the weather and its effect on yields). The contribution of price changes to output growth is not surprising, given the extent of the taxes on agricultural producers that applied in 1986. The benefits of the first round of reforms had continued to be taxed heavily through highly distorted prices. It took price changes in the late 1980s to kick along agricultural output again. But further institutional reforms are also possible.

Impacts on Agricultural Self Sufficiency

Economy-wide policies also have important implications for agriculture. The reforms to the international trading system have prompted the rapid increase in the international orientation of the Chinese economy, and even though substantial trade barriers remain, there is now a closer matching of China's comparative advantage and trade patterns. The expectation in a relatively resource-poor economy such as China is that in the long run the share of agricultural products in exports will fall and that agricultural self-sufficiency will also fall. These longer-run forces can be illustrated by the effects of a rural industrial boom, or a change in factor endowments or growth in incomes. The former pair of changes are shown to have relatively large impacts on the degree of agricultural self-sufficiency compared to the impacts of income growth on demand (via different income elasticities).

The short-run impacts of further reform could, however, be different. The combination of policies specific to particular commodities, and the effects of the exchange rate system, have taxed both exporting and import-competing parts of the agricultural sector. The dynamic effects of growth are likely to lead to further price reforms (and removal of sector-specific price distortions) as the balance of forces in the political economy of policy-setting changes.

Agriculture and Macroeconomic Management

Agriculture is also affected by the macroeconomic management of the Chinese economy. In general over the 1980s, the macroeconomic performance of China was impressive. However the process of decentralisation that was an integral part of the reforms led to some problems of macroeconomic imbalances. The institutions for macroeconomic control are still under development in China. The instruments that are used (credit controls, price controls) can have direct impacts on the rural sector and on agriculture. In addition, the distortions associated with these sorts of intervention and with the exchange rate system also mean that macroeconomic changes can have effects on the pattern of rural production which reduce welfare and growth. These occur not only because of the differential income elasticities of demand, but also because of an important nominal rigidity in the Chinese economy, that is, the exchange rate. Small changes in macroeconomic variables can have substantial impacts on trade patterns in particular.

Summary

In summary, China began the rural reforms with what in hindsight were the easier things to change, for example, the degree of household responsibility. Output growth boomed as the rural economy 'caught up' to its production possibilities. Once those productivity gains were exhausted, however, there were highlighted another set of reform issues, especially land tenure and price distortions. Furthermore, the end of the first stages of reform coincided with an increasing difficulty of controlling the Chinese macroeconomy. The greater swings in macroeconomic performance had substantial impacts on the mix of agricultural output. These problems highlight another reform agenda about money and foreign exchange markets. The agricultural sector (and China's agricultural trade partners) have just as much interest in these issues now as in price distortions and other aspects of land management. The original reforms generated a dynamic force of their own, which despite the presence of the reform cycles, prompted the trend towards the increasing reliance on markets as resource allocation devices. The same sorts of forces are likely to generate pressure for reforms to deal with the outstanding issues.

Economic Prospects for China in 1993—Predictions of Oxford Analytica

China is poised to enter its third consecutive year of rapid growth. GDP growth will continue in the 8 to 10 percent range, and foreign trade could increase by about 20 percent. For the past two years, the economy has been emerging from recession, with slack capacity and abundant supplies preventing overheating. This period is now over. Growth-induced strains are likely to become more evident in 1993, providing new challenges to policymakers as they debate the pace of reform. Inflationary pressures have already begun to mount. Markets for consumer goods have remained stable, but danger signs have emerged in the markets for producer goods that will make macroeconomic management more difficult in 1993.

The consumer markets show little sign of impending inflation:

- The urban wage bill increased only 16 percent in the first three quarters of 1992 while the price level increased 9 percent (12 percent in the larger cities). By contrast, industrial output, measured in constant prices, was up 20 percent over the same period.
- Another good harvest is being reaped. Total grain output is expected to exceed last year's record, and the steady growth of subsidiary farm products has continued. The prices on farmers' markets are stable.
- Sales of big-ticket durables have grown slowly, and the savings rate remains high.

As for the producer markets, fixed investment has jumped 37 percent, putting pressure on the industrial economy:

- Market prices for producer goods have been increasing since mid-1992. Structural steel and cement saw the biggest rises.
- Bottlenecks are emerging in the transport sector. Total freight traffic increased only 4.6 percent, and transport delays have increased markedly.
- Energy shortages are reemerging. The primary energy supply grew only 2.8 percent during the first 10 months of 1992.

Problems in energy supply have so far been averted by improved sector performance, however. Crude petroleum output increased only 1.8 percent, although production of refinery products was up 8.5 percent. Coal production increased 8.1 percent, and electric power generation was up 10.8 percent. The changes reflect the inefficiency of traditional industry and the impact of large stockpiles built up during the 1989-90 recession.

These trends will continue in 1993. Nominal investment growth will continue at about 30 percent, although price increases for investment goods will, to some extent, offset this. Delays and occasional shortages will increase.

Foreign trade will continue to be dynamic. Imports are accelerating from last year's 23 percent growth rate, and exports will maintain their 1992 growth rate, averaging about 17 percent. By increasing the availability of essential inputs, rapid import growth has eased strains on the economy.

Foreign investment is likely to accelerate further. Contracts for new investment, which typically lead actual investment by a year or two, doubled in value in both 1991 and 1992:

- In Guangdong province, rapid export growth based on foreign investment is expected to be maintained. The province's exports to the United States are growing at about 40 percent a year. (The United States' deficit with China was approaching $20 billion by the end of 1992.) With investment in export-oriented factories rising, this trend will continue.
- The performance of the Lower Yangtze provinces is even more impressive. Jiangsu's industrial output increased 35 percent during the first three quarters of 1992, and output in October 1992 was 47 percent higher than in the previous year. Jiangsu's exports increased by 19 percent, showing that its rapid growth is based largely on the domestic market.

While export growth has preserved the trade surplus and foreign exchange reserves, most of the slack within the domestic economy has now been used up. With sound foreign exchange reserves and a stable consumer market, the authorities are unlikely to apply the brakes to economic growth during 1993.

Although China's current leadership has accepted the market, it retains a distinct preference for control whenever possible. With market prices stable over the past two years, policymakers have been able to concentrate price reforms in state-controlled sectors. State prices were adjusted upward toward market prices, with the bulk of adjustments in 1991 concentrated in energy and ferrous and nonferrous metals. Because these commodities are produced in large state firms, the price hikes increased state revenues.

With this period over, reformers face greater fluctuations in market prices and a period of rising prices. With reform policies likely to return to a pattern of decentralization and the opening up of markets, future trends are likely to include the following:

- Local market experiments will be given more leeway.
- Shanghai's stock exchange will expand significantly, and local land markets will be formalized in a number of regions (in addition to Guangdong).
- Moves to tackle the inefficient state industrial sector will commence in 1993. A plan to lay off 30,000 coal miners and close 30 pits was announced in the official media in December 1992. Nevertheless, changes will be cautiously introduced.
- The Lower Yangtze region will match, and in some respects surpass, the degree of market orientation that Guangdong already displays.
- Because of its size, population, and energy and raw material resources, China will continue to expand as a center for manufacturing operations, particularly for those relocating from more expensive sites in East Asia.
- Foreign trade liberalization will become increasingly central to economic reform. The most important provisions of the October 1992 U.S.-China trade agreement will take effect in December 1993.
- These changes will be controversial. Differences about specific policy initiatives will intensify, but with economic fundamentals remaining positive, potential instability is unlikely to undermine rapid growth in 1993.

From reports of Oxford Analytica, the London-based economic research group.

NATIONAL ECONOMIES

China's Open Economic Zones Are Speeding Its Transformation to a Market Economy

One of the key aspects of China's reform efforts, initiated in 1978, has been the opening of its economy to promote modernization by using foreign capital and technology and by stimulating exports. A critical element of the Government's strategy to achieve these goals has been to designate a number of clearly defined areas as "open economic zones" in which outward-oriented activity will be promoted through foreign direct investment and trade.

In the following article, Michael Bell and Simon N'guiamba of the IMF Central Asia Department describe the various forms of open economic zones in China, their performance, and their impact on the Chinese economy in recent years.

The policy to open up China's economy has been implemented in four stages. The first stage involved the establishment of four Special Economic Zones (SEZs) in 1979–80. The SEZs were to be more ambitious in terms of policies, activities, and geographical coverage than traditional export-processing zones. They were to promote production for export and facilitate imports of advanced technology. In due course they came to serve as "laboratories" for experimenting with market-oriented reforms. Enterprises operating in the SEZs were offered preferential treatment in terms of taxation, import licensing, and tariffs.

During the second stage, which began in 1984, these policies were extended to other areas: 14 coastal cities were authorized to establish "open zones" within their jurisdictions. The third stage involved the establishment of Hainan island as an SEZ in 1988 and the opening of the most ambitious of the economic development zones — Pudong New Area (in Shanghai)—in 1990. In the last stage, which followed senior leader Deng Xiaoping's initiative in early 1992 to accelerate economic reforms, preferential policies were extended to cities in inland provinces—particularly those along the Yangtze River valley—and a number of cities mainly on China's northeastern borders.

A view of Shenzhen, the site of one of the four original Special Economic Zones.

Special Economic Zones

The Original SEZs. Ease of access to foreign markets was the basis for choosing the locations for the four original SEZs, which remained the only open economic zones in China through 1984. Three of the four are in Guangdong province: Shenzhen (near Hong Kong); Zhuhai (near Macao); and Shantou in the southeastern coastal area of the province. The fourth is located in Xiamen in the southeastern part of Fujian province.

An important difference between the SEZs and other areas of China is that investment decisions taken in the SEZs are largely outside the State Plan. Local authorities in SEZs are allowed to offer preferential policies to foreign investors, to develop their own infrastructure, and to undertake other investments, provided they can raise the funds. Enterprises in the zones may also make their own investment, production, and marketing decisions. This relative autonomy has been an important factor in attracting investment into the SEZs—both from other areas of China and from abroad.

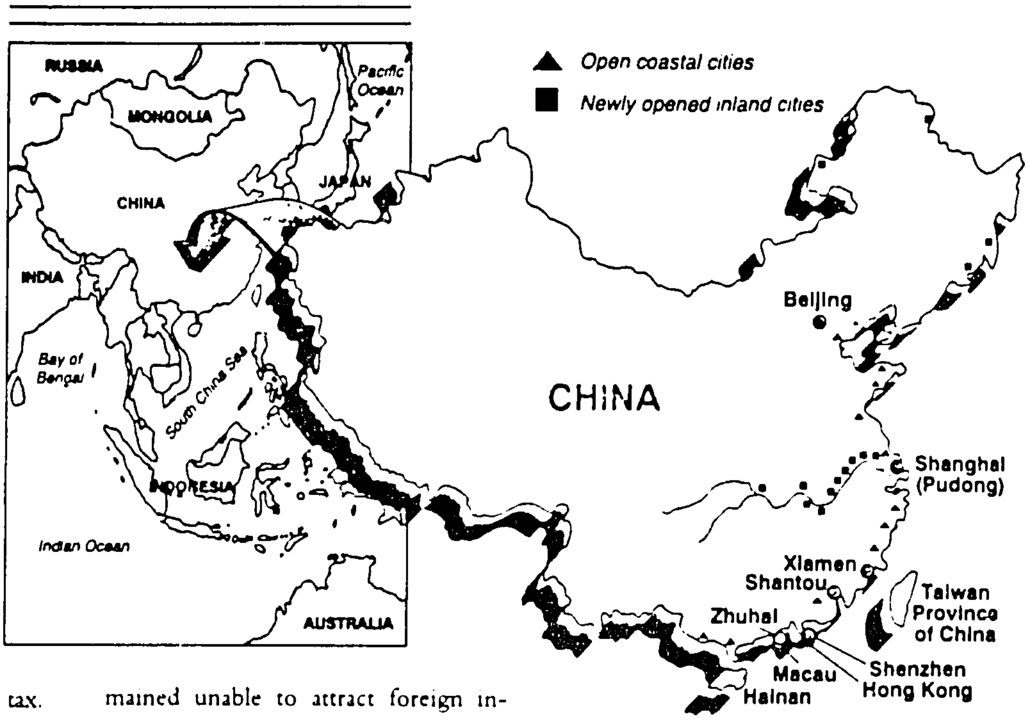
Enterprises operating in the zones comprise:

- state enterprises, including those owned by local authorities or by authorities of other provinces; and
- foreign-funded enterprises (FFEs), including wholly owned enterprises,

equity joint ventures, and contractual joint ventures (enterprises managed by foreign partners under contract).

FFEs operating in the zones generally make their own decisions with respect to their organizational and personnel structures, wage systems, and the hiring and firing of employees. With the authorities' approval, they may sell part of their output in the domestic market.

FFEs enjoy a tax holiday for the first two years. During the next three years, they pay 7.5 percent tax on their profits. Subsequently, they (as well as domestic enterprises in the SEZs) are subject to 15 percent tax. The tax rate outside the SEZs is 33 percent for FFEs and 55 percent for domestic enterprises.



During 1980–85, starting from a very low base, the four original SEZs attracted substantial foreign direct investment to develop their basic infrastructure and to initiate industrial production. In 1985, for instance, they accounted for more than one-third of all actual and planned equity joint ventures in China. Their performance was also impressive in subsequent years in terms of exports, foreign direct investment inflows, and industrial output. between 1987 and 1991, the value of their exports more than doubled to \$9.6 billion (about 13 percent of China's total); their contracted foreign investment increased eightfold; and their industrial production rose by more than 35 percent in 1991 alone. Provisional data for 1992 indicate substantial further increases in activity.

Hainan. Hainan island, which was one of the poorest regions of China through the mid-1980s, was designated a "special area open to foreign investment" in 1983. However, it remained unable to attract foreign investment mainly because of poor infrastructure. But as labor costs rose in Guangdong, Hainan—with its abundant cheap labor—developed into an attractive site for foreign investment in labor-intensive activities.

In 1988, Hainan was designated China's largest SEZ and began to focus more on export promotion and on attracting foreign investment. Its preferential policies are more generous than those of the other SEZs. For example, it is one of the few areas where foreign exchange earned through merchandise exports and other business transactions can be retained in cash, regardless of ownership. Among its other advantages are low land prices and policies that permit free movement of goods and capital.

Hainan is experimenting with a market-oriented system of economic management. One aspect is that trading in land-use rights is permitted: the authorities can lease land owned by the state for up to 70 years, and domestic and foreign investors are allowed to engage in land development. Its authorities are empowered to approve projects whose total investment is less than \$30 million. They may also issue bonds with the approval of the State Council.

During 1988–91, Hainan's economic development accelerated. It attracted substantial financial inflows from other provinces and from abroad, its exports more than doubled, and its per capita income caught up with the rest of China. By the end of 1991, it had approved the establishment of more than two thousand foreign-funded enterprises with a total value of contracted foreign investment amounting to \$394 million.

Open Coastal Cities

Encouraged by the success of the original four SEZs, the Chinese Government decided, in April 1984, to open 14 larger, established coastal cities to foreign trade and investment. At the time they were chosen, these cities were relatively well developed in terms of industry, infrastructure, and technical and managerial expertise.

The authorities of the 14 coastal cities can approve construction and industrial projects involving foreign investment that does not exceed $5 million ($10 million for Dalian and $30 million for Tianjin and Shanghai). Nonmanufacturing projects involving foreign investment are not subject to upper limits but must be financed mainly by foreign resources.

The coastal cities offer foreign investors most of the preferential policies prevailing in the SEZs. The main difference relates to the corporate income tax, which is generally 24 percent in the cities, although some types of projects are eligible for lower rates.

Certain areas within most of the 14 open coastal cities have been designated Economic and Technical Development Zones (ETDZs). These zones are often located near the harbor and are designed to provide basic infrastructure for the establishment of new enterprises. The ETDZs enjoy the same tax concessions as those offered in Special Economic Zones; these concessions are limited in other parts of the coastal cities.

The economic performance of the 14 coastal cities has varied. Although industrial growth in 8 of them was higher than the national average during 1984–90, that in all the cities taken as a group was well below the national average. The dollar value of the cities' exports (excluding exports from ETDZs) rose by 10 percent in 1991 and by about 15 percent in 1992—close to the national average. The value of foreign direct investment contracted by the 14 cities increased by nearly 35 percent in 1991 (compared with the previous year) and then threefold in 1992.

The apparent contrast between the slow industrial growth and the rapid export expansion in the 14 open coastal cities reflects their initial relatively low level of exports and the obsolescence of many of their long-established industries. It also indicates that the preferential terms offered in ETDZs have been more effective in increasing exports than in expanding industrial capacity.

Photo Credits: Denio Zara and Padraic Hughes for IMF; pages 113, 123, and 125. Shenzhen Investment Guide, page 114; Pudong Development Office of Shanghai, page 117.

Pudong New Area

China's policy of encouraging economic openness progressed further in April 1990, when the Pudong New Area of Shanghai was selected to become an open economic zone that would enjoy policies more flexible than those already in force in the four original SEZs. The Pudong New Area was expected to lead the opening up of the Yangtze River valley and to be the focal point of China's development during the 1990s. The authorities envisaged that, in the process, Shanghai would become a major economic, trading, and financial center for China—and indeed, for all of Asia.

Pudong's development aims at establishing a finance and trade zone, an export-processing zone, a free trade zone, and a high-technology park. Pudong differs from the original SEZs in that its preferential policies are broader in scope. Notably,

- foreign business is allowed to engage in retail sales;
- foreign-owned enterprises can trade their foreign exchange freely;
- foreign insurance companies may be established;
- foreign enterprises can build and operate port facilities;
- approved enterprises can engage in foreign trade without restrictions within a certain subzone; and
- foreigners can trade on a recently established securities market.

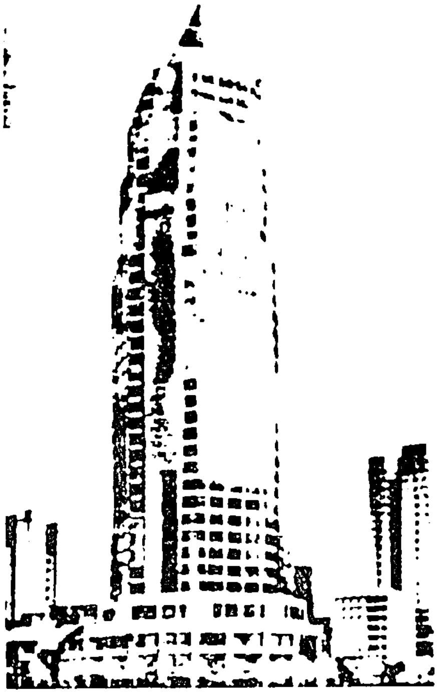
Pudong has enjoyed early success. Its output growth, led by manufacturing and services, was about 14 percent in 1991 (compared with 7.7 percent for China as a whole). Moreover, despite its infancy as an open economic zone, Pudong has attracted substantial investment, both foreign and domestic. Between 1990 and 1992, its authorities approved the establishment of 704 foreign-funded projects—most of them in high-technology activities—involving investment totaling more than $3 billion. In addition, 11 foreign banks have already opened branches in Pudong, and more than thirty others have applied to do so.

Domestic investment is also on the rise. By the end of 1992, China's central, provincial, and municipal governments had set up more than one thousand enterprises in Pudong, involving investment commitments of about $1.5 billion. Capital market activity also expanded dramatically in 1990–92. For example, the value of securities traded in Shanghai soared from about $500 million in 1990 to about $12.3 billion in 1992.

Inland Provinces

The level of foreign investment in inland provinces was relatively low from 1978 through 1991. Concentrated, for the most part, on resource-based ventures, it was confined largely to a few areas—mainly around Beijing and a number of cities in the provinces of Shaanxi and Sichuan.

Although the foreign trade of inland provinces developed faster than foreign direct investment, it still lagged far behind that of the coastal provinces. In 1990, exports from the inland provinces represented about 28 percent of the national total and their imports only 10 percent. The



The Pudong World Plaza (Shanghai) was constructed with foreign investment capital.

total trade of the inland provinces was 12 percent of GNP in 1990, compared with close to 40 percent for the coastal provinces.

An important reason for the relatively low level of foreign direct investment in inland provinces was the absence of preferential policies. Foreign investment was further discouraged by the limited power of local governments to approve investment projects, poor infrastructure, and the lack of technical and managerial expertise and skilled labor.

In 1992, the central authorities decided to apply preferential policies to 23 major cities in inland provinces, including 18 provincial capitals and 5 cities along the Yangtze River valley. In addition, 6 "development zones" were set up in the same region. The Government also permitted cities bordering neighboring countries to open their economies to the outside world. Meanwhile, many provinces have been trying to open up more cities.

Most of the tax incentives offered in the original SEZs, Hainan, and Pudong are to be applied in the newly opened cities of inland provinces. In addition, many provinces have transferred powers to local authorities to approve foreign investment projects in their respective areas. Some areas have, in fact, offered even more generous terms than those applied in the SEZs and Pudong without approval from the central government. These include a five-year tax exemption and a 50 percent reduction of corporate income tax over the subsequent five years.

Conclusions

China's moves to open its economy to the rest of the world over the past 13 years have helped increase its access to foreign capital, trade, and advanced technology, thus contributing significantly to the country's rapid economic development. The acceleration of the "opening-up" policy in 1992 has paid further dividends. In that year, the value of China's exports increased by over 18 percent to $85 billion, with manufactured goods accounting for 80 percent of the total. The exports of FFEs grew by about 44 percent to $17.4 billion, and their share in total exports rose to about 20 percent in 1992 (from 17 percent in 1991). China attracted commitments of foreign direct investment valued at $57.5 billion, and the amount of foreign direct investment that actually came in was $11.2 billion—an increase of 160 percent over 1991. Reflecting these developments, the number of FFEs operating in China rose to about eighty-four thousand at the end of 1992, from about thirty-seven thousand a year earlier.

Despite their positive impact, China's open economic zones raise questions. On the domestic front, the intense competition among the various provinces—with each trying to offer more generous policies to investors than the others—could have an adverse impact on government revenue. Moreover, the proliferation of development zones could divert land away from agricultural use, a critical issue given the scarcity of arable land. Partly in response to such concerns, the Government has announced that the opening of development zones will be slowed.

On the external front, China's ongoing negotiations on resuming its participation in the General Agreement on Tariffs and Trade may make it necessary for the authorities to review the policy of offering preferential terms to new investors in open economic zones.

Whatever the future of China's open economic zones, there can be little doubt that they have played an important role in the country's transformation to a market economy. They have achieved far more than their initial aims of attracting foreign investment and technology and of earning foreign exchange to pay for imports to modernize the economy. Their use as laboratories for experimenting with market-oriented policies and their spread, in various forms, have established them as "nodes of development" that are affecting increasingly large areas of the country.

As the Chinese economy becomes more market oriented and open, the time will come for a careful review of the role of such zones. The key question that might then arise is whether China's long-term development might not be best served by phasing out those special arrangements that should be regarded as transitional (such as certain tax concessions), while extending others to all areas of the country.

Overseas Development Institute
Briefing Paper
February 1993

CHINA'S ECONOMIC REFORMS

Although often held to be the last remaining large socialist country, China has abandoned many features of the command economy. It also has one of the fastest growing economies in the world: in 1992, economic growth reached 12 per cent. Much of this growth performance appears to be the direct product of the economic reforms over the fourteen years since 1979 when China also initiated new policies of opening up to the outside world. This Briefing Paper analyses the content of economic reforms, indicates some of the problems encountered in the reform process and traces the impact on incomes and income distribution.

Economic Performance

Originally, China's reforms were targeted to achieve a doubling of real GNP in the decade of the 1980s, with a further doubling in the 1990s, so that by the end of the century, China's real GNP would have quadrupled. In fact, real GNP grew at an annual rate of 9% in the 1980s, and the doubling target was reached three years early, in 1987. It was then calculated that with an annual rate of growth of 8-9%, the quadrupling target could be achieved in 1994 or 1995. By the end of the century, therefore, real GNP is expected to equal that of some major industrial countries such as the UK, Italy or France.

The reform process has been remarkably successful. It consists of six main components:

- the introduction of private farming under the 'household responsibility' system
- encouraging private business
- restructuring public enterprises
- promoting foreign trade
- policies to stimulate external financing
- decentralising administration to the provincial and local level.

Household Responsibility

The reforms began in the rural areas where a contract-based system with household responsibility replaced the people's communes. Peasants acquired the right to manage their own land and the practice of unified procurement, with production allocated among farms, ceased. Price control over the majority of farm products was liberalised and this enabled the agricultural sector to develop rapidly in the direction of specialisation and commercialisation. Aggregate output increased. For example, grain production has increased steadily from 305 million tons in 1978; 320m tons in 1980; 446m tons in 1990; to 435m tons in 1991. The output of cotton increased from 2.7m tons in 1980 to 5.67m tons in 1991; of oil-bearing crops from 7.69m tons in 1980 to 16.38m tons in 1991; and of cured tobacco from 0.72m tons in 1980 to 2.67m tons in 1991.

The household responsibility system has stimulated production increases and enhanced agriculture incomes (see below), but it has its limitations, particularly in consolidating the small family farm as a unit of production in a country of severe scarcity of cultivable land and where some flexibility has been permitted in the implementation of the 'one-child per family' policy in the rural areas, leading to some increase in rural population growth rates.

The main policy response to the growing partition of surplus rural labour has been the development of village and small town enterprises which employed about 100 million in 1991, accounting for 23% of the total rural labour force. The proportion of total rural output from such enterprises rose from 26% in 1980 to 59% in 1991. By allowing the peasants to 'leave the land but not the rural area', China has attempted to prevent labour migration to the large cities.

Private Ownership

One of the main tasks of the economic reforms is to transform China from a single public ownership economy to one with a dominance of public ownership co-existing with various other forms of ownership. As a result, the public sector is declining while the private sector in various forms is growing. During the period 1978-90, the public sector's share of GNP decreased from 98% to 93%, while that of the private sector increased from 2% to 7%.

Table 2 shows the related fall in the share of state-owned enterprises in respect of both industrial output and retail sales during the 1980s. In industry, at least, collective ownership has also surged, but in retail sales the recent rise in private and individual ownership is particularly striking.

Although the private sector still accounts for only a minor proportion of total industrial output, and most private-sector enterprises are small, a few larger companies are emerging, for example, the Nan-De Economic Group. The President of Nan-De, Qi-Zhong Mou, was a high school teacher in the 1970s, and began to run a few firms only in the early 1980s. Now, his 'Nan-De' contains more than 40 firms, has an annual turnover of some 600m Yuan (US$100m).

Restructuring Enterprises

Within the public sector the most important change is the removal of enterprise management from government intervention by decentralising decision-making from the state to the enterprise. In 1984, the State Council promulgated regulations', authorising state-owned enterprises to make their own decisions on production, sales, and management. However, not all the powers authorised by the regulations have been fully implemented and during the three years of retrenchment, 1989-91, China had to restore some government controls in order to combat inflationary pressures.

Several problems have emerged in the removal of enterprises from government intervention.

- First, the government requires that the party organisation remain active in an enterprise even after the enterprise's removal from government intervention. The issue is how to define the relationship between management and party committee within an enterprise, or rather how to define the roles and functions of the managing director and the party secretary. As a rule, the managing director is required to be fully responsible for managing the business of the firm, for all transactions and contracts as well as for its profits and losses, while the party secretary is in charge of supervising and supporting management. In fact, the party secretary is always more powerful and influential than the manager. Some documents

Table 1: Growth rate of some major economic indicators (%)

Year	*Population*	*GNP*	*Industrial Output*	*Currency in Circulation*	*Overall Retail Price*	*Per Capita GNP*
1980	1.18	7.9	9.27	29.3	6.0	6.5
1981	1.45	4.4	4.29	14.5	2.4	3.1
1982	1.57	8.8	7.82	10.8	1.9	7.2
1983	1.33	10.4	11.19	20.6	1.5	8.8
1984	1.31	14.7	16.28	49.5	2.8	13.2
1985	1.42	12.8	21.39	24.7	8.8	11.3
1986	1.56	8.1	11.67	23.3	6.0	6.6
1987	1.66	10.9	17.69	19.4	7.3	9.1
1988	1.57	11.3	20.79	46.7	18.5	9.5
1989	1.50	4.4	8.54	9.8	17.8	2.8
1990	1.44	4.1	7.76	23.9	2.1	2.5
1991	1.30	7.7	14.52	20.2	2.9	6.3

Sources: *China's Economic Year-Book; Statistical Year-Book of China*

Table 2: Patterns of Ownership in Industry and Commerce

	State ownership	*Collective ownership*	*Private and other ownership*
Industrial output (%)			
1980	76	23	1
1990	56	35	9
Retail sales (%)			
1980	51	45	4
1990	39	34	27

describe the role and function of the senior manager as 'the centre' of the enterprise, and that of secretary as 'the core' of the enterprise. The problem remains how to distinguish 'the centre' from 'the core'. Some enterprises have tried having one person concurrently in charge as 'manager and 'party secretary'. These experiments indicated that such a dual position made it unable to concentrate entirely on management. The issue of how to define the roles and functions of manager and party secretary at the enterprise level, even after the removal of government intervention, remains to be solved

Second, enterprise reform is not always supported by reform in other fields, in particular price reform. In the 1980s, price reform emphasised the raising of prices of certain products (for example, farm products, minerals and other industrial raw materials, transport and other services) in order to improve the price structure. More recently, it has been further deepened, with more emphasis on market forces in pricing and resource allocation. The proportion of administered prices in total retail sales dropped from 97% in 1979 to 23% in 1991, but there is still a long way to go in shifting price determination and resource allocation from planning to the market place. A number of enterprises (in particular coal, power supply and transport) still suffer losses owing to price distortions and therefore rely on subsidies. As elsewhere in the world, the issue of co-ordinating enterprise and price reforms remains a challenge.

Third, enterprise reform presents problems for social security. It is difficult for enterprises to implement their decision-making power in hiring and firing without the establishment of unemployment insurance, job retraining programmes and job information services. In addition, all levels of government are attempting to reform the pension system. Enterprises cannot be expected to take care of everything (from kindergarten, through housing, health care education and pensions) for every employee as they did before. Where some provincial governments are keen on setting up a pension system within their own region, this has led to big differences in contributions and benefits, and produced new obstacles to labour mobility.

Foreign Trade Promotion

China has implemented its economic policies of opening to the outside world through increased foreign trade and the utilisation of foreign capital. Since 1979, China's foreign trade has grown more than fourfold (see Table 3).

Although trade was often in deficit in the 1980s, there was a declining trend, and in recent years it has begun to show a continuing surplus. One main reason has been the need to compensate for internal market contractions, obliging enterprises to both promote exports and slow down imports. But another important recent reason for the rapid growth of foreign trade is the implementation since January 1991 of a new management system in China's foreign trading companies. This has a) cancelled regional discriminatory and preferential policies (exports and imports, whether in the special economic zones, the open coastal open cities or the interior, all now enjoy the same treatment) and b) abolished various financial subsidies, making firms engaged in foreign trade responsible for their own profits and losses. This reform has given considerable impetus to trading firms. The value of China's exports is now almost 20% of recorded GNP and has surpassed that of many developed countries. Local economists hold that because of the distortion in calculating China's exchange rate, such a high figure is exaggerated and 8% is more realistic. Even so, it still demonstrates that China's economy has already become closely integrated into the world economy (see Box), to the extent that what the USA alleges to be its US$18bn trade deficit with China has come to be a matter of considerable friction.

The Role of External Capital

Two kinds of external capital feature here: foreign debt and foreign direct investment (FDI). Of the US$66bn of external capital utilised by China in the period 1979-91, foreign debt

Table 3: Foreign Trade (US$bn)

Year	*1979*	*1986*	*1990*	*1991*
Total	29.33	73.85	115.44	135.70
Export	13.63	30.94	62.09	71.91
Import	15.67	42.90	53.35	63.79
Balance	-2.01	-11.96	8.75	8.12

China and the GATT

China is one of the original contracting parties to the GATT, although it broke off contacts with GATT for more than 40 years. Since introducing the policies of reform and opening in 1979, China's foreign trade has developed rapidly with GATT members.

In order to enjoy multilateral most-favoured nation treatment (MFN), the generalised system of preferences (GSP), and the achievements of GATT in the last several decades in reducing trade barriers and promoting free trade, China submitted its official application to resume its membership in July 1986. Other countries have expressed hopes that China will re-enter GATT in the near future and the first deliberations on its foreign trade system were completed in February 1992 and the negotiation on tariff concessions in October 1992. China could be set to resume its membership of GATT in 1993 whether or not the Uruguay Round negotiations are concluded. US support for China's resumed membership is crucial. China insists its MFN status must be without conditions.

In order to fulfil GATT obligations, China has committed itself to reducing its general tariff level by 6% within 3-5 years and also to reducing non-tariff barriers. This will force most industrial enterprises in China to face keen competition from abroad, especially in those commodities which used to enjoy high tariff protection, such as automobiles, electrical products, chemical products and high-quality textiles. It will force China to speed up its reform of the foreign trade system, the price system, the enterprise system and the financial system, pushing it to link its economy further with the outside world in terms of management, regulations and laws.

amounted to US$47bn, (70%) and FDI to US$19bn (30%).

China's *foreign debt* has grown threefold since 1985, and reached US$60.7bn in 1992. Before 1985, official credit accounted for 50% of medium- and long-term debt; since then, this figure has come down to 30%, while commercial loans have increased to 70%. The repayment of principal and the payment of interest on loans now amounts to US$8.5bn a year. Because of the improvement in its capacity to earn foreign exchange through exports, China's ability to meet its debt payments is strong. In 1991, the external debt service ratio was 12%.

Since the law on Chinese-Foreign Joint Ventures was promulgated in June 1979, the scale of *foreign direct investment* has expanded (see Table 4). China has brought in policies preferential to foreign investment: for example, the corporation tax rate for China's state-owned enterprises is 55%, whereas that for foreign enterprises is only 33%. In 1989, many western industrialised countries applied economic sanctions against China, but overseas FDI to China continued to rise.

The sectoral breakdown is significant. During the period 58.5% of cumulative total FDI was invested in manufacturing industries, 22.2% in real estate 4.2% in commerce and services, with only 2.8% in agriculture, 1.8% in construction, and 1.2% in communications and transportation. Investing more than half the FDI in industry has played a major role in the development of manufactured goods for export. Investment in infrastructure, mining, raw materials, communication and transportation is small, and this has created some imbalance between manufacturing industry and basic industry and infrastructure.

The development of foreign trade and the utilisation of foreign capital have underpinned the economic reforms nonetheless, further promoting the open policy. Since early 1992, China has rejected an open policy at all levels and has said it will adopt a 'four alongs' strategy: *along the seashore, along the Yangtze river, along the border* and *along the railway.*

- The *seashore* strategy refers to the establishment of a littoral open zone from the North: the city of Dalian, to the South: Guangdong and Hainan provinces, areas which have grown to be the most active and the strongest economic regions in the country. The other 'alongs' are less categorical:
- The *river* strategy aims to open up twelve cities on the banks of the Yangtze River.
- The *border* strategy aims gradually to open the border cities and actively develop trade and economic co-operation with neighbouring countries – especially the central Asian republics.
- The *railway* strategy aims to open up of the belt along the 'Euro-Asian continental bridge', in particular the less developed northwestern regions.

Nevertheless, the area of open regions been greatly enlarged and incentives have also been adopted to encourage foreign capital to extend into the fields of high and new technology industries and the tertiary sector, such as real estate, commerce and trade, finance and insurance.

Decentralising Government

In the 1980s, China carried out a programme of administrative decentralisation which shifted economic powers from central to provincial administration and below. In particular, the implementation of a new fiscal system of 'contracted revenue' led to the proportion of central revenue in GNP dropping from 23.3% in 1980 to 17% in 1991 and the share of the central budget in total fiscal revenue dropping from 64% to 48%. The administrative decentralisation has been conducive not only to accelerating the development of some coastal provincial economies, but also to keeping up local enthusiasm for the economic reforms. However, one consequence of administrative decentralisation has been local economic separatism or protectionism. Some examples:

- Local governments have competed to expand the scale of their investment in order to achieve as high a growth rate as possible, regardless of the consequences for the macroeconomy. They have often been sufficiently powerful and influential to be able to instruct the local banks to finance local construction projects by issuing loans, since the banking system has not yet become independent of the government. The propensity to expand, which is inherent in administrative decentralisation, could be the main reason for the high inflation in 1984 and 1988. In 1992 the overheating of the economy was again mainly caused by the expansion of local investment, although the central government took preventative measures, thereby avoiding a new round of high inflation. However, Central Bank Governor Li Guxian was quoted on 1 February 1993 as saying 'By no means will we implement a tight monetary policy.'

Table 4: Foreign Direct Investment by Source, 1979-90 and 1991

Regions	*1979-1990 Contracted investment (US$ billion)*	*share (%)*	*1991 Contracted investment (US$ billion)*	*share (%)*
Hong Kong and Macao	25.06	62.1	7.51	62.6
USA	4.46	11.1	0.54	4.6
Japan	3.10	7.7	0.81	6.8
Taiwan	2.04	5.1	1.39	11.6
Singapore	0.74	1.8	0.15	1.3
UK	0.60	1.5	0.13	1.1
Germany	0.53	1.3	0.56	4.7
Australia	0.30	0.7	0.04	0.4
Canada	0.29	0.7	0.03	0.3
Italy	0.21	0.5	0.02	0.1

250

- The local authorities have usually paid greater attention to short-term benefits. They have been eager to invest in processing industries with a high profit and a quick return on capital rather than in basic industries and infrastructure construction, thus intensifying the imbalance of the industrial structure.
- In the late 1980s, some local authorities introduced local protectionism. In order to develop local industries, they broke off the traditional economic connections between regions in order to protect local markets through reciprocal blockades and other trade barriers. The normal circulation of commodities was obstructed and led to so-called 'Silkworm Cocoon Wars', 'Tea Wars', and so on. The negative effects of this local separatism were severe and have not yet completely disappeared.

Changes in Income and Income Distribution

Living standards have risen rapidly over the past 14 years. Taking 1979 as the base period for per capita income, the income index for 1985 and 1990 at constant prices would be 160.8 and 230.8 respectively.

It is very difficult to do an internationally comparative study of China's per capita income or per capita GNP. World Bank statistics show that China's per capita GNP was US$410 in 1976, but about US$380 in 1990-1991: correspondingly, its current per capita income is lower than it was before 1979, if the figures are expressed in US dollars rather than China's currency, the yuan. However, the yuan depreciation from US$1.7 before 1979 to $6.0 now does not affect domestic incomes in the way it would a small poor export- or debt-dependent developing country. Instead, a rise in income over the past 14 years has been measured through improved consumption, both quantitatively and qualitatively. The index of per capita consumption, taking 1978 as base period 100, was 176.1 for 1985 and 208.4 for 1990; per capita consumption increased at an annual rate of 6.3% during this period. By the end of 1989, the possession of major durable consumer goods by every 100 households in the urban areas was as follows: camera 16.03, tape recorder 66.96, colour TV set 51.47, washing machine 76.21, and refrigerator 36.47. Some scholars outside China estimated that China's per capita annual income at the beginning of the 1990s reached US$1,100, though this might be overstated since China still has 74% of its population living in rural areas where the level of income and consumption is still low, and 9% of its population living in absolute poverty.

During 1978-86, significant economic progress, in particular the rapid growth in the rural economy, led to a reduction in absolute poverty in China. It is estimated that the number of people in absolute poverty decreased from 270 million in 1978 to around 100 million in 1985. However, no further progress in reducing poverty appeared to be achieved during 1986-90. By the end of the 1980s those living in absolute poverty still accounted for 9% of the total population, or almost the same ratio as before. Most of the poor were concentrated in the rural areas (especially in the remote border areas and interior hilly areas); their education and health also remained poor.

The stagnation in alleviating poverty during the period 1985-90 is largely attributable to the rise in prices of agricultural products. This caused the economic status of the poor living in the remote border areas and the hilly interior to deteriorate further since these areas are deficient in resources and most poor people are net purchasers of grain and other subsistence foods.

China's economic reforms and its economic development have also led to some significant changes in income distribution. One source of change has been the dual price system (a co-existence of market pricing and planned pricing). It is estimated that these price differences amounted to 357bn Yuan in 1988, or 30 per cent of national income. Commodity price difference accounted for 150bn Yuan; there were 113.9bn Yuan interest rate differentials between the formal and informal credit markets, and 93bn Yuan differentials between the official exchange rate and the black market rate. Effectively, 30% of national income leaked out from the chinks between the planned price system and the market price system. This leakage has enhanced income inequity and also encouraged corruption.

Initiatives on Poverty

The government is conscious that poverty alleviation lost its momentum in the late 1980s. Under the new Eight Year Plan (1991-8), two major poverty-alleviation initiatives have been introduced: (i) to extend assistance to the poorest of the poor in the worst physical environments and (ii) to integrate production, education, health, family planning and transport programmes into comprehensive packages involving the local governments.

The Regional Department of the State Planning Commission has initiated a Food-for-Work Programme which assists with the building of roads and river transport, irrigation works and other capital construction in the poor areas. All the central ministries and agencies as well as the provincial authorities have their own poverty-alleviation programmes and projects. The Agricultural Bank of China and other banks offer concessional loans for regional developments. In addition, the Ministry of Civil Affairs provides disaster relief and income support. In order to co-ordinate the poverty programmes administered by the various ministries, agencies and local governments, the Leading Group for the Economic Development of Poor Areas was established by the State Council in 1986.

Sustaining Reform

Although China's starting point as the centrally planned economy with the biggest population in the world was unique, in undertaking these economic reforms, China is finding itself confronted by a range of problems and imbalances familiar to other restructuring economies not just in the developing world but also among the OECD countries. Nonetheless, the reforms, when judged against the rapid economic growth they have unleashed, are strikingly successful; there is no convincing evidence yet that they have either overheated or run out of steam.

Dr Huang Fan-zhang worked with ODI staff to compile this Briefing Paper as a William Clark Visiting Fellow. Dr Huang works for the Economic Research Centre of the PRC State Planning Commission; ODI is responsible for the final text.

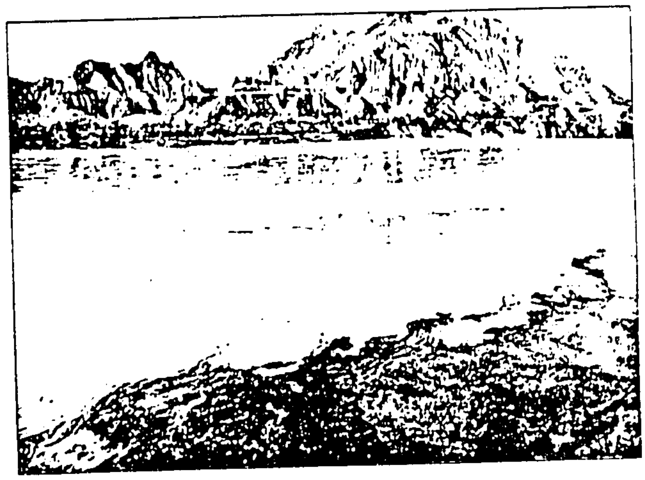
Overseas Development Institute Regent's College Inner Circle Regent's Park London NW1 4NS

283

People&the Planet

Country contrasts 1: China

China's war on waste and pollution



Once thought to be inexhaustible, China's water supplies are falling behind demand as industry and the cities grow and agriculture struggles to keep pace with a population heading towards 1.2 billion.
***Xiong Lei* reports from Beijing on China's response to the problem.**

On 16 February 1993, *The People's Daily*, China's leading national newspaper, carried two news stories highlighting the country's water dilemma.

The front page warned that the water level of the 6,300 km-long Yangtze, one of the three longest rivers in the world, dropped to 20 centimetres below sea level in mid-February at Shashi, in Central China's Hubei Province. It was the lowest water level for 20 years, and threatened to halt navigation on the upper reaches of the river.

The second story revealed that black-headed gulls, which have spent every winter for the past seven years in Kunming, capital of South-west China's Yunnan Province, departed for their annual migration a full three months ahead of schedule. They left abruptly because "they could no longer endure the deteriorating water environment" of Dianchi Lake, their habitat in Kunming, says Professor Wang Zijiang, an ornithologist with Yunnan University. "Fish and shrimps, the birds' principal food, are gone because of pollution."

The Chinese used to describe their water resources as "inexhaustible". No longer.

China has a total surface run-off of 2,700 billion m^3 a year, ranking fifth in the world after Brazil, Canada, the United States and Indonesia. "But actually China is a water-deficient country," says Qu Geping, director of the National Environmental Protection Agency. "Divided by its huge population of 1.17 billion, there accumulates in China each year only 2,500 m^3 of water to each person – which is barely equal to the amount actually consumed by each person annually in the United States."

This per capita water volume ranks China 88th in the world: only one-quarter of the world average.

China is further disadvantaged by an uneven distribution of water resources and rainfall. Surveys show that 62 per cent of China's farmland is located in areas where the annual surface run-off is less than 18 per cent of the total. Also, 85 per cent of the rainfall in North China and 70 per cent in the south falls in the summer, between June and September. As a result many dry areas have to prepare against floods every year.

Left: *The Pearl River at Canton.*
Top: *A polluted section of the Yangtze.*
Above: *Watering by hand in Guangdong province.*

According to Qu Geping, the ideal population size for China's limited water resources is no more than 650 million people. The country's huge population has long outstripped its water balance.

Even though China's per capita water consumption remains low – averaging only about 100 litres a day – the supply still cannot keep pace with growing demand. According to the Ministry of Construction, while China's urban water supply capacity grows 7 per cent annually, the demand goes up by 10 per cent. In 1992, 300 of the country's 479 cities suffered water shortages.

In the countryside, more than 20 million hectares of farmland and 93 million hectares of pastures are thirsting for water. It is a situation made worse by the pressure of people on existing and former wetlands. During

282

the past 40 years, much land was reclaimed from lakes in order to feed an ever-growing population. That cost China 35 billion m³ of freshwater resources. From the early 1950s to the early 1980s, the total lake area shrank 11 per cent; more than 450 lakes vanished completely.

Furthermore, excessive exploitation

of groundwater has resulted in land subsidence and falling groundwater levels in many Chinese cities. In Xi'an, capital of Shaanxi Province, the groundwater table has dropped more than 80 metres in the past 40 years. "Some 80 per cent of the groundwater resources in North China have been exploited," says Wang Weizhong, an official overseeing resource management with the State Science and Technology Commission. "It no longer pays to develop the remaining ones." He adds that the water problem "has become a major restriction on the development of China's economy."

Several large-scale water diversion projects aimed at relieving the thirsts of northern cities like Tianjin, Dalian, Qinhuangdao, Qingdao and Xi'an were built in the 1980s. But Qu describes these as "ways when there was no way out." The water from these projects is very costly in terms of capital construction, says Zhang Linxiang, senior engineer and deputy director of the Department of Water Affairs Administration of the Ministry of Water Resources.

The project to divert water from the Yangtze River in South China to Beijing and other areas in the north will be built. But Qu Geping points out that the project, huge though it is, will still not provide universal coverage. While it is essential to promote family planning and slow population growth to alleviate mounting pressures on water resources, the process is "long and slow", he says. "A more urgent task is to extend resources by reducing waste and pollution."

Since the 1980s, the Chinese parliament has issued 11 laws and decrees on water, including a water law, laws for pollution prevention and control, and for water and soil conservation. Nationwide, more than 400 decrees and regulations dealing with protection of water resources and at the rational consumption of water have been issued by local governments.

In past winters the Ministry of Water Resources would receive about 60 urgent requests seeking emergency help to resolve water disputes between various provinces. "Thanks to the implementation of water laws and decrees, last winter we hardly received any messages like that," claims Zhang. "Meanwhile, losses due to mismanaged water projects have been reduced by 20 to 30 per cent annually."

Beijing's efforts to save water

As a centuries-old capital city, Beijing was once the scene of interweaving rivers and lakes. It was dotted with wells in the Ming Dynasty (1368-1644), and boats shuttled in the canal between the capital and Hangzhou, 1,000 km away in south- east China.

Although urbanization and population growth devoured most of the rivers and wells, Beijing managed to live on its seemingly abundant groundwater resources and never knew a water crisis until the 1980s.

"The worse water famine came in the summer of 1981," recalls Duan Wenjie, chief planner of the Beijing Waterworks Company. "The groundwater level had been dropping one or two metres a year, and there wasn't enough rainfall or other surface runoff to replenish it."

Between 1949 and 1992, Beijing's daily per capita water consumption went up from 28 litres to about 200 litres. Meanwhile, the annual investment in water supply jumped from 125,000 yuan (US$41,700) to more than 200 million yuan (US$35.1 million). But the demand seems to have grown faster.

From the 1981 water famine the local leaders became more aware of the necessity to reduce consumption while extending sources. Wang Mingming, deputy director of the Beijing Municipal Water- Saving Office, says, "We have worked hard to make it known to the public that it is a virtue to treasure water resources and use it economically."

While the city had two more waterworks in 1985 and 1988, decrees and regulations on water saving were issued by the Municipal People's Congress and government, stipulating that all industrial enterprises should recycle their used water, and every household must have a water meter installed.

The decrees and regulations also forced all new projects to have water saving facilities designed, installed and operated simultaneously with the project. An overall plan gives an annual quota for water consumption to each hotel, factory, shop, government office and other work unit.

The city now has more than 200 licensed water inspectors to oversee the implementation of the regulations, Wang says. Those found guilty of wasting water are penalized.

"We also promote water-saving facilities and techniques," says Wang

People & the Planet is a joint publication of the United Nations Population Fund, the World Conserva Union and the International Planned Parenthood Federation. It is published by Planet 21, an inde dent, non-profit, publishing company, in association with a wide range of international organizat which have an interest in various aspects of population, environment and development, and with fun support from the Swedish International Development Authority.

Below left: *Chef with his ducks in the central Chinese city of Chengdu.*
Below right: *New industries are heavy water users: circuit board factory in Shenzhen.*

Mingming. These include nine- and 11-litre tanks for flushing toilets, replacing the old 17-litre ones, water-saving tap washers, air-cooling facilities and computer-controlled car-washing equipment. Municipal government figures show that 82 per cent of water for industrial use was recycled up to 1992, against 46 per cent in 1981.

Duan Wenjie says the waterworks company appreciates what the water-saving office has done. "In one year after its establishment, consumption reduced by 24 million m³. The down-curve was maintained for a few more years and now annual consumption decreases by 10 million m³." ■

Xiong Lei

As people become more conscious of the need to save water, more advanced techniques are introduced. In the past eight years, water-saving irrigation techniques, such as sprinkling and drip irrigation, have been applied to 2.33 million hectares of farmland in North China, improving efficiency by 50 per cent.

But this is only a tiny fraction of the 35 million hectares of irrigated farmland, which consumes about 400 billion m^3 of water a year. Due to seepage and other defects, more than half the water is lost. For every kilogramme of wheat, 40 per cent more water is used in China than in advanced countries.

The industrial sector also promises great potential savings in water use. China's industry consumes 26 billion m³ of water annually, of which only 45 per cent is recycled. "Our water consumption is unreasonably high compared with more developed countries," says Chai Wenzhong, an engineer with the Ministry of Construction. "For every ton of steel we use 20 m³ more of water, and for every ton of paper, we use 200 m³ more."

"By recycling another 15 per cent of water in industrial use, 5.25 billion m³ can be saved annually," adds Chai.

Zhang Linxiang points to Beijing's outstanding example. "In the past 10 years the city's industrial output value more than tripled, but its industries' water consumption did not go up. That is encouraging."

Much water can also be saved by pollution control, insists Qu Geping, "but it is more difficult". Every year some 60 billion m³ of industrial wastes and urban sewage are discharged throughout the country. Although 63 per cent of the 30 billion m^3 of industrial waste water is treated before discharge, the disposal is carried out in a scattered way at individual factories rather than concentrated efficiently at central treatment plants.

And even where some treatment has taken place, the disposed wastes still pose a serious pollution threat. "Almost every city is surrounded by a polluted river," observes Zhang Linxiang. "While the surface water in urban areas has been severely contaminated, the groundwater in a number of cities is also polluted to varying degrees."

Qu Geping thinks a total investment of 100 billion yuan (US $17.54 billion) would be needed to build two-stage treatment facilities for all the waste water. "That is far beyond the state's financial means," he adds. But if the percentage of treated sewage is raised from less than 10 per cent at present to 20 per cent, some 3.5 billion m³ of water could be recycled for use by Chinese cities every year.

At present only 40 out of nearly 500 cities have two-stage sewage treatment plants in operation. But more and more cities are seeing the economic benefits of doing so and are building their own treatment plants.

While emphasizing the need for two-stage sewage treatment in urban areas, Qu thinks it is more important to reduce industrial wastes by updating technology. "Most industrial enterprises are still using equipment and technology of the 1950s and 1960s, which produce too much waste," insists Qu. "This cannot go on."

Although China's water situation is grim, it is not hopeless. "People of some developed areas in South China are increasingly conscious of their environment and have the economic strength to ensure co-ordinated social and ecological development," concludes Qu.

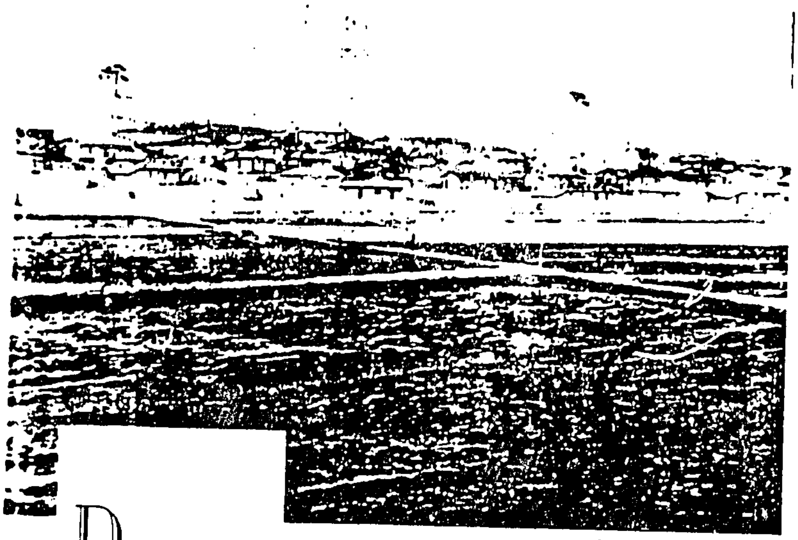
Experts foresee that by the year 2000 about half of China's increased water supply will have to come from various water conservation measures. "While money remains a problem, we can try to alleviate the water stresses by promoting new technologies," says Wang Weizhong. "We also look forward to more international exchanges in this field." ■

Xiong Lei is a journalist working for China Features in Beijing.

CHOICES

THE HUMAN DEVELOPMENT MAGAZINE

VOL.2, NO. 2



The Tumen River Delta area today (above) and plans for the future (right)

Development of the Tumen River Delta area could bring huge economic rewards to countries in the region. But what will it take to turn this bold plan into reality?

A Field of Dreams In Northeast Asia

By Holly Ornstein Carter

Beijing – It would be hard to find more unlikely partners if you wanted to start a corporation. Their resumes read: little experience with capitalism, historic mistrust of one another, financially unstable.

Despite these shaky credentials, China, Russia and North Korea have begun working together, under the leadership of the United Nations Development Programme (UNDP), to create a sub-Siberian Hong Kong in a remote corner of northeast Asia. The unusual alliance has also brought collaboration from South Korea and Mongolia, and the interest of Japan, all of which stand to benefit if the plan realizes its goal: to transform the Tumen River Delta area – where the borders of China, Russia and North Korea meet – into a major international shipping, trading and manufacturing zone.

Carved out of the three countries, the economic zone would be managed much the same way as a corporation, with each of the partners collecting fees from jointly-run power plants, railway systems and shipping facilities.

"We can show the world that political barriers can be lowered for economic development," says UNDP programme manager John Whalen, "and that economic development can be the new world order."

In the process, the Tumen River Area Development Programme (TRADP) could serve as an instructive blueprint for other parts of the world where economic cooperation could help countries overcome both underdevelopment and political strife.

Expected to cost billions over the next 20 years, the initial cooperative zone, which spans 1,000 square kilometres, would get a vast port complex, roads, a telecommunications network, a new urban centre and an airport. The plan also envisions a transcontinental railway system stretching 10,000 kilometres from the port area to major markets in Europe, which is of special interest to the Japanese.

The potential of a new Asian gateway for global trade is clear to just about everyone. The development would offer easy access and improved transportation links to major markets in the industrialized Chinese provinces of Jilin and Heilong-Jang, as well as to the minerals, oil, coal, timber and other natural resources found in Russia, North Korea and Mongolia. Processed and manufactured goods and even cereal grains are prospective exports.

On the map the Tumen is at the centre of northeast Asia. But standing on the banks of this shallow river it is hard to imagine being at the centre of anything. It is even harder, perhaps, to see this thinly populated delta area, surrounded by mountains, mud huts and rice fields, as a booming metropolis of 500,000 people, which is what planners have in mind. For now, the picture is one of timeless calm, with villagers tending their fields, storks flocking to tidal estuaries, old trucks bumping along unpaved roads and leaky boats docked in quiet ports.

Frozen in time by communism, this part of the world has suddenly come to life with talk of increased economic activity and capitalism. But to many, the venture means entering new and uncharted territory. "When you talk about 'CEOs' and 'corporations' many people here don't understand," says Herbert Levin, a special adviser to the United Nations who attended an October meeting of the six countries in Beijing.

Even the Chinese, with experience in land-leasing and special economic zones, are somewhat intimidated by so much talk of capitalism. "Legal and financial terms need clarification because we are not familiar with them," says Chinese team leader Long Yongtu. "We need to learn the rules of international trade. But no matter what the future outcome, the lessons China and other countries are learning are invaluable to their growth and integration into the global economy."

The goals of the Tumen River plan are as impressive as they are ambitious. But daunting challenges lie ahead, including vast sums of required capital, a lack of inhabitants and infrastructure in the area, and the risks to a pristine environment, which is home to many rare and endangered species including the Amur leopard, the black stork and the Mandarin duck.

Originating in the forests of the Long White Mountains (Changbai Shan) on the border of China and North Korea, the Tumen stretches 516 kilometres through North Korea, past Hunchun in northeast China, and empties into the Sea of Japan. Most of the Tumen marks the eastern border between China and North Korea, but the last 15 kilometres form the border between Russia and North Korea. In 1860, China lost access to the Sea of Japan as the result of the Peking treaty with Russia. The Chinese are anxious to regain access to it, and stand to, once the plan comes to fruition.

Sceptics are quick to point out the development's hefty cost, and say that it is too ambitious for the times. "The capital is too much and the area's resources too few," says John Seel, a Korean scholar who recently toured the proposed economic zone. "The roads are awful, there are few cars, and it's really dead." He asks, "How do you develop a Rotterdam when there are no people?"

But even the boldest of plans start with a single step, and in the case of TRADP that step was taken at a 1990 meeting in Changchun, China, co-sponsored by UNDP, where different strategies for developing Northeast Asia were brought to the table. However the real beginning of inter-governmental cooperation took place in Ulaanbaatar in July 1991, when China, both Koreas and Mongolia agreed that the plan was in their common interest. UNDP was asked to serve as a neutral catalyst. Later that year, North Korea, China and Russia agreed in principle to leasing the necessary 1,000 square kilometres needed for the development area.

While most of the activity will take place in the immediate economic zone (called the Tumen River Economic Zone – TREZ), which links Rajin in North Korea, Hunchun in China and Posyet in Russia, it is anticipated that development will also occur in a larger geographical area, reaching the cities of Vladivostok, Chongjin and Yanji.

The goals of the Tumen River plan are as impressive as they are ambitious. But daunting challenges lie ahead, including vast sums of required capital, a lack of inhabitants and infrastructure in the area, and the risks to a pristine environment.

Despite political differences, members of the initiative's Programme Management Committee (China, Russia, North Korea, South Korea, Mongolia, and Japan as an observer) realize that cooperative development can only fuel their economies. "The project will result in a better quality of life, more goods, more jobs and greater contact with the outside world," says K.G. Singh, UNDP's regional director for Asia and the Pacific.

Along with regaining access to the Sea of Japan, China hopes to stimulate economic development in its northeast area.

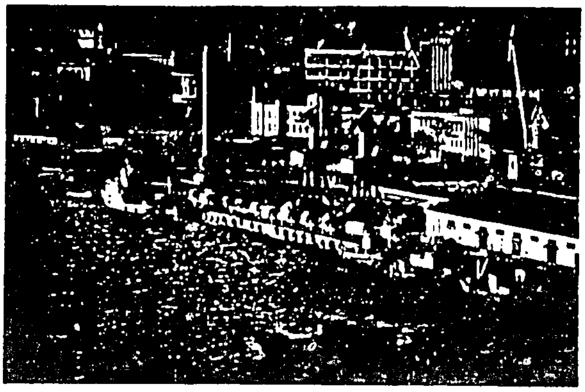
While it has had success so far with special economic zones – like Guangdong across from Hong Kong – China eagerly seeks growth and technology and is anxious for foreign investment.

Russian officials, initially worried that the cooperative venture might detract from their own free trade zone in Vladivostok, now believe that TRADP will complement rather than compete, and that the development will increase business in other Russian ports like Posyet and Nakhodka.

The North Koreans, faced with critical shortages of food, fuel and hard currency, are even more anxious for new economic opportunities to attract trade and foreign capital.

North Korea recently passed a law allowing for the development of economic and free trade zones in Chongjin, Rajin and Sonbong. But outsiders are still wary, especially when North Korea has over $6 billion in foreign debt. The multinational Tumen cooperation could help North Korea obtain an important basis with which to attract foreign money.

For Mongolia, a land-locked and geographically isolated country, TRADP could help end its foreign exchange shortage by providing an important transport corridor for growing Euro-Asian trade.



North Korea's port at Chongjin is part of the wider geographical area that would benefit from theTumen development.

"My people will benefit by a connection with northeast Asian countries, the Republic of Korea, Japan and the United States," says Rentsengiin Batmend, a senior official and head of the Mongolian national team. "We face shortages of consumer goods and foreign currency, and this would help us earn more money."

Finally South Korea and Japan are attracted by potential new rail routes to Europe, and by better access to resource-rich Siberia and Mongolia and the cheap labour available there.

As for raising the necessary capital, there has been only tepid response from big money sources so far. Among the six countries involved, only two poss s relative strength in capital and technology – Japan and South Korea – and they have yet to make any firm financial commitments.

Despite the large benefits to be gained, Japan is reluctant to foot the bill for economic reasons. Russia and North Korea do not enjoy high credit ratings in the investment markets. Moreover, unresolved political issues between Japan and both countries have overshadowed economic partnership.

South Korea is keen on increased cooperation with its northern neighbour, but is a bit wary of the expense. "We are eager to promote progress in TRADP," says Tae Yon Kim, South Korea's team leader and assistant minister for international policy coordination. "But South Korea cannot finance the whole or even a majority of that cost."

China, however, whose economy is booming, has agreed to invest more than $100 million to extend a railway it is building in the area into Russia, with the idea of creating a link to the Trans-Siberian railroad.

While the financing issue has yet to be resolved, TRADP planners are convinced the idea will see the light of day. The question is one of scale and timing, says Herbert Behrstock, chief of the East Asia and Pacific division at UNDP.

Still, its size and complexity make some question its feasibility. "Multinational deals are almost impossible to administer," says a Western diplomat who watches the Tumen River Area Development Programme for his government. "Take the Saint Lawrence Seaway project in Canada (a facility jointly operated by the United States and Canada) as an example. Look at the original claims of how it would improve lives, but it has been a huge failure and cost $8 billion. The UNDP project is even more difficult."

Indeed, naysayers are quick to point to the difficulties that lie ahead. But the programme's potential for success must also be measured in relation to where these countries were two years ago and what has already happened. When TRADP was conceived in 1991, South Korea and China had no relations, Mongolia was still communist, North Korea had not opened at all and neither Koreas had yet joined the United Nations.

In the last two years national teams from the six-member countries have met formally twice, once in February 1992 in Seoul and again in Beijing last October. UNDP has committed $3.5 million for feasibility studies and the Finnish government has recently provided $1 million specifically for forestry research and for studying a land bridge concept to Europe.

The next crucial step will be completing a number of studies now under way and confirming government interest to proceed. Investment would then be sought from multinational banks and corporations, bilateral aid agencies and private banks.

"We are now drafting an investment prospectus and finalizing international agreements," says Mr. Whalen, the UNDP programme manager. "We are also contacting potential investors and preparing master plans for transportation and telecommunications development." To improve communications, UNDP is planning a microwave-fiberoptic telecommunications system in the area.

As TRADP moves from the theoretical to the practical, more attention is being placed on the environment. Long decades of isolation have preserved the area's untouched beauty and abundant wildlife. With prodding from the Russian delegates, the environmental issue, a major concern of UNDP in all its programmes, has become firmly etched into the agenda.

"Environmental studies should be done before Greenpeace takes out a full-page advertisement in *The New York Times* saying, 'Stop the Tumen development before it destroys the last wilderness frontier,'" warns Mr. Levin.

Overall a lot of work remains. But while the visionaries continue to dream and the sceptics continue to doubt, the process has already contributed to peace and cooperation in this unimposing corner of Asia.

To critics who see TRADP as too ambitious for what is now a sleepy area, Mr Whalen reminds us that "when Hong Kong was to be established by the British, Lord Palmerston, the foreign minister, said: 'Why do we need this barren rock?'" ■

Holly Ornstein Carter is a freelance journalist based in Seoul.

281

The Challenge of Indochina: An Examination of the U.S. Role

Congressional Staff Conference

April 30 - May 2, 1993
Conference Report

Dick Clark, Director

The Aspen Institute
Vol. 8, No. 4

The Persistence of a Bitter Past: Impediments to U.S.-Vietnam Normalization

Frederick Z. Brown

Director, Southeast Asian Studies, School of Advanced International Studies, Johns Hopkins University

Clearly, the prime impediment to normalization remains a satisfactory resolution of the fate of American servicemen missing in Southeast Asia, the neuralgic POW/MIA issue. The Clinton administration inherited the Bush administration's 1991 "road map" specifying the reciprocal steps that would have to be followed in the normalization process, including conditions that Vietnam would have to fulfill. After the POW/MIA issue, the road map's principle condition was continued Vietnamese cooperation on the Cambodia peace process (see appendix).

Until April 12, 1993, there had been slow but steady progress thanks to joint field operations—22 by the latest count, in many regions of the country—Vietnamese and American search teams. While not yielding spectacular results in terms of artifacts, remains, or information, these operations were indicative of Vietnam's seriousness of purpose and significant commitment of resources. Moreover, the U.S. Senate Select Committee on POW/MIA Affairs report, issued January 13, 1993, stated, "There is no compelling evidence that proves that any American remains alive in captivity in Southeast Asia." The report was generally complimentary concerning Vietnam's recent cooperation.

The decision in October 1992 to allow U.S. investigators to examine the war archives of Vietnam's Ministry of Defense for evidence on the fate of American servicemen was, it seemed, a major breakthrough. In December 1992, the Bush Administration responded by partially lifting the economic embargo by allowing American companies to sign contracts on prospective commercial ventures—but not to implement them—and to perform certain other acts helpful in promoting the companies' commercial position vis a vis their foreign competitors.

Rumors abounded that President Bush, in the waning days of his administration, would take further steps toward normalization, perhaps even lift the embargo entirely and agree to embassies in Hanoi and Washington. This hope proved vain. The Vietnamese, for whatever reason, had not chosen to go the last mile in providing information on the remaining one hundred or so "last know alive" cases that might have precipitated a favorable decision. But even had they done so, given the bitterness of the election campaign and Mr. Clinton's position regarding the Vietnam War, the outgoing Republicans would probably not have chosen to spare the incoming Administration the political pain of dealing with this delicate issue. No one was actually pointing the finger at who had gotten the United States into the Vietnam mess (was it Truman or was it Eisenhower?) but one thing was sure: Clinton, not Bush, would have to make peace with Hanoi and to declare that the POW/MIA issue was finally resolved—and to take the political heat.

The Clinton Administration had been slow to pick up the Vietnam issue, partly because of its sensitivity and partly because of pressing foreign policy problems elsewhere—Bosnia, Somalia, Russia. On March 22, Secretary of State Warren Christopher noted the "strong business incentives" and said the United States was ready to move ahead "as soon as they [the Vietnamese] are forthcoming on the MIA issue...that is the only thing stopping us from lifting our sanctions." On March 31, in his hearing before the Senate Foreign Relations Committee, Assistant Secretary for East Asia and the Pacific Winston Lord elaborated on this theme:

> We are taking an especially close look at our policy in Vietnam. Let me emphasize that obtaining the fullest possible accounting for Americans missing from the Vietnam War, including those lost in Laos and Cambodia, will remain a central objective. . .
>
> Looking to the future, Vietnam, a rapidly-growing country of 70 million, the fourth largest in East Asia, can play an important political and economic role. If the necessary groundwork is laid we can strengthen regional stability. . .
>
> On the economic side, Vietnam has undertaken market reforms, opening up promising vistas for trade and investment . . . At the same time, Vietnam continues under a repressive Communist political system. There are scant traces of freedom. As we seek to normalize relations, the intensity and warmth of our ties will depend on progress in this area . . .

Over the next two weeks this line hardened. White House spokesman George Stephanopoulos retreated into language making clear that no progress would be made without a full accounting of MIAs (there was no elucidation as to what "full" meant); the potential positive side of U.S.-Vietnam relations was downplayed.

BOMBSHELL

On April 12, 1993, *The New York Times* reported the discovery of a document purportedly detailing a 1972 briefing on American POWs to North Vietnam's Politburo by General Tran Van Quang. The Russian-language document was found in January 1993 in the files of the Soviet Communist Party by Harvard University researcher Stephen Morris. According to the document, which was a translation from the Vietnamese, Vietnam held 614 more American POWs than were released in "Operation Homecoming" in January 1973 as part of the Paris Accords ending active U.S. involvement in the Vietnam War. Morris had discussed the Russian-language version of the document with former National Security Advisor Zbigniew Brzezinski, who arranged for him to brief NSC officials in mid-February. President Clinton was briefed on the report before his meeting April 3 with Russian President Yeltsin in Vancouver.

The White House did not receive a copy until April 8, when Ambassador Malcolm Toon (the president's liaison with Moscow for POW/MIA affairs) requested the Russian text, and the document's existence was not revealed before the *Times* broke the story from Moscow on April 12. The initial U.S. reaction was to reiterate the requirement for full resolution of the POW/MIA issue, including of course determination of the truth or falseness of the alleged Quang report, before there could be further consideration of normalization. On April 18, retired General John W. Vessey, Jr., the president's special emissary for humanitarian affairs, arrived in Hanoi with a party of 18 U.S. officials to discuss the matter with ranking Vietnamese officials.

At a Hanoi press conference on April 19, General Vessey said: "I don't think one can draw conclusions about the document based simply on General Quang's statement . . . What General Quang told us is not inconsistent with what we know about him and I have no reason to disbelieve General Quang."

Asked if he had more doubts about the document than he had when he came to Hanoi to find out whether it was genuine, General Vessey replied simply: "Yes."

Whatever the past history of the POW/MIA issue, the alleged Quang report must be thoroughly investigated and a determination made as to its authenticity and its accuracy. If proven authentic and accurate, the impact of the report will postpone indefinitely lifting the embargo and establishment

2.5

of relations. Even if the Clinton administration declares unequivocally that the Quang document is a fabrication, a host of questions will have to be answered (Who created the document? Why? When? What other relevant documents are there in the KGB or GRU's files?) before the matter can be laid to rest.

The answers to these questions will determine if and when Washington will agree to make good on the final step of Phase II of the 1991 road map: "To work with others to help Vietnam eliminate arrears to International Financial Institutions."

CAMBODIA—STILL A PROBLEM?

With the signing of the October 1991 Paris Agreements and Vietnam's cooperation in implementing the settlement over the past 18 months, the Vietnamese would appear to have satisfied one major U.S. condition for normalization.

During 1992, Hanoi had been partially rewarded for its cooperation in the form of reestablished telephone communications between Vietnam and the United States. This move benefitted the Vietnamese-American community and their families in Vietnam, and of course AT&T. In March 1993, the Clinton administration's Interagency Group on Vietnam policy (Departments of State, Defense, Treasury, Commerce, CIA) began to discuss whether Vietnam had indeed complied with the road map's requirements regarding Cambodia. The deteriorating situation in Cambodia, with violence increasing and the Khmer Rouge threatening to disrupt the May elections, was deemed not to be the fault of Vietnam.

Unless there is a massive breakdown of the peace process that causes Vietnamese unilateral intervention, or unless the Vietnamese can be held directly responsible for the malfeasance of the Phnom Penh regime (over which they are deemed to have some influence), the Cambodia question would seem to have been removed as a roadblock.

THE EMBARGO, THE IFI's, AND THE ROAD MAP

Since 1975 Vietnam has been subject to a comprehensive schedule of U.S. sanctions, including a prohibition on commercial and financial transactions and private investment in Vietnam. Vietnamese assets in the United States, about $250 million with accrued interest, are frozen. As described above, Washington relaxed several aspects of the embargo in 1992 but key features remain in place and are causing severe handicaps for American businesses.

Commercial opportunities for U.S. corporations in Vietnam exist in the aircraft industry, petroleum, electronics, communications and information, tourism, banking, agribusiness, shipping, and insurance. As yet, these opportunities cannot be realized. On November 6, 1992, Japan announced that it would grant a $360 million official development assistance (ODA) loan to Vietnam. For bilateral political reasons, Japan had kept faith with the U.S. embargo in terms of ODA. Although still concerned over a possible adverse U.S. reaction, Japan nonetheless feels less constrained. The ODA is expected to reach Vietnam during 1993; it is repayable over 30 years at 1 percent interest rate. Six Japanese banks have agreed to provide bridge loans to permit Vietnam to repay its outstanding debt of $180 million from pre-1978 loans.

By all odds the most damaging aspect of U.S. policy has been, and remains, blocking of loans from the World Bank, the International Monetary Fund, the Asian Development Bank, and other international financial institutions (IFI). Although Vietnam has developed lively trade relations with the outside world, because of the blockage of IFI loans, major foreign investment has lagged and the country's infrastructure development remains stymied.

At this writing we cannot forecast what will happen in the IMF and World Bank meetings to be held at the end of April. Certainly, the Clinton administration's conclusions on the Quang document will weigh heavily in these deliberations.

DEMOCRACY AND HUMAN RIGHTS

Regardless of how quickly the latest impediment of the Quang document can be removed, normalization will not be a magical moment achieved by the stroke of a pen. The United States has never had "normal" relations with any government of Vietnam or with the Vietnamese people, either North or South. The United States was at war with half of Vietnam for the first 20 years of that country's

2 \

independence from France, 1954 to 1973. Mutual hostility has endured for another long period. In this context, what does "normal" really mean? What is certain is that normalization is a process, not a fixed destination. An intelligent relationship will take years to build even with the best of intentions.

Nowhere is this more evident than in certain issues that were on the horizon several years ago but now loom large in anticipation of a "new U.S.-Vietnam relationship."

While economic change proceeds in Vietnam, political change lags. Hanoi faces the dilemma of other Marxist regimes in the throes of readjustment: how to gain economic salvation without losing political control. At the seventh congress of the Vietnamese Communist Party in July 1991 and in the new constitution of the Socialist Republic of Vietnam, adopted in April 1992, the principle of "democratic centralism" and the leading role of the Party as "the force leading the State and society" were reaffirmed. The Party explicitly rejected the concept of political pluralism. Despite democratic stirring within its own ranks and in the population at large, the party today denounces political change outside the boundaries of the Party as a mortal threat. "Stability" during difficult times is imperative and "peaceful evolution," that is, fundamental social change that takes place without the sanction of the party, is dangerous and intolerable.

Although the enhanced powers of the elected National Assembly under the 1992 constitution provide some hope for a more representative system, all candidates must still be vetted by the Communist Party's "mass organizations." In Vietnam today there seems to be wide latitude in private expression of opinion. The news media, which are firmly controlled by the state, may vigorously criticize corruption and inefficiency but may not challenge the primacy of the Party or seriously question government policies.

The regime's internal security apparatus is as ubiquitous as ever. Amnesty International reports that more than 100 former soldiers and officials of the previous South Vietnamese regime remain held without trial in reeducation camps. Arrests for expression of political dissent regularly take place. As of December 1991, more than 80 prisoners of conscience, including Buddhist and Catholic leaders, were incarcerated.[1]

The fate of communist governments in Eastern Europe astonished and shook the Party. In the face of widespread popular cynicism and internal pressures, many of which stem directly from economic liberalization and the increased flow of information into Vietnamese society, the Hanoi Politburo is seeking a Vietnamese solution that avoids both the disaster of Tiananmen Square and the turmoil that has plagued the former Soviet Union. The leadership cites the experience of Singapore, South Korea, Taiwan, and Indonesia, pointing out that authoritarianism is essential to provide the political stability for economic development. These countries, Hanoi claims, have done extremely well economically without political freedom. Nonetheless, the question still is: Can Vietnam ever achieve genuine economic progress in the absence of considerably greater openness in the political realm than it now permits?

U.S. POLICY

Vietnam will move at its own pace away from the current Leninist system toward a peculiarly Vietnamese version of what Robert Scalapino calls "soft authoritarianism," an amalgam of socialism and free market economics kept in place by a structured political system that maximizes economic development and only gradually admits the existence of more than one party. The models of Indonesia and Singapore are frequently cited.

How can the United States hasten the demise of Leninism? What degree of respect for human rights on the part of the Vietnamese government should we realistically expect, and in what timeframe? What is the most effective way to promote values we hold to be universal? For many Americans, particularly those with deep connections to Vietnam, these questions are not easily contemplated.

Democracy and human rights were prominent features of the Bush administration yet were handled selectively and according to realpolitik policy requirements in specific bilateral circumstances. Continued Most Favored Nation (MFN) trading status for the People's Republic of China was justified in terms of using the free market and trade relations to fuel China's burgeoning economic development on the presumption that liberalization in politics would eventually follow. By withdrawing MFN, the United States would hurt the very forces advocating changes in the political sphere, so went the argument. On human rights, the Bush administration applied measured pressure on specific cases to gain Chinese cooperation, playing "good cop" to the potential strong measures of Congress, the "bad cop." By and large, this strategy has proved moderately successful.

On *humanitarian issues*, the Reagan and Bush administrations tested Hanoi early and gained good cooperation concerning Amerasian children, the Orderly Departure Program, emigration for former reeducation camp inmates, and repatriation of boat people without prejudice. These programs have worked well and are scheduled to conclude in the near future. The Bush administration was able to limit *political* conditionality in normalization to the issues of Cambodia and progress on POW/MIAs (the latter was disguised as humanitarian to suit the requirements of *both* Hanoi and Washington). Concerns about democratization and human rights were readily apparent but were kept low key.

For the Clinton administration, the issues of human rights and democratization are assuming a far more prominent profile. Normalization with Vietnam is likely to be affected more profoundly.

Two schools of thought have debated the appropriate strategy toward a Hanoi regime that in many respects remains stubbornly Leninist. One, which might be dubbed Let-them-stew-in-their-own-juice, sees no advantage in establishing a relationship with Vietnam's current leadership. It holds that U.S. interests are best served by prolonging Vietnam's economic mess and awaiting an Eastern European-style upheaval, causing the downfall of communism. The longer the embargo stays in place, the better. This school is represented by Claudia Rosett, who writes in the *Wall Street Journal* that "American aid and respect would be only likely to retard Vietnam's progress by helping prop up a party that—like China's—has been forced by its own gross economic failures and the collapse of Moscow's aid to resort to unleashing its markets."[2]

U.S. Senator Bob Kerrey, who won the Congressional Medal of Honor for service in Vietnam, goes further. He argues against any relaxation of the embargo even should the POW/MIA issue be satisfactorily resolved. Citing the "universal truth" of certain values held by the United States, Senator Kerrey maintains that "our price for normalization should be freedom for the people of Vietnam. Political freedom (speech, religion, travel) is a glaring omission from the so-called U.S. "road map" which is the declared basis for moving toward normal diplomatic and trade relations between our two countries."[3]

The contrary school of thought rejects these arguments and holds that normalization is in fact the best means to promote changes the United States advocates globally as a matter of principle: pluralism, respect for human rights, market economics, and civil freedoms in general. The theory maintains that Vietnam cannot remain immune to the winds of social change sweeping the world. Normalization, by opening up Vietnam to outside influence, will help nature take its course. The full lifting of the U.S. embargo on trade and investment and the infusion of capital from international financial institutions plus bilateral economic assistance programs from Japan and other international donors already in the pipeline, will have a major impact on Vietnam. Both schools deserve critical examination. This writer will make the case for only one perspective, however: that normalization is the best way to promote the demise of Leninism in Vietnam.

Initially, the economic benefits of normalization may well create the economic stability the Hanoi regime feels it needs in order to maintain political control. The evidence since 1986 suggests that as long as economic reforms bring benefits, as they have so far, the Vietnamese people may be willing to accept political limitations. Yet this passivity belies the political frustration beneath the surface and the pervasive sense that the Communist Party no longer enjoys the "mantle of Heaven." Over the longer term, as Vietnam's society modernizes, receives information, and joins the outside world, popular attitudes are certain to change, just as they are changing elsewhere in Asia. The fears of the Marxist are indeed well-founded: political and economic change cannot be separated forever. The FAX, the Xerox machine, the computer, and the erosion of ideology by science, education, cultural exchange, and the marketplace—these facts of modern life make "peaceful evolution" in Vietnam inevitable, initially to a softer authoritarianism and later to a more sophisticated participatory system of governance.

294

By demanding acceptance of the American perspective on human and civil rights as a precondition for diplomatic and economic relations, the United States may actually retard the progress of the very values and institutions it seeks to advance. The Vietnamese people are energetic and endowed with a strong spirit of independence; over time, they are capable of designing by consensus their own political system. Given Vietnam's tortured history, this can only be a complex, lengthy process. The "soft authoritarianism" that results will not be Jeffersonian democracy, but neither will it be the joyful (and sometimes violent) confusion of Philippine democracy. The Clinton administration should make clear American values: respect for human rights, guarantees of civil freedoms, and a belief in participatory government and political pluralism as the *real* fundaments of stability.

All these factors considered, it would be shortsighted and hostile to our own national interests to make Vietnamese acceptance of these values and institutions the precondition for diplomatic and trade relations. The United States should be prepared to see the Vietnamese people conduct their political evolution themselves. There may be ways to help—but we should not attempt to guide or direct. Above all, we should abstain from the rhetorical "feel-good" flourishes that recall previous failed attempts to dictate the politics of Vietnam.

NOTES

1 For names of prisoners and other details see *Amnesty International Report 1992* (New York: Amnesty International USA, January 1992), p. 274.

2 "Don't Normalize Ties With Vietnam," *Wall Street Journal*, April 17, 1992.

3 "Updated Statement Regarding Vietnam's Release of Photographs of American Prisoners," press release from Senator Kerrey's office, October 23, 1992.

Malaysia: The Next NIC?

by Donald R. Snodgrass

Rapid economic growth and export-oriented industrialization in East and Southeast Asia seem likely to spawn more NICs in the coming decade. Malaysia is best positioned to attain NIC status, with Thailand coming up fast from behind.

East and Southeast Asia have led the world in economic growth since 1970. Eight of the ten fastest-growing economies in that period were from this region, including the four famous Little Dragons: Taiwan, South Korea, Hong Kong and Singapore. Coming up fast from further behind were Malaysia, Thailand, Indonesia and the Big Dragon, China. In 1988-92, foreign investment projects valued at more than $100 billion were approved in Malaysia, Thailand and Indonesia. The new capital brings with it new products, technologies and skill requirements. Labor is also on the move in the region, flowing from lagging countries to more advanced nations feeling the pinch of labor shortage.

Will these processes lead to the creation of new Newly Industrialized Countries (NICs)? While a minority view has it that there can be no more NICs, most observers believe that several Asian countries will be able to follow – more or less, allowing for changes in the world environment – in the footsteps of the Little Dragons.

If this is correct, who will be the next NIC? Malaysia should be considered the favorite in this race because it has reached the highest level of per capita income, has established a strong record of economic growth over the past 25 years and is doing most of the things necessary to become a NIC. Over the last five years, the Malaysian economy has grown at an average of 9 percent per annum. Nevertheless, some observers pick Thailand (the poorer but even faster growing second favorite) or even Indonesia or China, currently far back in the pack but larger and moving fast as well.

Answers to a few short questions should solidify the case. First, what do we mean by a NIC, anyway? Second, how close to qualifying are Malaysia and its rivals? Third, is it still possible to become a NIC in today's world? Finally, and most importantly, what will the aspirants have to do to become NICs?

What is a NIC? While many definitions and criteria have been suggested, we can pin down the concept by defining a NIC as an economy that has attained, largely through industrialization, a favorable enough combination of per capita income and growth to justify the expectation that it will become a developed, high-income country within two decades. (The figure is arbitrary but seems to conform to past practice.) The World Bank currently defines a high-income economy as one in which GNP per capita exceeded $7,620 in 1990. Twenty-five economies made the grade in 1990 (including Taiwan, which is omitted from World Bank statistics), but only a handful of them, including three of the Little Dragons, had joined that select group over the past 25 years. The fourth Dragon, South Korea, was at $5,400 per capita in 1990 and will cross the line in this decade. The only other middle-income country that qualifies as a NIC on this definition is Greece.

Malaysia should qualify as a NIC . . . by 2000.

My definition ignores national scale, which would have to be taken into account if we were primarily interested in a country's impact on world trade. A large nation like China or, to a lesser extent, Indonesia can be a major factor in world trade long before it becomes a NIC. Recent performance suggests that China could become the dominant Asian economy in the 21st Century, but that will occur in the more distant future.

Next in line. How close are Malaysia and other second-tier economies to becoming NICs? Based on 1990 income levels and average 1965-90 growth rates for per capita income, Malaysia was 31 years away from becoming a high income economy in 1990 while Thailand was 40 years away. Outside the Asia-Pacific region, Portugal had 15 years to go, Brazil 33 years and Mexico 41 years. Accelerated growth rates after 1990 could shorten those periods. Malaysia and Thailand substantially exceeded their long-term average growth rates in 1987-92, but they probably cannot maintain 9-10 percent growth for three decades. Still, Malaysia should qualify as a NIC by my definition by 2000 and could well become a developed country by 2020 in line with a national goal set in 1991. Thailand should become a NIC early in the next century.

Malaysia and Thailand have depended heavily on expansion of manufactured exports to achieve their recent high growth rates. Replacing primary commodities such as rubber and tin in Malaysia and rice in Thailand, manufactures have soared to 60 percent of gross merchandise exports in Malaysia and 75 percent in Thailand. Since most of these products are made in factories owned by multinational corporations, development is also heavily dependent on foreign investment.

Concern over protectionism. Is this pattern of development sustainable? Whether the world environment will be as supportive of these trade and investment flows in the future as it has been in the past is a major concern in these countries. Increasing protection in developed country markets and the formation of trading blocs, especially those such as NAFTA that include other would-be NICs (Mexico and potentially other Latin American countries), worry them. Growing competition from lower-wage countries forces them to seek new sources of competitiveness.

Yet there are also promising developments. Successful negotiation of the Uruguay Round would benefit the ASEAN economies significantly. Trade within the Asia-Pacific region has grown rapidly, fed by structural changes that have led to large intra-regional capital flows. At least up to the recent onset of recession in Japan, the Asian-Pacific countries have been able to maintain high growth rates while the rest of the world was in slump. This has reduced their dependence on North American and European markets. Finally, ASEAN countries have recently agreed to staged reductions in intra-group trade barriers and ASEAN itself is likely to expand to bring in Vietnam and perhaps other countries in the near future. This should encourage growth in intra-ASEAN trade, hitherto limited. On balance, and despite unceasing worries, growth through international trade and investment is likely to remain possible for these countries.

How to become a NIC. What must they do to take advantage of these opportunities and become NICs? At one level, the answer is simple: They must continue to industrialize and successfully export manufactures. East Asian experience shows export orientation to be important both for transcending market size limitations (a critical point for the smaller countries) and for achieving competitive efficiency. How to do these things, however, is a complex matter.

Should would-be NICs emulate their predecessors? The literature on how the Little Dragons,

Whether the world environment will be as supportive of these trade and investment flows in the future . . . is a major concern.

and Japan before them, did it expands daily and almost exponentially. Among the posited causes – surely interrelated in complex ways – are: value systems that stress respect for authority, hard work, emphasis on education and future-orientation; high savings rates; impressive human resource development; and social homogeneity. The role of the government in guiding private producers – in "governing the market," as one widely-read work puts it – is a final much-debated issue.

Southeast Asian countries have not been slow to seek lessons in East Asian experience. Malaysia, for example, inaugurated a much-discussed "Look East Policy" in 1982. But there are three important differences between East and Southeast Asian societies.

First, while East Asian countries and the Southeast Asian city-state of Singapore have virtually no natural resources, Malaysia, Thailand and Indonesia can draw upon a wide range of resources: relatively fertile and uncrowded arable lands, tropical forests and deposits of oil, natural gas and hard minerals. In the past, this favorable resource endowment helped them become middle income economies while not yet industrialized. More recently, growing problems of natural resource depletion and continuing labor force expansion have forced them to industrialize. But they should still be able to offer a more balanced line of exports than did the NICs, including some products made from local resources.

A second important difference is that Southeast Asian societies are ethnically heterogeneous. Their governments are controlled by indigenous groups but foreigners and ethnic Chinese immigrants play major roles in their economies. This complicates the sort of government-private sector cooperation that many analysts see as significant in the cases of Japan, Korea and Taiwan.

Ethnic heterogeneity in the ASEAN countries has contributed to the emergence of significant economic disparities, both overall and between indigenous and immigrant groups. Governments have responded to these disparities in various ways. In Malaysia before 1970, modern economic activities were essentially left to foreigners and ethnic Chinese. A New Economic Policy (NEP) adopted in 1971 introduced steps to decompartmentalize economic activity and bring the majority Malays into industries and occupations in which they had previously taken little part. Confounding fears that the NEP would slash the growth rate, the Malaysian economy accelerated its growth in 1970-90. A deep recession in the mid-1980s prompted the government to modify the NEP to facilitate Chinese and multinational business investment, with spectacular results. Thailand has been more successful than Malaysia in assimilating its Chinese minority while Indonesia has largely relied on benign neglect, but ethnic heterogeneity is an ever-present issue in these societies as well.

A third difference is that the Southeast Asian countries have developed larger public sectors than the East Asian countries, partly though their

. . . several Asian countries will follow . . . in the footsteps of the Little Dragons.

efforts to give indigenous people a larger economic role. In Malaysia, the NEP caused rapid growth of public expenditure up to the early 1980s and the creation of more than 1,000 public sector enterprises. Fiscal prudence and privatization have partially reversed this process in the past decade.

Some writers have discussed "ersatz capitalism" in ASEAN and the "myth of Southeast Asian business competence." They cite widespread rent-seeking, the large role of multinationals, the narrowness of the existing industrial base, the weakness of interindustry linkages and the pau-

Thailand has been growing even faster than Malaysia . . . but it started from a lower income level.

city of local R&D as signs of underlying weakness. But such talk was also heard in the NICs in their early days and one sympathizes with a Marxist critic who responded, "That's not ersatz capitalism; that's capitalism."

As recently as the 1970s, Malaysia was best known as the leading supplier of natural rubber and tin to the world market. Now manufacturing generates more GDP than agriculture, forestry and fishing and accounts for 60 percent of merchandise exports, as noted earlier, while rubber and tin yield only 3 percent and 1 percent respectively. Oil, gas, timber and palm oil (in primary or lightly processed form) remain important export products.

The phases of Malaysian industrialization have included a mercifully short and mild import-substitution phase in the 1960s, which was followed by vigorous promotion of labor-intensive exports (chiefly semiconductors and textiles) in the 1970s. In the early 1980s a Korean-style heavy industries campaign began, leading to production, among other things, of a Malaysian car. In the mid-1980s a United Nations Industrial Development Organization-sponsored study urged Malaysia to emphasize resource-based industries and encourage the development of local suppliers to the export industries.

While some industries based on resources such as timber and vegetable oil supplies have been successfully (if expensively) promoted, industries which rely more on local labor and infrastructure, like electronics (now far more automated and sophisticated than 20 years ago) and electrical appliance assembly (a recent major addition), are still more important.

Malaysia is no longer competitive in simple manufacturing processes that depend heavily on cheap labor because its labor surplus is exhausted (unlike Thailand, which still has a large, low-income rural workforce). More than one million immigrant workers have entered the country, mainly from Indonesia and the Philippines, to take jobs that no longer attract Malaysians. To move up the technological ladder and compete effectively on the basis of capital, skills, natural resources and technology, Malaysia must now do several things: train more people in the skills utilized in more sophisticated manufacturing processes and adaptive R&D; involve more indigenous Malaysians (*Bumiputera*) in all forms of economic activity; and regain its infrastructural advantage over its neighbors (the boom has created a need for large investments in roads, ports and power generation). Like Singapore and other countries that have relied heavily on multinationals, it must also find ways to foster more local entrepreneurship.

Malaysia's strong record of growth, industrialization and pragmatic devotion to the achievement of economic development amid ethnic complexities justify a bet that the nation will be able to deal with these problems and emerge as the next Asian NIC around the year 2000.

If Malaysia succeeds in becoming a NIC around the year 2000, what Asian country will come next? The most likely answer is Thailand. It has been growing even faster than Malaysia and in a similar manner, but it started from a lower income level and will take a bit longer to reach the NIC level. Unlike Malaysia, Thailand can continue for some time to draw on its low-income rural population to create an industrial labor force that can compete in the more labor-intensive forms of manufacturing. To do so, however, it must deal with problems such as strengthening its infrastructure and improving secondary education outside Bangkok. ■

Mr Snodgrass is institute fellow, Harvard Institute for International Development and is currently visiting the Institute of Strategic and International Studies, Malaysia.

WORLD BANK NEWS

LENDING

Former Soviet Republic Has 'Great' Potential

To help keep Kyrgyzstan's economy going while the country moves ahead with economic reforms, the International Development Association on May 13 approved a credit of SDR 43.3 million ($60 million), which will pay for badly needed imports and technical assistance.

The credit marks the first IDA assistance to Kyrgyzstan since the country joined the Bank in September, 1992. Cofinancing of $70 million is expected from the governments of Japan, the Netherlands and Switzerland.

The bulk of the credit will pay for imports needed by the country's telecommunications, transportation, energy, health and agriculture sectors. It will also pay for imported environmental-protection technologies. The imports will arrive at a crucial time for Kyrgyzstan's economy, says Kutlu Somel, formerly senior agricultural economist in the World Bank's Europe, Middle East and North Africa Technical Department.

"The countries of the FSU are going to be in a fairly serious situation for the near future," says Somel. "Kyrgyzstan will be more so because it's a small country, it's been neglected, and some of the industries had been developed to deliver goods to the FSU, a market which has diminished substantially."

Foundation for Growth

At first glance, the Central Asian nation of Kyrgyzstan looks better off than many developing countries. A well educated population, a strong industrial base and a good infrastructure offer great economic potential for this mainly rural country of 4.4 million people.

But despite its assets, Kyrgyzstan faces a worsening economic picture. The breakup of the former Soviet Union (FSU) deprived the country of markets for its exports, major cash transfers, and heavily subsidized imports for its suffering economy, leaving production at a standstill in many industries.

Aiming to reverse the economic downturn, Kyrgyzstan in 1990 launched reforms to transform its centrally managed economy into a market-based system. But the cost of imports kept rising and exports continued falling. In 1992, Kyrgyzstan's economic output fell by a quarter and is expected to drop by 16 percent this year. An estimated one-third of the country's population now lives below the poverty line.

Keeping Output Up

The imports earmarked by the IDA credit are crucial to keeping economic output up in public enterprises, unemployment down and the government budget deficits within reasonable limits, says Somel. Inputs, raw materials, and spare parts will all be covered under the plan. Purchases range from agricultural chemicals to power transmission lines and irrigation pumps.

The government will set aside part of the credit to make loans to private enterprises which want to buy imports. By funneling funds to the private sector, the government will keep entrepreneurial activity alive while also helping the public sector.

The funds will also help support Kyrgyzstan's burgeoning foreign exchange operations only weeks after the country introduced its own currency, the *som*, earlier in May. While the credit will beef up foreign exchange markets, it will also allow Kyrgyzstan to withdraw some of its own money from the markets, thereby reducing the chances of inflation.

Kutlu Somel

The credit will also help pay for expert advisory services to assist the government in reforming enterprises, privatizing some industries, supporting the private sector and developing a private financial system. And it will hel[p] build up a social safety net and develo[p] laws and policies leading to a marke[t-] oriented agriculture and mining secto[r] and procurement systems.

Early Reforms

The Kyrgyzstan government intro-duced reforms ahead of many other FS[U] countries. The reform program focuse[d] on rapidly reducing the state's role in th[e] economy, introducing a new tax system, strengthening the autonomy of the cen-tral bank, speeding up the freeing o[f] prices, and reforming family allowance[s].

In 1992, it launched more reforms, in-cluding privatization. By January, 199[3] 12 percent of state assets, mostly smal[l] scale trade and service enterprises, wer[e] sold to private hands. The governmen[t] eliminated most barriers to private sec-tor activity in trade and distribution b[y] the end of 1992. But some exports, lik[e] wool and tobacco, were exempted to bu[y] oil and gas from the FSU for this year.

But despite the reforms, Kyrgyzsta[n] has witnessed severe drops in its outpu[t] and standard of living. In 1993, output i[s] expected to be 40 percent lower than i[n] 1990. Real wages fell by 37 percent be-tween early 1991 and late 1992, and pen-sions and minimum wages have droppe[d] to only a few dollars a month. By the en[d] of 1992, inflation had reached 2,000 per-cent for the year.

Although Kyrgyzstan faces a toug[h] economic challenge ahead, Somel say[s] the country boasts strong economic po-tential. The IDA credit, he says, will help the country keep economic productio[n] going, fully use the 1 million hectares o[f] irrigated land, and diversify its crop mi[x] away from a heavy emphasis on live-stock.

If Kyrgyzstan keeps its reforms on trac[k] and doesn't suffer from powerful shock[s] or natural disasters, Somel says the coun-try could turn its economy around by th[e] second half of the decade. Somel cau-tions against "crystal ball-gazing," bu[t] says Kyrgyzstan could see economi[c] growth by 1997 at the earliest. □

DEMOGRAPHIC PERSPECTIVE

World Population Growth Rate

Why Declines Stalled in the 1980s

By SHIRO HORIUCHI

World population has been growing rapidly since World War II, adding more and more people each year. The pace of growth has varied but its slowdown to zero growth remains a distant prospect.

In the late 1960s, the global population growth rate hit an all-time peak of 2.1 percent per year. With declining birth rates, it dropped to 1.7 percent in the late 1970s. There it has essentially remained. Why?

A sudden stop

World population growth accelerated during the 1950s and 1960s, giving rise to warnings of a "population explosion". Post-war mortality declines, particularly for infants, and continuing high birth rates in developing countries produced a rapid population increase. The sudden, short-term rise of birth rates in the United States and other developed countries (the so-called "baby boom") added to the increase.

Then the growth rate reached its turning point. The downturn of the early 1970s was important. It was the first time that the growth rate of the world population had ever declined significantly—not due to catastrophic events such as epidemic or war—but as a result of family planning. From the mid-1960s to the mid-1970s, significant fertility declines started in many developing countries, including the two largest populations, China and India, and several populous countries such as Brazil, Egypt, Indonesia, Mexico and Thailand. World births are estimated to have decreased slightly, from 612 million in the first half of the 1970s to 604 million in the second half.

Around 1980, however—counter to projections by the United Nations, the World Bank, and other trend watchers—the decline halted. Recent returns from the 1990 round of censuses in many countries suggest that the growth rate leveled off, remaining almost unchanged at around 1.7 percent during the 1980s (see figure).

Continuation of this stagnation would have a considerable long-term impact. If the growth-rate declines of the 1970s had continued along the same trajectory in the 1980s and thereafter, the world could have attained zero population growth by 2030, with a population size of 6.7 billion. But if the growth rate remains on the plateau of the 1980s, world population will about double from its current 5.5 billion to 10.7 billion by 2030.

Anatomy of a stall

Why did the decline in the growth rate stall only 10 years after it began? Three major factors were at work. First, fertility declines failed to develop or lagged in some developing countries. Second, declines slowed in India and China. Third, the increasing proportion of women at peak child-bearing years raised the birth rate.

Some countries lagged. There is a growing gap between developing countries that have experienced the demographic transition from uncontrolled childbearing to lower fertility levels and those "pre-transition" countries where the transition has not yet taken hold. Countries where significant proportions of the population began to exercise birth control are largely located in East Asia, Southeast Asia, Latin America and North (Mediterranean) Africa. Most pre-transition countries are located in sub-Saharan Africa and South Asia. India is the most important exception: it is the largest country in South Asia, but it had achieved some fertility reduction in the 1970s. India, however, has substantial regional fertility differentials and some states, with larger population sizes than many countries, still have notably high birth rates. The Middle East has countries in both categories, including some oil-rich countries that have an unusual combination of economic prosperity and high fertility.

Falling birth rates in those developing countries that experienced transition accounted for much of the world growth-rate decline in the 1970s. The growth-rate plateau in the 1980s reflects delayed starts of fertility declines in the pre-transition countries. Most developing countries where fertility reduction had not begun by the mid-1970s still have the highest fertility levels today: total fertility rates (TFRs) of about six to eight children per woman. Nearly 20 percent of the world population is estimated to be living in countries with TFRs above 5.5.

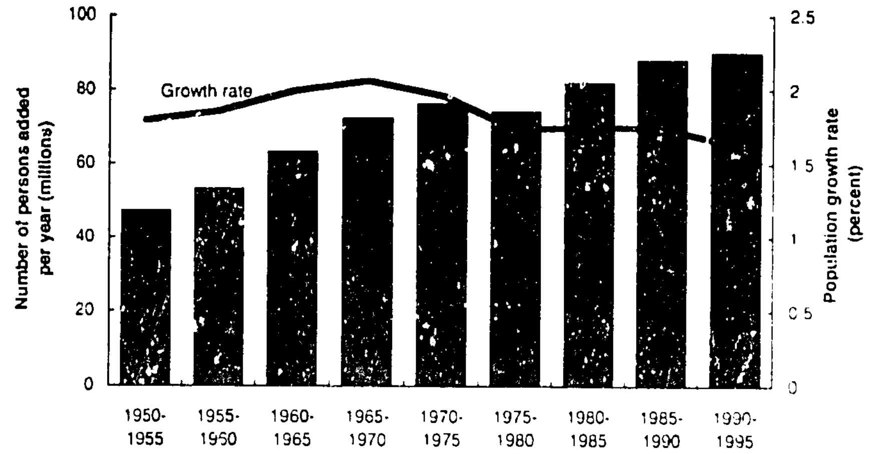
The lag of socioeconomic development in very poor countries may be a key reason for continuing high fertility levels. Economic gaps among developing countries seem to have widened during the 1980s: the annual growth rate of per capita gross domestic product from 1980 to 1989 ranged from 6.7 percent for East Asia to -2.2 percent for sub-Saharan Africa. In addition, the 1980s was a decade of slowdown in international population assistance, limiting financial resources for family planning programs in very poor countries. The total bilateral and multilateral population assistance, adjusted for inflation, more than quadrupled between the period 1960-1969 and 1970-1979 but increased by only 16 percent between the decade of the 1970s and the decade of the 1980s. U.S. population assistance actually decreased by 10 percent between the decade average of the 1970s and the decade average of the 1980s, in inflation-adjusted terms.

China and India slowed. Flat fertility trends in China and India in the 1980s were a second major factor in stagnation of the global growth-rate decline in the 1980s. In both countries, significant fertility declines started around 1970. Most of the countries that started fertility reductions in the 1965 to 1975 period remained on the downward slope during the 1980s. But the fertility decline bottomed out in China around 1980 and in India during the late 1970s.

The TFR in China fell steeply from 6.45 children per woman in 1968 to 2.24 in 1980. This sizable reduction of about four children per woman during a single decade may be the fastest fertility decline ever experienced by a large population. The spectacular decline, however, stopped suddenly, and the TFR showed small ups and downs around 2.5 children during the 1980s. In China, despite the government's promotion of delayed marriage and a one-child family, many people still marry at relatively young ages and desire two or more children. This has led to relaxation of the government's one-child policy, and some local flexibility in the interpretation of government policies.

The early fertility declines in India were more moderate. The TFR fell from about 5.7 children in the late 1960s, settling at about 4.7 children by the late 1970s. In India, the National Congress Party was criticized for promoting birth control excessively and defeated in the 1977 election, after which family planning programs slackened.

World Population Growth Rate and Absolute Growth, 1950-1955 to 1990-1995



··· = projection
Source: UN Population Division and PRB projection for 1990-1995

Age structure. A third major factor—often overlooked, but very important—in the stalled population growth declines was that the population age structure of the 1980s favored a rising birth rate. The proportion of the world's women in the peak childbearing ages of 20 to 34 is estimated to have increased from 21.0 percent in 1970 to 24.5 percent by 1990. This change reflects the coming of age of the relatively large number of children born during the 1950s and 1960s, when advances in child mortality let an increasing number of infants survive in developing countries. Although the age-structure change began to exert upward pressure on the population growth rate in the 1970s, the effect intensified in the 1980s and remains quite strong.

Had these three factors not been operating, the annual growth rate would have fallen substantially—from 1.73 percent per year in the late 1970s to an estimated 1.40 percent in the early 1980s, instead of edging up (as it actually did) to 1.74 percent during that period. Projections also show that effects of the three factors on the growth rate in the early 1980s are comparable to each other, accounting for about 0.08 to 0.13 percentage points of the global growth rate.

Outlook

What do the three factors tell us about future prospects of the world population? First, it seems certain that changes in age structure will begin to favor a decline in the rate of growth. The proportion of the population who are women of childbearing age will start to decrease as the generations of the 1950s and 1960s are replaced by those born in the 1970s.

Recent data indicate that China's TFR, already at a relatively low level of about 2.6 children per woman in 1987, was reported this year to have fallen to 1.9 in 1992, similar to rates in neighboring Japan, Republic of Korea, Singapore and Taiwan, as well as in the United States and Europe (see story, page 1).

Continued on page 9

Shiro Horiuchi is assistant professor at Rockefeller University.

POPULATION UPDATE

Estimated United States Population:

As of March 1, 1993	257,288,000
As of March 1, 1992	254,477,000

The population estimates shown are based on April 1990 population as enumerated in the 1990 Census. Data from U.S. Bureau of the Census, *Current Population Reports*, P-25, 1100.

Estimated World Population:

As of June 1993	5,498,000,000
Annual growth	90,000,000

Extrapolated from the mid-1993 population on PRB's *1993 World Population Data Sheet*.

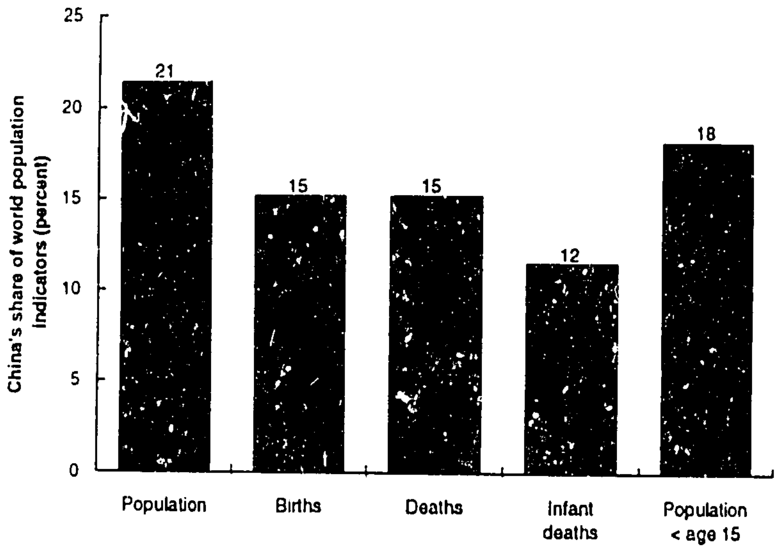
Latest Provisional Statistics for the U.S.: November 1992

	12 Months ending with November				
	Number		Rate		
	1992	1991	1992	1991	1990
Live births	4,096,000	4,119,000	16.0	16.3	16.6
Fertility rate	—	—	69.5	69.8	71.0
Deaths	2,189,000	2,161,000	8.5	8.5	8.7
Infant deaths	34,400	36,700	8.5	9.0	9.1
Natural increase	1,907,000	1,958,000	7.5	7.8	7.9
Marriages	2,354,000	2,383,000	9.2	9.4	9.8
Divorces	1,194,000	1,186,000	4.7	4.7	4.7

Note: Fertility rate is given per 1,000 women ages 15-44; infant deaths per 1,000 live births; other rates per 1,000 population.
Source: National Center for Health Statistics, *Monthly Vital Statistics Report*, vol. 41, no. 11 (1993)

SPEAKING GRAPHICALLY

Why China's Trends Influence World Population Totals



Source: PRB's *1993 World Population Data Sheet*.

With one-fifth of the world's people, China has a major influence on world population trends. Fifteen percent of human births and deaths occur in this one country.

World population growth

Continued from page 7

The birth rate in India resumed a falling course around 1985. India has a smaller population but has more room than China for further fertility decline and thus could exert a greater long-term impact on the world population than China. Since there are considerable fertility differentials among states of India, the speed of future decline seems to depend heavily on performance of family planning programs in the states of relatively high fertility levels.

Because of the expected direction of age-structure changes and the presumed fertility declines in China and India, the growth of world population is likely to begin to decline again during the 1990s.

However, it is still difficult to predict when pre-transition countries will begin to show significant declines. A few countries in sub-Saharan Africa and South Asia, in particular Kenya and populous Bangladesh, have recently started fertility reductions, although their birth rates are still very high. Whether they are isolated events or signal a forthcoming large wave remains to be seen. In addition, whether the birth rate reductions in Bangladesh and Kenya will continue for some time, as observed in the majority of developing countries that started fertility declines earlier, or they will run into periods of stagnation before reaching very low levels, as occurred in India, is not clear at this moment. Clearly, however, the timing and speed of birth-rate reductions in the highest fertility countries can make a considerable difference in the future trajectory of global population growth. ■

See also S. Horiuchi, "Stagnation in the Decline of the World Population Growth Rate During the 1980s," Science *257, 1992: 761-765; and "Global Trends of Age Distribution 1950-1990," in* Changing Population Age Structures, 1990-2015 *(Geneva: United Nations Economic Commissions for Europe, 1992) pp. 4-22.*

21

World's Countries Ranked by Population Size

1993 Rank		Population (1000's)	2010 Rank		Population (1000's)	2025 Rank		Population (1000's)
1	China	1,178,526	1	China	1,397,813	1	China	1,546,301
2	India	897,443	2	India	1,166,193	2	India	1,379,556
3	United States	258,328	3	United States	298,609	3	United States	334,716
4	Indonesia	187,638	4	Indonesia	238,830	4	Indonesia	278,170
5	Brazil	151,969	5	Pakistan	190,720	5	Pakistan	275,108
6	Russia	149,001	6	Brazil	185,613	6	Nigeria	246,030
7	Japan	124,767	7	Bangladesh	164,766	7	Bangladesh	211,224
8	Pakistan	122,398	8	Nigeria	161,969	8	Brazil	205,250
9	Bangladesh	113,882	9	Russia	153,034	9	Iran	161,913
10	Nigeria	95,060	10	Japan	130,397	10	Russia	152,280
11	Mexico	89,998	11	Mexico	118,455	11	Ethiopia	140,800
12	Germany	81,064	12	Iran	106,787	12	Mexico	137,483
13	Viet Nam	71,788	13	Ethiopia	94,496	13	Japan	125,806
14	Philippines	64,648	14	Viet Nam	91,729	14	Viet Nam	107,226
15	Iran	62,847	15	Philippines	85,542	15	Egypt	104,607
16	Turkey	60,706	16	Egypt	82,478	16	Zaire	104,630
17	Egypt	58,292	17	Turkey	81,790	17	Philippines	100,846
18	United Kingdom	58,030	18	Germany	78,197	18	Turkey	98,744
19	Italy	57,837	19	Thailand	69,164	19	Thailand	76,403
20	France	57,678	20	Zaire	68,588	20	Germany	73,201
21	Thailand	57,163	21	United Kingdom	59,910	21	Tanzania	72,950
22	Ethiopia	56,746	22	France	58,766	22	South Africa	69,963
23	Ukraine	51,866	23	Myanmar	57,720	23	Myanmar	69,861
24	Korea, South	44,600	24	Italy	56,411	24	Kenya	61,860
25	Myanmar	43,456	25	South Africa	55,853	25	United Kingdom	60,974
26	Zaire	41,166	26	Ukraine	52,324	26	Sudan	60,602
27	Spain	39,124	27	Korea, South	51,677	27	France	58,664
28	South Africa	38,965	28	Tanzania	47,546	28	Korea, South	54,779
29	Poland	38,477	29	Kenya	45,235	29	Iraq	52,615
30	Colombia	34,943	30	Colombia	44,504	30	Italy	51,926
31	Argentina	33,533	31	Sudan	43,045	31	Ukraine	51,476
32	Canada	28,138	32	Poland	41,332	32	Colombia	51,260
33	Morocco	27,955	33	Argentina	39,947	33	Uganda	49,624
34	Tanzania	27,811	34	Spain	38,904	34	Afghanistan	48,779
35	Kenya	27,714	35	Algeria	38,186	35	Saudi Arabia	48,749
36	Sudan	27,407	36	Morocco	38,112	36	Algeria	46,780
37	Algeria	27,256	37	Afghanistan	34,619	37	Morocco	45,297
38	Romania	23,211	38	Iraq	34,545	38	Argentina	44,599
39	Peru	22,909	39	Canada	32,693	39	Poland	42,733
40	Korea, North	22,646	40	Uganda	32,456	40	Nepal	41,032
41	Uzbekistan	21,705	41	Nepal	30,525	41	Ghana	37,988
42	Taiwan	20,869	42	Saudi Arabia	30,298	42	Côte d'Ivoire	37,942
43	Venezuela	20,702	43	Peru	30,088	43	Uzbekistan	36,993
44	Nepal	20,363	44	Uzbekistan	29,799	44	Syria	36,529
45	Iraq	19,162	45	Korea, North	28,491	45	Spain	36,367
46	Malaysia	18,412	46	Venezuela	27,609	46	Mozambique	36,290
47	Uganda	18,100	47	Ghana	26,594	47	Canada	35,652
48	Sri Lanka	17,839	48	Malaysia	25,978	48	Peru	35,619
49	Australia	17,753	49	Mozambique	25,406	49	Madagascar	33,746
50	Saudi Arabia	17,502	50	Syria	24,194	50	Malaysia	33,486

Source: Population Reference Bureau's 1993 World Population Data Sheet.

WORLD POPULATION CLOCK

		WORLD	MORE DEVELOPED COUNTRIES	LESS DEVELOPED COUNTRIES	LESS DEVELOPED COUNTRIES LESS CHINA
MID-1993 POPULATION:		5,505,914,000	1,230,101,000	4,275,813,000	3,097,287,000
BIRTHS PER:	YEAR	141,226,000	16,898,000	124,327,000	102,831,000
	MONTH	11,768,833	1,408,168	10,360,611	8,569,252
	WEEK	2,708,436	324,075	2,384,353	1,972,096
	DAY	386,921	46,297	340,623	281,729
	HOUR	16,122	1,929	14,193	11,739
	MINUTE	269	32	237	196
	SECOND	4.5	0.5	3.9	3.3
DEATHS PER:	YEAR	51,192,000	11,632,000	39,560,000	31,782,000
	MONTH	4,266,000	969,304	3,296,660	2,648,491
	WEEK	981,762	223,072	758,686	609,814
	DAY	140,252	31,868	108,384	87,074
	HOUR	5,844	1,328	4,516	3,628
	MINUTE	97	22	75	60
	SECOND	1.6	0.4	1.3	1.0
NATURAL INCREASE PER:	YEAR	90,034,000	5,267,000	84,767,000	71,049,000
	MONTH	7,502,833	438,917	7,063,917	5,920,750
	WEEK	1,726,675	101,011	1,625,664	1,362,580
	DAY	246,666	14,430	232,238	194,655
	HOUR	10,278	601	9,677	8,111
	MINUTE	171	10	161	135
	SECOND	2.9	0.2	2.7	2.3
INFANT DEATHS PER:	YEAR	9,831,000	237,000	9,594,000	8,465,000
	MONTH	819,250	19,773	799,460	705,413
	WEEK	188,539	4,551	183,985	162,341
	DAY	26,934	650	26,284	23,192
	HOUR	1,122	27	1,095	966
	MINUTE	19	0.5	18	16
	SECOND	0.31	0.01	0.30	0.27

Source: Population Reference Bureau's 1993 World Population Data Sheet.

PRB Population Reference Bureau, Inc.
1875 Connecticut Ave., N.W., Suite 520
Washington, D.C. 20009
(202) 483-1100

NEWS RELEASE

FOR FURTHER INFORMATION
CONTACT: Carl Haub, PRB: (202) 483-1100,
H: (301) 869-4874

FOR RELEASE: Wednesday, May 12, 1993, AMs

95 PERCENT OF POPULATION GROWTH IS IN THIRD WORLD

Population growth in Third World countries reached a record high in 1993 and may soon account for all world population increase, according to an annual survey of country populations by the Population Reference Bureau (PRB). "We are at a point where, except for the United States, population growth is essentially a Third World phenomenon," said Carl Haub and Machiko Yanagishita, PRB demographers who conducted the study. PRB is a private, nonprofit, educational organization which collects and disseminates demographic information on world and U.S. trends.

Globally, population growth is entering its most rapid period ever. In 1993, world population will top the 5.5 billion mark toward an expected 6 billion by 1997. Each of the coming few decades will see about a billion people added. "The world will quickly swell to 8.5 billion by 2025," said Haub, "but that's only if birth rates continue to come down as expected. If they do not, growth will be even faster."

Currently, 90 million people are added to the world's population each year, equivalent to adding one Mexico every twelve months. In contrast, population growth is grinding to a halt in most developed countries whose very low birth rates virtually guarantee coming population decline.

Africa leads the world in rapid population growth. In Africa, women average over six children each. If most African countries continue to grow at their present rate, they will double in size in roughly 20 years. Today, most African governments have labelled their high birth rates a problem, but the introduction of effective family planning methods in Africa will be an arduous process. In

—more—

some countries, such as Zimbabwe, Kenya, Botswana, and Rwanda, the acceptance of family planning by a growing number of couples shows that birth rates can be brought down.

In 1993, world population is growing at 1.6 percent per year. While the rate has slowly declined from its late 1960s peak of 2.1 percent per year, it has not declined fast enough to forestall huge world population increases. Both the United Nations and the World Bank have projected an "ultimate" population size of about 12 billion, assuming an uninterrupted fall in birth rates. This is a remarkable change from a world which held only 2.5 billion as recently as 1950. *If birth rates do not fall as quickly as projections assume they will, world population could easily rise to the 20 - 30 billion range.*

Women in Europe average only 1.6 children each during their lifetimes, compared to 2.0 in the United States. The world's lowest fertility is in Italy at only 1.3 children per woman and in Hong Kong, 1.2. In the United States, a modestly high birth rate and the world's highest amount of immigration will now produce unexpectedly high growth. *With a net immigration of about 900,000 per year, the U.S. effectively absorbs 1 out of every 100 people added to world population each year.* At least for now, population decline has begun in Russia, Ukraine, and other areas of the former USSR. The lowest birth rate in the Third World is in East Asia, which contains population giant China, a country that packs 1.2 billion people into an area one half the size of the United States. China's controversial population control program is largely responsible for the recent drop in the world growth rate.

These conclusions and many other aspects of world demographic change can be found on the PRB's annual *World Population Data Sheet* which provides the latest data on population trends.

#####

Copies of the *1993 World Population Data Sheet* can be ordered from PRB at $3.00 per single copy, with bulk order prices available. **Journalists can receive an additional copy by calling 202-483-1100 or 1-800-877-9881.**

THE CSD - NO BACKPEDDLING YET

By William R. Pace

As the negotiations of the United Nations 47th General Assembly on the follow-up to UNCED and establishing a U.N. Commission on Sustainable Development neared completion, it was evident that those who predicted the Earth Summit commitments would be eviscerated by governments, agencies and other reactionary forces of the UN, had been proven wrong. It was clear during both the General Assembly and the ECOSOC negotiations that governments are still taking the UNCED commitments very seriously.

A number of key government representatives have expressed that, unlike the vast majority of their assignments, the establishment of the Commission on Sustainable Development (CSD) may be, as was the Human Rights Commission in 1946, an historically important event. As an example, the EC has been trying to establish unprecedented bargaining powers for itself in the new Commission, so it seems already that the CSD has become a field involving very high level negotiations and manoeuverings.

Furthermore, the developing countries and activist Third World NGOs are clearly hoping to use the CSD to monitor the lending policies and practices of the international financial institutions, including the Global Environmental Facility of the World Bank. The ECOSOC resolution calls for the World Bank, IMF, and other intergovernmental organisations and specialized agencies to appoint special representatives to the CSD.

But What Role Have NGOs Achieved?

NGOs hope to use the CSD to examine linkages between trade, development and environmental degradation, and to look at country sustainable development plans, including the consumption practices of Northern industrialized societies. UNCED involved the greatest number of citizen activists and organisations ever in an international intergovernmental process. This included 400 NGOs who were already in consultative status with ECOSOC, who can participate in all U.N. conferences and commissions, and 1000 others; referred to as "UNCED NGOs" in this article.

Many believe that the North-South dialogue between NGOs and governments was as important as the main "products" of UNCED: the treaties, declarations and Agenda 21. But this dialogue and debate about perceptions, power, roles, rights and wrongs, was far from complete after Rio. Many hope that the meetings of the CSD will become the setting for an ongoing global debate, examining what the "enhanced" roles of NGOs, citizens activists, and representatives of major groups will be in the post-Cold War, post-Earth Summit, United Nations.

Secretary General's Report

The report of the Secretary-General (SG), based on the General Assembly decisions and Agenda 21 commitments, made a number of progressive proposals and assumptions. It proposed accrediting the 1000 additional UNCED NGOs to the U.N. Roster for participation in the work of the CSD. [This was extraordinary, as the number put on the Roster via SG recommendation over the last 40 years is reportedly less than 30.] It assumed unprecedented involvement of NGOs in the CSD and recommended expanded consultations such as meetings with NGOs in advance of CSD meetings.

Initially, the only vocal opposition to these recommendations came from a few representatives of the international NGOs, all members of the Conference of NGOs in Consultative Status with ECOSOC (CONGO). While these representatives did not completely agree with each other, in general they expressed opposition to language in the SG report, which they interpreted as calling for UNCED NGOs to be able to participate in the CSD on an equal footing with Category I and II consultative status NGOs (See *The Network* #22 for an explanation of these roles). They opposed language which called upon NGOs to organise themselves into networks and coalitions and establish mechanisms, when limitations of space and time required, to select representatives to be in CSD meeting rooms and to speak on behalf of NGOs.

Though publicly supporting the calls in Agenda 21 for more enhanced, inclusive, regionally balanced NGO involvement and participatory rights in the follow-up to UNCED, they have not offered any alternatives to the UNCED vs. existing ECOSOC procedures dilemma, since last July. Their defensive actions have backfired badly and are creating the conditions they claim to be trying to prevent.

Despite the fact that India, the Philippines and China also opposed accrediting the UNCED NGOs, the decision appears to be to grant all the UNCED NGOs accreditation, "subject to the approval of the Council, bearing in mind the provisions of Article 71 of the Charter of the U.N." This disappointing compromise will probably allow governments to vet lists of NGOs from their countries to exclude those they do not want on the Roster. This could eliminate important grassroots national and regional NGOs.

The Way Forward

During the General Assembly debate on UNCED/CSD resolutions, there was open and frank recognition that the new Commission would fail if its meetings and work were confined to government representatives. Thus, the support for active citizen and NGO participation in the CSD was dramatic. Governments and others who expected that the UN would return to business as usual after UNCED, have been rebuffed.

The Secretary-General has delivered more than most had hoped for in terms of recommended procedures and in establishing the Department of Policy Coordination and Sustainable Development. Governments have not closed the door on the needed citizen, NGO and major group involvement. Nor have governments yet imposed the kind of restrictive and hypocritical types of procedures on the CSD, which have straight-jacketed and darkened the work of the Human Rights Commission for the last 40 or so years.

The mandated monitoring functions of the CSD are daunting: the implementation and elaboration of Agenda 21; the establishment of sustainable development plans and practices by governments and agencies including multilateral financial institutions, reviewing international ODA commitments, and so on. The scene is being set for the CSD. The key question now is will NGOs take their place in it?

William R. Pace, is Executive Director, Center for Development of International Law and Co-convener International NGO Task Group on Legal and Institutional Matters (INTGLIM).

Contact: c/o Center for Development of International Law, PO Box 53149, Washington, DC 20009; Tel. (1 202) 462 5251 Fax: 462 4941.

151

MONDAY DEVELOPMENTS

The Impact of AIDS on Sustainable Development

A computer presentation model to convey the impact of AIDS on the developing world and an overview of the new AIDSCAP program were featured in the workshop, "Demographic Implication of AIDS on Sustainable Development."

AIDS Impact Model. The AIDS Impact Model (AIM), funded by the Agency for International Development (AID), is an interactive program for graphically illustrating the current status and possible future of the HIV/AIDS epidemic in individual countries. The primary use for the AIM model is to brief decision makers, government leaders and other influential people in developing countries about the background, epidemiology, impact and interventions for AIDS.

> *"The situation is too serious to be left to governments."*
> — Anthony M. Schwarzwalder
> AIDSCAP Deputy Director

The model, demonstrated by John F. May, demographer and senior associate for The Futures Group, depicted the HIV/AIDS status and future for a hypothetical sub-Saharan country with a typical level of infection. Presentations are usually prepared for individual countries and shown by local presenters to key audiences.

The model's background section shows audiences what we know about the history and current status of the epidemic. It graphically shows the "AIDS pyramid" of reported and unreported cases, prevalence, age distribution, incubation period and cumulative numbers.

The epidemiology section shows alternative projections of future infection levels, such as what would happen if there were no interventions to prevent the disease. The impact section describes the socioeconomic impact of AIDS in the future. Key points are:

- One of the worst impacts of AIDS deaths will be the increase in the number of orphans, which will in turn cause a tremendous strain on the social system;
- AIDS will eventually require a large portion, in some cases half, of the health budget of some countries;
- AIDS will become a major threat to child survival, as important as measles and malaria; and

The computer model shows how various interventions will affect the prevalence of HIV and what can be done to prevent a worsening epidemic. The model shows the individual and collective effect of interventions such as blood screening, condom promotion, education and communications to reduce the number of partners, and programs to detect and treat sexually-transmitted diseases. "Interventions make a difference," said May. "We can control the epidemic through these interventions. The best effects will be achieved when the interventions are combined."

AIDSCAP Program. The AIDS Control and Prevention Project (AIDSCAP) is a $168 million, five-year program whose purpose is helping developing countries deal with the prevention of AIDS. AIDSCAP was created in 1991 by a cooperative agreement between USAID and Family Health International (FHI), with the support of nine subcontractors.

A major focus of the project is helping NGOs build the capacity to carry out AIDS prevention programs. "The situation is too serious to be left to governments," said Anthony M. Schwarzwalder, AIDSCAP deputy director. "We expect that three-quarters of the money for this project will go to PVOs and NGOs." The program emphases are:

- Increased acceptance, availability and utilization of condoms;
- Behavior change, including partner reduction; and
- Improved management and treatment of sexually-transmitted diseases, including HIV.

Strategies for enhancing the capacity of NGOs to deliver effective and sustainable AIDS prevention programs include institutional needs assessment, collaborative institutional goal setting, collaborative skills transfer, formal training programs, training of trainers and field-generated materials and systems. Some of the issues faced by AIDSCAP, according to Schwarzwalder, include "the trade-off between relief and sustainable development, and the decision when to move from targeted interventions (such as working with intravenous drug users) to large, nationwide education programs."

working in collaboration with NGOs in priority countries in Africa, Asia and Latin America/Caribbean. The first round of grant awards were to World Vision (Thailand), Save the Children (Haiti), American Red Cross (Jamaica) and CARE (Cameroon). Schwarzwalder reminded the audience that the second round of competitive grants is coming up with concept papers for funding work in Brazil, Côte d'Ivoire, Malawi and Senegal due June 4.

There are also sub-projects for PVOs or NGOs displaying outstanding ability in the HIV/AIDS field in priority and selected associate countries. NGO support activities include "rapid response/seed money," which funds small, short-term projects; and "institution building and networking," which provides management or technical training.

More information on AIDSCAP is available by contacting Anthony Schwarzwalder or Wendy Githens at the project's headquarters, 2101 Wilson Blvd., Suite 710, Arlington, VA 22201; 703/516-9779. For more information on AIM model, contact John May at The Futures Group, 1050 17th Street, NW, Suite 1000, Washington, DC 20036; 202/775-9680.

AFRICA

Remarks of Secretary of State Warren Christopher, "The United States and Africa: A New Relationship," at the African American Institute Conference, Reston, Virginia, May 21, 1993, Office of the Spokesman, U.S. Department of State, May 21, 1993.

Remarks of Anthony Lake at the Brookings Africa Forum Luncheon, The Brookings Institution, Washington, DC, May 3, 1993.

Woods, James. "An Update on U.S. Priorities in Africa," CSIS Africa Notes, Center for Strategic and International Studies, May 1993.

Russell, Avery. "Making Pregnancy and Childbearing Safer for Women in West Africa," Carnegie Quarterly, Carnegie Corporation of New York, Winter 1993.

Deng, Francis M. and Larry Minear. The Challenges of Famine Relief: Emergency Operations in the Sudan (Introduction), The Brookings Institution, 1993

Brown, Frederick. "Can Africa Afford a Green Revolution? (Point)," Choices, United Nations Development Programme (UNDP), Vol. 2, No. 2, 1993.

Shiva, Vandana. "Can Africa Afford a Green Revolution? (Counterpoint)," Choices, United Nations Development Programme (UNDP), Vol. 2, No. 2, 1993.

"AIDS Threatens African Development," World Bank News, The World Bank, May 13, 1993.

Fried, Diana. "Simple Technology Yields Dramatic Benefits," Oxfam America News, Oxfam America, Spring 1993.

A New South Africa in the Making: Role of the United Nations (Overview), United Nations Centre Against Apartheid, 1992.

"NGOs get Tentative Thumbs-Up," Democracy in Action, Institute for a Democratic Alternative for South Africa, April 15, 1993.

Randall, Richard. "Case Study #1--Economic Adjustment in Zimbabwe (Appendix)," The World Economy in Transition, United Nations Association of the United States of America (UNA-USA), 1993.

"African Petroleum Sector Loses Millions of Dollars Annually," World Bank News, The World Bank, April 8, 1993.

Dugan, Patrick. "Managing the Wetlands," People & the Planet, Planet 21, United Nations Population Fund (UNFPA), the World Conservation Union and the International Planned Parenthood Federation, Vol. 2, No. 2, 1993.

U.S. Department of State

Office of the Spokesman

Embargoed Until Delivery
Scheduled for 10:40 a.m. EST

May 21, 1993

"THE UNITED STATES AND AFRICA: A NEW RELATIONSHIP"

REMARKS BY

SECRETARY OF STATE WARREN CHRISTOPHER

AT THE

23RD AFRICAN-AMERICAN INSTITUTE CONFERENCE

SHERATON RESTON HOTEL

RESTON, VIRGINIA

THE UNITED STATES AND AFRICA: A NEW RELATIONSHIP

Good morning, Maurice Tempelsman, Vivian Derryck, friends: I welcome this opportunity to speak to you today about the Clinton Administration's approach to Africa. I am especially pleased to be the first Secretary of State ever to address the African American Institute.

Our Administration is well aware of what you have accomplished, through 40 years of dedicated work, in building better ties between America and Africa, and in helping the people of Africa build better lives for themselves.

America and Africa are linked in fundamental ways.

As the world's oldest democracy, we have an enduring interest in the success of the new democracies of Africa. As a multi-racial society, the U.S. is especially encouraged by the approaching transition to democracy in South Africa.

And there are links of conscience -- and links of cooperation.

When a child dies of hunger in Africa, that tragedy touches us in America. When American scientists seek a cure for AIDS, they carry the prayers and hopes of Africans and Americans.

When our Agency for International Development makes a substantial investment in child survival programs, that makes a difference in helping Africa to reduce infant mortality rates. And when the American company Merck provides a drug that frees millions of Africans from the devastating effects of river blindness, that action not only extends the frontiers of pharmacology, but lessens the distance from America to Africa.

That distance is also lessened by the end of the Cold War. During the long Cold War period, policies toward Africa were often determined not by how they affected Africa, but by what advantage they brought to Washington or Moscow. Thankfully, we have moved beyond the point of adopting policies based on how they might affect the shipping lanes next to Africa rather than the people in Africa.

In today's changed world, we can and will move to a productive new relationship with Africa. The President and I are committed to building that new relationship based upon our common interests and our shared values.

The Clinton Administration will provide strong and visible support for the movement to freedom in Africa -- to democracies and free markets. We will work with the nations of Africa to address the health, environmental and population issues that threaten lives and imperil sustainable development. And we will help Africa build its capacity for preventive diplomacy and conflict resolution so that the people of that continent can live free of the terror of war.

Promoting Democracy and Human Rights

At the heart of our new relationship will be an enduring commitment to democracy and human rights. President Clinton has made it clear that promoting democracy and human rights is a pillar of American foreign policy. And that pillar stands just as tall in Africa as it does in every part of the world.

It is democracies -- not dictatorships -- that offer the best means to defend human rights, to put African nations on the path to progress and to address the vital social and economic concerns that cut across national borders.

The United States will work through our A.I.D. program and with the multilateral assistance and lending institutions to help Africa build its economic capacity. Under the Clinton Administration, these global concerns will not be relegated to the footnotes of our foreign policy agenda. Instead, they will be given the top tier attention they deserve.

107

Today Africa has gained our attention and respect through the courageous efforts to build democracy and opportunity on that continent. While the drive for democracy and free markets has attracted more attention in Eastern Europe and Latin America, the people of Africa are demanding their freedom as well.

Listen to the words of President Chiluba of Zambia: "We know what is right. Democracy is right. The greatest lesson we can learn from the past 27 years is that freedom is at the core of every successful nation in the world and in Africa today."

The people of Africa know where their future lies: not with corrupt dictators like Mobutu, but with courageous democrats in every part of the continent. From Senegal to Benin, from Madagascar to Mali, African nations are building strong democratic institutions. They recognize that democracy offers the only framework for tolerance and harmony because it safeguards individual rights and provides protection for minorities.

AAI has played an extraordinarily useful role in promoting democracy. You have monitored elections, trained officials, and provided civic education. You understand that democracy must work not only on election day -- but every day -- through a vibrant civic culture and a commitment to free and open debate and the rule of law.

Democracy worked on election day last September in Angola. But since then, the people of Angola have been denied the benefits of their participation in that process. President Clinton acknowledged the importance of that free and fair election when he announced this week that the United States now recognizes the Government of Angola.

We intend to remain actively engaged in promoting a negotiated settlement between the Angolan government and UNITA that enables all the people of Angola to enjoy the benefits of democracy. U.S. recognition is designed to help achieve that goal and to encourage UNITA to join the process of peace and national reconciliation. As President Clinton said, we hope UNITA will be a part of the government we recognize. We continue to believe there can be no military victory in Angola -- and the U.S. will not support those who pursue a military solution.

Now South Africa stands on the verge of its own transition to non-racial democracy. The United States supports that peaceful transition. We oppose those who seek to derail the negotiations and we reject those who resort to violence.

We hope that within a short time, a date will be set for a truly democratic election in South Africa. That election will echo around the African continent and across the world as a roaring triumph of human rights.

The credit for that monumental achievement will belong most of all to those in South Africa who dedicated their lives -- and in some instances, gave their lives -- so that a new day of freedom would dawn. Credit will belong to Nelson Mandela, who walked out of prison after 27 years -- unconquered, unbowed, standing tall in his belief that the people of South Africa could still build a future based upon the inherent worth and dignity of every human being.

It will also belong to F.W. De Klerk, whose vital contribution can be measured by how far his views have evolved, and by how far a majority of white South Africans have come with him.

The transition to non-racial democracy in South Africa is also the product of principled opposition to apartheid in the international community. In the finest American political tradition, a coalition of conscience in this country has carried out a long and uplifting campaign against the apartheid system half a world away. Our own sanctions have played an important role in the progress made to date.

The installation of a non-racial government in South Africa will resonate with every American, but especially with those in cities and towns across this nation who joined the effort to bring an end to apartheid.

In sharing the spirit and lessons of our own civil rights movement, we are not saying that America has found every answer or that we have yet formed a perfect union. But we are committed to the basic principle that human rights are universal -- that every citizen in every country ought to be judged as an individual, irrespective of race or economic condition.

South Africa's successful transition is important for Africa, the United States and the world. The United States will help -- and we expect the other industrial democracies to help as well. Once a Transitional Executive Council has been put in place -- and a date for elections has been set -- we will work with our G-7 partners to help South Africa re-enter the global economy. We have urged the World Bank and the parties in South Africa to begin planning now the projects that will translate into economic growth. Similarly, the American business community should be a part of the effort to help the people of South Africa build a strong and vibrant economy once the progress toward democracy is irreversible.

Unfortunately, South Africa has had no monopoly on the violation of human rights on the continent. American policy must reflect that fact. We cannot hold Africa to a lesser standard for human rights than we apply to other parts of the world. I want to make clear that the United States will take human rights into account as we determine how to allocate our scarce resources for foreign assistance.

The promotion of democracy is central to the goals of the Clinton Administration. That is why President Clinton chose to invite the first President of a democratic Namibia, Sam Nujoma, as the first African head of state to be recognized at his White House.

<u>Sustaining Africa's Capacity for Development</u>

It is the democratic nations of Africa, reflecting the will of their people, that are best positioned to make the kind of economic changes that improve the lives of their citizens. The development challenge facing most African nations remains imposing, but it is within the capacities of free market democracies to overcome.

Economic crises still afflict many of the continent's nations. For many countries, per capita incomes have been stagnating or falling; trade and investment flows have remained weak; debt burdens stunt the prospects for new growth. Drought, famine and civil war have turned crises into calamities; no region of the continent has been spared the ravages of man or nature.

The trend toward democracy in Africa must be reinforced by sustainable economic development. The peace and stability that democracy brings can lead to desperately needed private investment -- and with it, development capital, technology transfer and technical expertise. Disinvestment in Africa will only be reversed when Africa makes itself a more attractive place for new capital. Applying the rule of law, reducing corruption, assuring the remittance of profits, and building more skilled workforces -- all of these things will help give Africa a far greater role in the global economy.

The first responsibility for building that capacity rests with African countries themselves. But the developed nations of the world -- including the United States -- share a responsibility to help. For the coming fiscal year, we are requesting bilateral development funding for Africa of $800 million. In addition, we will continue to provide over half a billion dollars in humanitarian and other assistance to Africa.

The United States and the international community will be more willing to support the economies of African nations that have embarked on serious reform. We are working with other creditor nations to provide additional debt reduction for countries cooperating with IMF adjustment programs. The Administration is requesting congressional support to enable the U.S. to participate in a multilateral debt relief effort. This new initiative would reward those poor countries implementing difficult reforms.

New trade policies will also help African nations to compete in global markets. Protectionist barriers still impede Africa's competitiveness and its prospects for growth. Africa has much to gain from a successful conclusion of the Uruguay Round negotiations that the U.S. is pushing to complete by the end of this year.

Africa's economic future is inseparable from its environmental future. An Africa that is yielding to the desert sands and scrub, and an Africa whose soil is eroding, is an Africa diminishing its capacity to feed itself. An Africa that is losing its forests and renewable water supplies is an Africa that is compromising its ability to meet basic needs for the future.

One African leader has said that the problem of soil erosion has become so serious that his country, viewed from space, appears to be bleeding into the ocean. We must help to heal these environmental wounds. To that end, AID will spend at least $70 million on environmental and natural resource projects in Africa this year.

One environmental challenge in which the U.S. was particularly helpful was the devastating drought in southern Africa. Working with interested nations and the donor community, the U.S. provided close to $1 billion to respond to this catastrophe. Today, the threat of famine is gone and the countries of the region are harvesting a good crop.

Sustainable development cannot be accomplished without a renewed sense of urgency about population growth rates that will double the size of many African nations in 15-20 years. Rapid population growth imperils efforts to combat poverty and protect the environment. No longer will the United States pretend this problem does not exist.

Instead, we will work in partnership with nations in Africa and elsewhere to provide a full range of family planning and reproductive health services, and we will work to improve the status of women.

Resolving Conflicts in Africa

Let me be clear: the Clinton Administration's new relationship toward Africa will differ in important respects from the approach of the past 12 years. At the same time, I salute former President Bush for launching Operation Restore Hope -- a military mobilization for a mission of mercy in Somalia. What a proud moment it was to see American soldiers help to feed starving children in a place far from our shores but clearly close to our hearts.

Certainly America was not alone in that effort. Other nations -- including many in Africa -- were instrumental in providing relief. While serious problems persist in Somalia, the efforts of the international community have alleviated suffering and provided the opportunity to rebuild that nation. Somalia's experience reminds us that the international community can respond compassionately and effectively. But it also reminds us that we must not wait until thousands of people have succumbed to starvation.

Now we need to apply those lessons in Sudan. The civil war in Sudan has resulted in terrible suffering and appalling violations of human rights. The U.S. is working with governments in the region, the UN and others to bring the fighting to an end. We must do whatever we can to ensure the delivery of adequate relief supplies to stem this tragedy, especially as the rainy season begins.

In Liberia, where brutal conflict has raged, we support the efforts of the Economic Community of West African States (ECOWAS) to restore peace. We seek a negotiated settlement leading to full disarmament of all warring factions; free and fair, internationally-monitored elections; and the establishment of a democratic government.

But Liberia's future will be determined in Monrovia, not in Washington. Only Liberians can create a real and lasting peace, heal the deep scars in Liberian society, and determine who will lead them in the future.

Liberia's suffering must be brought to a swift and peaceful end. That country deserves a better fate, like the future now dawning to the east across the continent in Eritrea. The intertwined tragedies of Eritrea and Ethiopia are receding into history, we hope, never again to be repeated. After thirty years of civil war, an independent Eritrea has emerged, aided in part through peace talks sponsored by the Carter Center in Atlanta.

Just last month, Eritreans voted overwhelmingly for independence from Ethiopia in a UN-monitored referendum. On April 27, Eritrea declared independence -- and that same day the United States recognized Eritrea. Alongside a newly democratic Ethiopia, this new nation can take its rightful place as a beacon of hope astride the Horn of Africa.

I have spoken of American efforts to end some of the military conflicts in Africa, but our most enduring contribution may be assisting Africa to build its own capacity for conflict resolution and peacekeeping. The United States is working closely with the Organization of African Unity, providing support for peacekeeping in Rwanda and training for election monitors elsewhere. As the OAU prepares to observe its thirtieth anniversary, it is important not only to recognize what that organization has done, but to focus on how it can play a greater role in preventing and stopping wars on the continent.

I also want to acknowledge the often-overlooked involvement of Africans as peacekeepers abroad. Nigeria and Kenya in the former Yugoslavia -- Cameroon in Cambodia -- Ghana and Sierra Leone in Lebanon: these and other African nations are making the world safer.

The OAU and other African organizations need to step up mediation and preventive diplomacy to give people in Africa the chance to live free of war. In the exercise of creative, often life-saving diplomacy, Africa's destiny will be shaped by Africans.

<u>A New Relationship</u>

I have outlined today the basis for a substantially new American relationship with Africa. It will be a new relationship in which America can assist Africans in building democratic institutions and laying the foundation for economic growth, but in which our role is to enhance -- not to erase -- African solutions.

It will be a new relationship grounded in our firm belief that while dictators in Africa are not yet extinct, the future lies in free elections and free institutions.

It will be a new relationship reinforced once a new South Africa has moved from repression to democracy.

The people and governments of Africa are moving to democracy and free markets with a growing conviction that they are on the path to progress. They are embarked on a uniquely African journey, as awe-inspiring as anything on this continent of breathtaking beauty.

It is a journey worthy of America's respect and support -- and that respect and support is what I pledge today.

Thank you.

REMARKS OF ANTHONY LAKE
As Prepared for Delivery

Brookings Africa Forum Luncheon

Washington, DC
May 3, 1993

I am delighted to have this opportunity to join you for the Brookings Africa Forum. I want to thank Francis Deng and the Brookings Institution for organizing and hosting this event.

This is my first public speech since President-elect Clinton asked me to become his National Security Advisor. It was not an accidental choice. Africa occupies a special place in my work and my affections. My dissertation was on U.S. policy toward South Africa. I have written on a range of African issues. And I have spent some of the happiest, most challenging times of my life on the Continent. I know that in the past there has been a sense that some administrations have taken years to figure out where Africa is on the map. I hope you will find in us a sense not only of where Africa is, but where we all hope it is going in the future.

This is an exciting and challenging time -- a time of change and promise. It is fundamentally a new era in world affairs. The Cold War is over. The Soviet Union is gone. The nuclear arms race has been shifted into reverse. Democracy is on the march. Global commerce is expanding.

Certainly, we face new threats, from weapons proliferation to violent ethnic conflict. But we also have the opportunity to pursue new forms of global problem solving -- through re-invigorated multilateral institutions, and through new partnerships that the Cold War had made impossible.

The global changes that receive the most attention are in Europe and Asia: the unification of Germany; the democratic struggles of Russia and the other new states; the prosperity of the Pacific Rim; the conflict in the former Yugoslavia. But you know as I do that the winds of change are blowing again across Africa as well.
Some of those winds are harsh: continuing conflict in Liberia and Angola; human rights abuses, corruption, and resistance to democratic change in Togo and Zaire; and hunger, poverty, and environmental degradation across too much of the continent. But many of the winds of change in Africa carry the breath of hope: a new wave of democratic reform; a new generation of gifted leaders; new movement toward market economies and integration with the global economy; promising new efforts at conflict resolution and peacekeeping; new initiatives to protect Africa's fragile and glorious environment; and, I would add, the seeds of a new relationship with a new administration in Washington.

Today I want to offer a few thoughts on the nature of these changes, and how our Administration plans to address them.

I believe the most important change for Africa's long-term prospects is the Continent's new progress toward democracy.

For by its nature, democracy provides an inclusive and non-violent means of conflict resolution. It therefore provides an alternative to the kind of violent disputes that have drained so much of Africa's resources and hope in recent years. Moreover, well-structured democracies are more responsive to the material needs of their people. And democracies make better neighbors: they don't tend to wage war on each other.

That is what makes Africa's movement toward democracy so hopeful. In recent years, we have seen the proud birth of democracy in Namibia, and at least thirteen African countries have held multiparty elections. I was privileged to be an observer in Namibia at that time, and was moved by what I saw. Elections are expected in another fifteen countries before the end of the year.

Above all, in South Africa today, the statesmanship of both Nelson Mandela and F. W. DeKlerk and the courage of the South African people provide real hope that we may soon see what once seemed so remote -- the end of apartheid and the arrival of a true non-racial democracy in South Africa. All of us join in mourning the losses South Africa and the African National Congress have recently suffered, such as Chris Hani and Oliver Tambo. Yet we also join in hoping that their life's work has brought within reach the achievement of a new democratic day for all the people of South Africa.

Democracy means more than elections. As we have sadly witnessed in Angola, elections are not enough, in themselves, to bring peace and justice. Genuine democracy implies more, such as respect for individual and minority rights, and tolerance for a loyal opposition. These traditions are not well established in some parts of Africa. Yet Africa's substantial movement toward democracy suggests these concepts and institutions can ultimately be universal.

The movement toward African democracy is not something that has been noticed only by the Administration's African experts. It has caught the attention of their boss as well. When Ambassador Cisse and Ambassador Kitleli presented their credentials to President Clinton on April 14, he remarked to me afterward how impressed he was by his conversations with them. He was also impressed -- as he had told them -- by the progress toward democracy that had been made by both Mali and Lesotho. And he said he was very encouraged by this trend elsewhere in the Continent.

This movement toward democracy in many ways echoes the period of change Africa witnessed a generation ago. When Africa threw off colonialism, it was because Africans were tired of living under a ruling elite who put their own interests before those of the African people. Today, the rulers are African rather than European. But the African people have been saying once again that any ruling elite that puts its interests before those of the vast majority is no longer acceptable. They are protesting bloated, corrupt, or inefficient governments, and insisting on honest leaders who focus on the broad needs of their people.

To be sure, Africa's democratic institutions will not always look like our own, nor necessarily should they. And democracy is not the answer for every ill that afflicts Africa. But it is a means to address many of those problems more effectively. And for that reason we must do what we can to help Africa nurture and sustain those institutions. We need to promote people-to-people programs and other efforts that can help foster civil society -- business groups, women's organizations, service clubs, student leagues. Such institutions operate on the principle of broad participation in community-level decision making, and thus create a base for democracy. Our administration is also examining how we can restructure our foreign assistance efforts, in part to reward and encourage those nations at the forefront of the democratic march.

The second encouraging change in Africa is the increased movement toward market economies and sustainable development. The past decade has seen the demise of statist economic systems around the world for one simple, non-ideological reason: they don't work.

Now, however, many African countries are undergoing the difficult transition toward economic liberalization. There is already some evidence that growth is higher in countries that are moving ahead with such economic adjustments, such as Ghana and Burundi. These transitions take years and must be sustained, but they are the only definitive remedy for the poverty that plagues the Continent. Addressing the problem of poverty also requires a measure of justice to ensure that a nation's additional income, earned by the many, is not distributed only to the few.

President Clinton is committed to exploring means to assist Africa's economic reforms and economic growth. For example, too many African nations face high debt burdens, which can hamper their economic transitions and recoveries. The total debt burden of Sub-Saharan Africa now exceeds its annual GNP and is more than three times the value of African exports. The Administration is exploring with Congress the possibility of joining with the other creditor nations of the Paris Club in providing debt reduction for the poorest, most debt-laden countries cooperating with the IMF in economic adjustment programs. This new initiative is particularly designed to reward with debt reduction those poorest countries implementing difficult reform programs.

The strongest way we can assist Africa's economic development, however, is by helping to integrate Africa into the growing global economy. Government aid is dwarfed by the economic power of private trade and investment. African nations themselves must do much of what is necessary to integrate into the world economy. In many cases, they need to move away from state-owned enterprises, fixed exchange rates, price-distorting subsidies, and corruption that makes business difficult. African nations should also stimulate growth by removing the barriers to trade between themselves. Efforts at regional cooperation such as fostered by SADC -- the Southern Africa Development Community -- can be helpful in this regard.

But we have a role to play as well. We can help American businesses learn more about the opportunities for African trade and investment. For example, last year, sub-Saharan Africa imported about $60 billion in goods, but only about $5 billion came from the US. It is both our interest and Africa's for that to change. Among other steps, the Administration will seek to promote more active African participation in international economic institutions, such as the GATT.

Africa's future requires not only economic growth but also economic justice. With 80 percent or more of the population employed in subsistence agriculture in most African countries, the urban elite too often demands more than their share of a country's resources. This is particularly true of the governing elite. There must be less invested in conspicuous consumption and more in health and education, where the welfare of the great majority lies.

One cannot speak seriously about Africa's economic future without speaking also about Africa's environment. In Africa, economics and environment are inseparable. And, today, Africa's environment is under great strain. About two-thirds of sub-Saharan Africa's wildlife habitat has been destroyed by development. Uganda's forests have been decimated and its once plentiful grasslands have nearly been eliminated. Africa's desert is gaining ground at some three to six miles each year. In Ethiopia, the Rift Valley's acacia forest is fast becoming semi-desert.

No one who has visited Africa can help but feel the great tragedy that these statistics embody. And no one who understands Africa's economy can help but see the imperative of addressing Africa's environmental needs as part of an economic strategy.

There are encouraging signs. Many African leaders have taken impressive steps to preserve natural habitats, protect species, and promote methods of sustainable development. Our government is trying to do its part as well. The U.S. Agency for International Development plans to spend at least $70 million on environmental and natural resource projects in Africa this year.

We also must focus more energy on the underlying forces that strain Africa's natural and human resources, such as population growth and disease. After more than a decade of ideological impasse over many family planning efforts, our government has an opportunity to open a new chapter in our population efforts in Africa and elsewhere. And I pray that our stepped-up investments in research on AIDS here in the US may lead to advances in treatment, and eventually cure, to bring some measure of relief to an African AIDS epidemic that has become one of its most devastating problems of all time.

The third major challenge for Africa and our policy toward Africa involves the prevention and resolution of conflict. Much of the hardship and deprivation in Africa today results from the numerous civil wars that have raged across the Continent. In Angola, Mozambique, Sudan, and until recently Ethiopia, conflict has been a fact of life for years. Fighting in Liberia, Somalia and Rwanda has caused horrendous suffering as many people have had to flee their homes, their farms, and their means of support.

The United States cannot solve every conflict. But we can play a constructive role to help prevent and resolve disputes. Our work with multinational organizations is especially important. The best example of that is our current effort in Somalia. Half a year ago, Somalia was being decimated by civil anarchy and horrible famine. Today, the guns are quiet, food is flowing, crops are growing, and there is talk of civil reconstruction in the air. Now we are in the process of transferring peacekeeping responsibilities to the UN force, UNOSOM II. UNOSOM II will enforce cease-fires, disarm factional militias, and help create an atmosphere in which Somalia can restore civil government.

Peacemakers and peacekeepers are on the front lines in other nations as well, such as Liberia and Angola. Peacekeeping efforts need to be accelerated in Mozambique in order that the fragile peace there is strengthened. But in addition to helping solve disputes, we must also work to help prevent disputes. We need to place greater emphasis on such tools as mediation and preventive diplomacy. Africa's own organizations, such as the Organization of African Unity, have shown promise in recent years, and we need to help build their capacity to engage early and effectively. This implies an activist approach in nations that are disasters in the making.

The coming years will be a challenging time for Africa. None of us underestimates the magnitude of political, economic, environmental, and health problems that confront a great many of Africa's states.

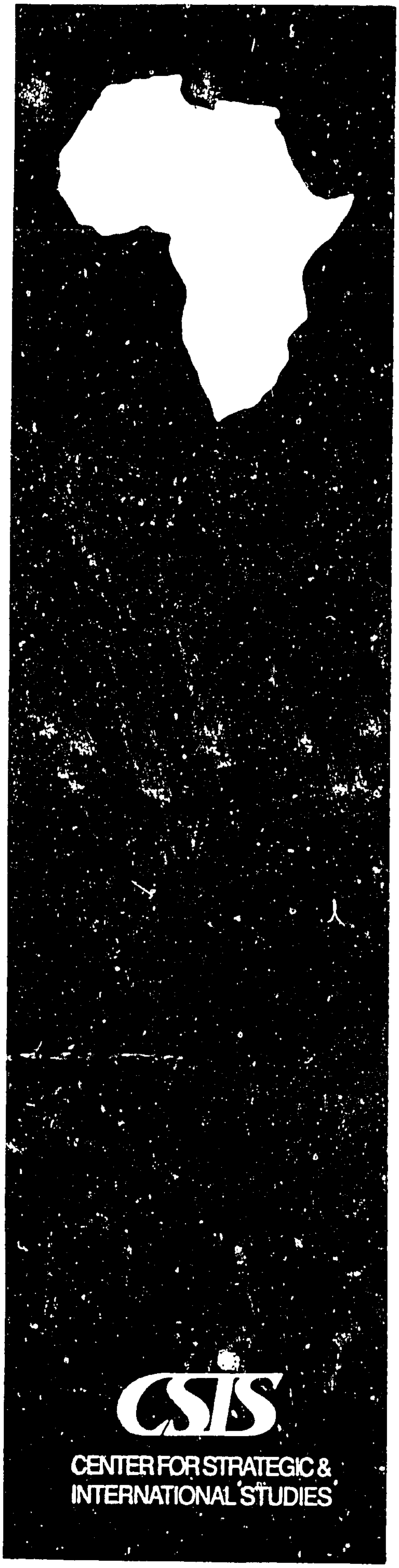
Yet anyone who knows Africa also sees the greatness and power that dwell across the Continent. It is the greatness of natural beauty and the power of untapped resources. It is the greatness of diverse and rich cultures and the power of talented peoples yearning for a better future. And the progress toward democracy and reform in Africa today tells me that future is now much more than a dream.

During the presidential campaign, then Governor Clinton noted that progress when he said this: "A revolution is underway in Africa. From South Africa to Ethiopia -- from Kenya to Zaire -- Africans are struggling to achieve political and economic freedoms that we Americans often take for granted. We have a strong interest in helping them to translate those freedoms into a better life for themselves and their children."

I share that conviction. And I share the determination of now President Clinton to put those words into action. As we do, I look forward to working with many of you in this room and the great nations you represent. Thank you.

Number 148

May 1993



CSIS AFRICA NOTES

A publication of the Center for Strategic and International Studies, Washington, D.C.

An Update on U.S. Priorities in Africa

by James L. Woods
Deputy Assistant Secretary of Defense for African Affairs

U.S. policy toward Africa is undergoing substantial change. The need for new directions was already evident in the mid-1980s (see "Some Observations on U.S. Security Interests in Africa" by Noel C. Koch, then Deputy Assistant Secretary of Defense for the Africa Region, *CSIS Africa Notes* no. 49, November 1985). The end of the cold war and priority shifts set in motion by the Clinton administration have accelerated development of new approaches and priorities. As outlined by Assistant Secretary of State for African Affairs George E. Moose at his confirmation hearing, the new administration's main goals for Africa include the growth of democracy and human rights, sustainable economic development, and environmental protection. Central to these goals are the complementary objectives of conflict resolution and peacekeeping, and the downsizing and professionalization of Africa's often fractious militaries. The Department of Defense (DoD) and the House Foreign Affairs Committee's Subcommittee on Africa have also focused attention on these aspects of U.S. policy, as evidenced in recent hearings held by the Subcommittee and a conflict resolution initiative by the full Committee.

The four documents on the following pages of this issue of *CSIS Africa Notes* detail these evolving concerns, with special emphasis on conflict resolution and peacekeeping. The first two are my testimony (slightly abridged to reduce redundancy) before the Africa Subcommittee on March 31 and May 12 of this year. The third item is an excerpt of a recommendation submitted by the Africa Subcommittee to the House Foreign Affairs Committee for a section on Conflict Resolution in the Committee's pending report on FY 1994 Foreign Assistance Authorization. The fourth item is a table summarizing the administration's FY 1994 budget requests, as these might be available for specific African countries as well as regional and functional groupings. Two important items not included in the table are (1) Africa's share of the not-yet-allocated $1.549 billion Public Law 480 worldwide budget (of which approximately 33 percent [$511 million] would go to Africa if FY 1993 percentages were used) and (2) the pending allocation of new Department of Defense initiatives for FY 1994 ($300 million for peacekeeping, $50 million for support of democracy, and $48 million for humanitarian assistance) that would provide for activities in Africa.

This convergence of views within the administration, and between the executive and legislative branches, is remarkable. Even more remarkable is what I believe to be a much wider emergent consensus shared by important private sector actors and key European countries. In early May 1993 I had the opportunity to make official visits to a number of European capitals (Brussels, Bonn, London, Paris, Lisbon) to compare with European defense and foreign policy officials our views of trends in Africa and appropriate responses. I found an extraordinary degree of agreement on Africa's problems and a similar unprecedented near-consensus that we should focus our activities mainly on the areas enumerated above. When it came to priorities and tactics, however, that consensus was lacking. This is not necessarily a critical deficiency, because the tactics of pursuing this new agenda are in fact only beginning to be worked out, here and abroad. The problem of lack of resources is a more serious and immediate matter. Our European allies are experiencing the same budgetary constraints as the United States, particularly in the areas of security assistance and peacekeeping—where already limited resources are now increasingly challenged by new demands in the former Soviet Union, and in Eastern and Central Europe.

In sum, we have at least a partial design of a promising post-cold war policy framework for Africa. We face, however, the arduous tasks of devising the effective tactics and mustering the resources to give it a strong likelihood of success.

1. **Statement before the Subcommittee on Africa of the Committee on Foreign Affairs, U.S. House of Representatives (March 31, 1993)**

. . . . I do not appear as an expert on peacekeeping, but as a person with policy oversight responsibilities—since 1986—for sub-Saharan Africa. I have followed the issues of peacekeeping and conflict resolution closely, have been personally very involved from time to time as a member of negotiating teams formed by the Department of State, and have attempted to encourage greater support of peacekeeping on an interagency basis. [It should be noted, however, that the views I share with you today] are not authoritative rules or views of the Department of Defense on peacekeeping in general. . . .

President Bush last year and President Clinton this year have affirmed that the United States is strongly committed to strengthening peacekeeping capability to prevent, contain, and resolve conflict across the globe. With the end of the cold war, peacekeeping actions which earlier would have been vetoed in the United Nations Security Council are proliferating. Regional organizations are also beginning to play a more active role. Gone is the unwritten rule that neither of the superpowers could provide large numbers of peacekeepers to UN operations. The United States has done so (in Kuwait), is doing so (most notably in Somalia), and will continue to do so. Russia has expressed an interest in doing so, finances permitting.

As my office has become increasingly involved in conflict resolution issues, I have noticed that too often "terms of art" have various meanings to different people. So before I talk about the Department of Defense's commitment to peacekeeping in general and our specific efforts in Africa, let me set forth for you some terms that are in use, including at the UN, to describe different stages of conflict resolution.

- First, there is *preventive diplomacy*. This is the sphere largely of my State Department colleagues and one in which [Assistant Secretary of State for African Affairs Herman] Cohen and his predecessor, [Chester] Crocker, have been notably active and successful. Here the United States attempts to prevent disputes from arising between parties, to prevent existing disputes from escalating into conflicts, and to limit the spread of conflicts when they occur.
- Second, and very closely related, is *peacemaking*. Here we try to secure resolution of disputes that could lead to conflict. The tools used are still diplomatic, including mediation and negotiation.
- Third is *peacekeeping*. This is the prevention, containment, moderation, or termination of hostilities among, between, or within states through the intervention of a neutral party. This is usually organized and implemented through a regional or international organization (most often the United Nations). Its object is to maintain or restore peace. It involves the use of military forces, and often police and civilians. It is usually conducted with the consent of the principal belligerents. Peacekeeping activities under the UN's aegis are Chapter Six actions. Through the late 1980s, these were the principal conflict resolution activities conducted by the United Nations.

CSIS AFRICA NOTES is a briefing paper series designed to serve the special needs of decision makers and analysts with Africa-related responsibilities in governments, corporations, the media, research institutions, universities, and other arenas. It is a publication of the African Studies Program of the Center for Strategic and International Studies, Washington, D.C. CSIS is a private, nonpartisan, nonprofit policy research institute founded in 1962.

Editor: Director of African Studies Helen Kitchen
Deputy Editor: J. Coleman Kitchen

SUBSCRIPTION RATE: *CSIS Africa Notes* is sent airmail/first class to subscribers worldwide. The annual subscription price for 12 issues and occasional supplements is $48.00. Please make checks payable to: *CSIS Africa Notes*, Suite 400, 1800 K Street, N.W., Washington, D.C. 20006, U.S.A.
Telephone: (202) 775-3219. Telex: 7108229583.
Cables: CENSTRAT. Fax: (202) 775-3199.

ISSN 0736-9506

- Fourth is *peace enforcement*, a growth industry in recent years. This involves military operations to restore peace or establish agreed conditions in an area of conflict or tension, even though the parties may not consent to intervention and may still be engaged in fighting. When conducted by the UN, these are Chapter Seven actions.
- A fifth category in some minds is *peace-building*, [which] entails postconflict actions to strengthen and solidify the peace in an effort to preclude the resumption of armed conflict.

For now, the lead organization for conflict resolution in Africa (and throughout the world) is the United Nations. But before I discuss the UN, let me briefly sketch U.S. involvement in several non-UN conflict resolution efforts in Africa. We have worked with and through (1) the Economic Community of West African States (ECOWAS), (2) the Organization of African Unity (OAU), and (3) bilaterally or with ad hoc groups of actors.

In August 1990, an ad hoc ECOWAS military arm, ECOMOG, [was] deployed to Liberia to try to put an end to the fighting that had raged there since the previous December. The United States has strongly encouraged ECOWAS in this regional peacemaking endeavor. The United States provided ECOWAS $10.15 million in FY 1991 Economic Support Funds (ESF); $3.45 million in FY 1991 Foreign Military Financing (FMF) (Gambia $250,000, Ghana $500,000, Guinea $500,000, Ivory Coast $1 million, and Sierra Leone $1.2 million); and $15 million to Senegal in FY 1992 ($5 million in FMF and $10 million in DoD goods and services). Further, Ambassador Cohen and I and members of our staffs have been involved in countless meetings in Washington and abroad to encourage negotiations for an end to the conflict in Liberia.

The OAU is currently working to develop its own conflict resolution mechanisms. Although the OAU has been involved in peacekeeping operations, it has not developed a standing capacity to respond to the needs for mediation, conciliation, and arbitration in Africa. At the 1992 OAU Summit, Secretary General Salim Salim proposed that the OAU move full time into managing conflicts, knowing that non-African countries would have to provide some of the resources.

The United States has moved to provide assistance to this initiative. In early 1992, Ambassador Cohen and I agreed to seek a presidential determination making the OAU eligible for U.S. security assistance support. The president approved, and issued such a determination on August 25, 1992. We then moved promptly to provide the OAU with $1 million for use in PKOs [peacekeeping operations] ($500,000 in FMF and another $500,000 in ESF). Recently, we designated our military attaché in Addis Ababa as a liaison officer to the OAU and he has begun working with his military counterparts to identify ways in which we might help improve the OAU's planning and execution capabilities for peacekeeping.

The first use of some of the funds provided to the OAU has been in Rwanda, in support of the OAU cease-fire monitoring force. We have also been involved in diplomatic efforts to end that civil war. U.S. observer delegations, including military experts, have provided technical advice and guidance to the OAU-sponsored peace negotiations. In that regard, LTC Tony Marley (previously of my staff and currently on Ambassador Cohen's staff [in the Department of State]) has since late February been shuttling between Kigali, Kampala, and Arusha providing impartial technical advice to both parties in the tragic civil war. We have also worked behind the scenes bilaterally with the various players, providing advice and encouraging compromise. The perception, by all sides, of the United States as an "honest broker" has facilitated communication between the rebels and the Rwandan government.

Those efforts by LTC Marley and others are examples of the third type of involvement in conflict resolution—bilateral or ad hoc multilateral efforts. Since the mid-1980s, I, members of my staff, and officers from the Joint Staff have been involved, as members of State-led teams, in many of the conflict resolution negotiations that Ambassador Cohen has described [in his testimony before the Subcommittee]. Specifically, these included Namibia, Angola, Ethiopia, and Mozambique, where we worked bilaterally or in concert with representatives of other countries, including Portugal, Italy, South Africa, and Russia.

[In this post-cold war era, as I noted earlier, the United States] is relying principally on the United Nations to take the lead in peacekeeping. The Department of Defense has been actively working with the UN in this regard. You are all well aware of our activities regarding Somalia, but let me describe some less well-known activities in Angola and Mozambique. In Angola, Department of Defense personnel played an important supporting role in the peace accords negotiations, including serving as technical advisers on the U.S. delegation. We then provided military officers to serve as observers to the joint commissions overseeing the peace process. To supplement international emergency relief and to provide for soldiers encamped for demobilization, we airlifted, from DoD excess stocks, over 3 million meals ready to eat (MREs), thousands of tents, and over 60 tons of nonfood items (blankets, plastic sheeting, etc.); and shipped 140 sea-vans of MREs (approximately 2.6 million meals). We also provided three C-130s, communications, and other support to assist in demobilization and to help with electoral preparations.

The UN mandate in Mozambique, which extends from the October 1992 signing of the peace accord through elections, now scheduled for late 1993, reflects lessons learned in Angola and other countries. In Mozambique, the UN plans a contingent of up to 8,000 military and civilian personnel, including an international observer force of 350. Before the elections can be held, it is critical that the new national army be formed, trained, and deployed and excess soldiers from both sides demobilized.

We are providing two U.S. military officers to assist our defense attaché in Maputo in participating in the UN-chaired commissions overseeing the peace agreement. In addition, in response to a UN request that the United States provide military engineers to assist in road repair in Mozambique, a joint State/DoD engineering assessment team is just completing a fact-finding mission in Mozambique. [It has] been gathering data on the scope of the repairs required and the UN's capability to support the possible deployment of U.S. engineering assets.

In both Angola and Mozambique, we see a potential for the U.S. military to play a peace-building role through involvement with the new armed forces, which will require substantial training assistance. In doing so, we would be joining several of our European allies who have agreed to provide that training initially. When political circumstances are right, the United States could establish a security assistance program with Angola and expand our security assistance program with Mozambique. Our focus would continue to be on training, through the IMET [International Military Education and Training] program (to include expanded IMET and IMET-funded Mobile Training Teams). If the Congress has at that time also made FMF funds available for Africa, we could consider these countries' militaries as candidates for assistance in nation-building activities through the Africa Civic Action program. We also think that both countries would benefit from participation in our coastal security and biodiversity programs—again on the assumption that FMF funding is available at the time.

Last month, Shasi Tharoor, the United Nations' Special Assistant to the Under Secretary General for Peacekeeping Operations, noted at a Carnegie Endowment meeting that "the UN has had as many PKOs in the past 43 months as it has in the previous 43 years." Moreover, although still referred to as peacekeeping operations, the nature of the operations has changed and many of them involve enforcing peace, not merely keeping it. Consequently, if the United States is to work as effectively as possible in dealing with this changed and still changing milieu, both we and the UN must make changes in the way we do business.

A number of possibilities—repeat, possibilities—exist for improving UN capabilities. Some things which concerned offices at the Pentagon are looking at include:

- a reorganized and expanded UN secretariat staff to increase information flow and enhance planning and implementation capabilities;
- establishment of early warning systems to alert senior UN policymakers before a crisis erupts, so that preventive measures can be taken;
- speeding up the UN's ability to determine that a disaster requiring an international response exists;
- enhancing the UN's ability to respond with humanitarian assistance (for example, the UN's commodity purchase and contracting system needs reform to improve timeliness);
- adoption of standardized military procedures and interoperable equipment among UN-deployed forces;
- establishment of a UN training center to enhance both unilateral and combined training of staffs and forces;
- formation of an integrated UN strategy for dealing with complex international emergencies which combine military, humanitarian, and political resources;
- creation of public information resources—radio stations and newspapers—for use in complex emergencies to get the UN's message to the public;
- notification by member states of the specific capabilities that could be made available for the full range of peacekeeping (and humanitarian) operations, as well as stockpiling of that equipment most likely to be required.

We recognize that criticism is easy, and we are actively looking for ways to help implement some of these and other improvements. We are or will be helping the UN by temporarily augmenting key positions on the military staff with temporary duty U.S. military officers, by seconding [U.S.] personnel (civilian and military) to key positions on the civilian staff of UNOSOM II in Somalia, and by establishing an intelligence-sharing mechanism. However, we need to do more. . . . The Department of Defense has been working intensively to develop ideas following President Bush's September 21, 1992 speech to the United Nations on peacekeeping, and the Clinton administration is now formulating a detailed conflict resolution strategy. All of the elements are not yet in place but I can describe the broad outlines of two key initiatives which most directly concern the Department of Defense.

First, Secretary [of Defense] Aspin is proposing a reorganization of the policy cluster where I work, to include the establishment of an assistant secretary of defense for democratic security. This office would have conflict resolution as one of its primary functions. Presently there is one individual who works conflict resolution full time. By the end of this year, we hope to have up to 10 people devoted to this important task.

Second, the just-submitted FY 1994 Department of Defense budget reflects the Clinton administration's commitment to conflict resolution as an important means to promote U.S. interests. Specifically, for the first time, [the Department of] Defense is explicitly budgeting not only for ongoing conflict resolution operations but for possible future contingencies. The budget contains a request for $300 million for peacekeeping; this will cover our incremental costs of participation in UNOSOM II in Somalia and will make substantial funds available to meet new peacekeeping operation requirements which may arise. I emphasize that this canvas is only partially filled in. Please recognize that we are trying to formulate an overarching policy and strategy on the run while simultaneously dealing with operations in Somalia and working in varying degrees on situations in countries such as Mozambique, Angola, Rwanda, Liberia, Sudan, and

Togo—to mention only the view from Africa!

Like the Department of State's Bureau of African Affairs, DoD considers itself involved in peacekeeping for the long haul. It is getting much attention but we are far from having worked out the details of our approach. This process will benefit from continuing exchanges between the executive and legislative branches, and I am sure the advice and ideas we get from this type of hearing will be beneficial in developing new national policy approaches in this important area. . . .

2. **Statement before the Subcommittee on Africa of the Committee on Foreign Affairs, U.S. House of Representatives (May 12, 1993)**

[The letter from the Subcommittee inviting me to speak here today asked] me to evaluate U.S. foreign assistance programs and U.S. policy toward Africa. There is no way I can accept that challenge; the writ is too large, my time too short. But I am prepared to make a few observations about several selected aspects, from the perspective of one who has spent the last 14 years working these issues for the Department of Defense. First, I see an absolutely undeniable and very critical link between security, political stability, and development. If there is no security, there can be no political stability and consequently no sustainable development. Without development, conditions deteriorate and there is no security. From this, I suggest several guidelines:

- There should be more attention to designing comprehensive and integrated approaches to development, encompassing its political, economic, and security components.
- There should, therefore, be even closer exchange and informal coordination among the concerned actors, including our own interagency community, the international lending community, other bilateral donors and the private sector—to include some very important NGOs and PVOs. If we are working in sharply divergent directions or with very different priorities, the outcome is seldom felicitous.
- The security components of this process, and conflict resolution in particular, ought to [be pursued more consistently] as subsets of a clearly articulated, broader political strategy. The main dimensions of that strategy ought to be political, diplomatic, and developmental, and the military activities we promote should be designed to promote and support those broader strategies and their specific goals. This means more attention by those of us in the defense community as to how we fit in and how we can best contribute. And to our diplomatic colleagues and other interested parties, I suggest more intense attention to now to deal with the security component of their policies and to how best to put the Department of Defense to work in pursuit of the common national objectives we share.

We in DoD are working with our African friends to look ahead and to adjust to changing circumstances. Our approach was not born in recent months; in fact we began to chart our present course in the mid-1980s We are well aware that there is no laboratory formula that we can apply. The decisions that must be made will be tough, and we must accept the fact that we will sometimes fail. But our goal is to move forward, mustering all the resources that we can bring to bear. Among these resources are the [Department of State's] security assistance program which the Department of Defense administers, and other DoD programs, some new. . . .

One major area, newly emphasized, is an improved capacity for conflict resolution and peacekeeping operations (PKOs). Our activities in Somalia are well known to you and have been discussed in this forum recently.

At this point I want to join [Assistant Secretary of State for African Affairs] Moose in commending the Subcommittee for the broad outlines it has developed for an amendment on conflict resolution. We in the Department of Defense strongly support your goals of institutionalizing both the OAU's and subregional organizations' conflict resolution capability, assisting in African demobilization and soldier-retraining, working to change African military culture, and developing African conflict resolution skills. At the same time, there are certain elements on which I would need additional information before I could develop a definitive Department of Defense response, such as the source of the direct funding to the Organization of African Unity for its conflict resolution unit. We look forward to working with you on this in consultation with the Department of State.

Last year (FY 1992) we provided modest funding to the Organization of African Unity in support of its Neutral Monitoring Group (NMOG) in Rwanda, a potential first step in the OAU's development of formal and continuing mechanisms for conflict resolution and peacekeeping. OAU Secretary General Salim A. Salim's proposal of such mechanisms will be considered at the [annual OAU summit in June] and we need to be receptive to such efforts. There is $3.166 million in PKO monies proposed for the OAU in the FY 1994 security assistance budget.

In FY 1992 we also assisted the Economic Community of West African States (ECOWAS) in its efforts to establish peace in Liberia through ECOMOG. This is the first instance of one of Africa's subregional organizations undertaking direct peacekeeping efforts. For FY 1994 the administration has proposed $12 million in PKO monies in support of these peacekeeping activities. State and Defense intend to continue to work with ECOWAS (and hopefully in the future with other subregional organizations such as the Southern African Development Community [SADC]) in improving their conflict resolution capacities.

In addition to assistance to the OAU and to ECOWAS, the FY 1994 proposed security assistance budget for Africa includes $10 million in FMF for peacekeeping and other regional requirements. We intend that much of this money go toward assisting African countries to demobilize forces and downsize their military.

We believe downsizing and demobilization are absolutely essential to the success of the goals of democracy and conflict resolution. We believe many African countries have too many men under arms and put too many of their scarce resources into unnecessary military expenditures. We hope to receive funding adequate to assist Africans in their transition to smaller, more professional armies--institutions more affordable and more in keeping with their hopes for development and their desires for democracy. Mr. Chairman, I know this is a priority for you and we in the Department of Defense could not agree more.

Before turning from security assistance to some new programs, let me again strongly endorse the IMET and expanded IMET programs. Dollar for dollar, I believe that this is the most effective program we have in Africa, both through providing African military—and in some cases civilian—leaders the opportunity of a first-rate educational experience and through exposing them to the very American concepts of the primacy of civilian rule and the role of an apolitical military. We in DoD strongly endorse the modest $7.745 million IMET request for Africa in FY 1994. This will be money well spent.

Although they do not come before this committee for review, there are some activities which the Department of Defense undertakes on an ad hoc basis and some new, innovative proposals that we have made for FY 1994 which closely complement the Department of State's security assistance requests.

As I noted to this committee in an earlier hearing, the Department of Defense already plays limited but important roles in peacekeeping operations. We have provided personnel to negotiating missions and to teams headed by the Department of State. We have provided military planners (usually logisticians or airlift specialists) to the UN as well as the airlift to deploy and redeploy UN peacekeepers. We have provided observers and monitors to agreed peacekeeping operations (such as in Angola and the Western Sahara), and we have provided maps and other informational products and communications equipment helpful to those engaged in monitoring compliance.

For FY 1994, the Department of Defense has budgeted $300 million in a new line to cover the costs to DoD of peacekeeping, within a new appropriation for global cooperative initiatives. This will eliminate the need to reallocate readiness-related funds during program execution for peacekeeping, and it will speed our response to new situations. It does not fund long-standing PKOs, such as the UN truce supervision organization in Korea, which is in the army's budget, or massive peace-enforcement operations such as Somalia (UNITAF) which could require supplemental funding.

Among the activities which might be supported by the $300 million PKO fund are military observers in the Western Sahara (MINURSO), observers in Angola, and, of course, the incremental costs to the Department of Defense of participation in UNOSOM II in Somalia.

The Department of Defense is also requesting $50 million to support the spread of democracy worldwide. These funds would help institutionalize and expand military-to-military contacts such as EUCOM's very successful program with the former Soviet Union and Eastern Europe; provide education and training on the appropriate role of the military in a constitutional democracy; and provide advice in building democratic structures and converting defense industries to civilian use.

One point I want to make clearly. These initiatives will in no way circumvent congressional oversight of the traditional security assistance accounts. They are complementary and supplementary but are meant as Department of Defense initiatives and not a replacement for security assistance.

Of course, only a portion of these new initiative monies would be spent in Africa in a given year and that portion would be circumstance driven. But given the number of African countries which have recently gained or are moving toward democratic polities, the all-too-many conflicts where peacekeeping is ongoing, and other tragic situations which cry out for peace, I am sure that the continent will benefit greatly if these programs are funded. Just as I urge you to [fund fully] the FY 1994 security assistance request for Africa, I also urge you to endorse these new initiatives to your colleagues on the Armed Services and Appropriations Committees. . . .

Carnegie Quarterly

MAKING PREGNANCY AND CHILDBEARING SAFER FOR WOMEN IN WEST AFRICA

A woman in her late thirties languishes on a cot in a government hospital in Ubiaja, a town about an hour's drive from Benin City in southern Nigeria. A rough cotton sheet loosely covers her sunken frame. Her large protuberant eyes are expressionless, indifferent to the murmur of patients and nurses in the ward.

At her bed stand a young resident doctor, the matron of the ward, and two visiting physicians from the University of Benin and Columbia University's School of Public Health. They are discussing her "case."

The doctor is clad in hospital green with rubber boots. It is high noon and he has already performed three operations that day. To the visitors he explains the patient is depressed. She was brought in by relatives in her ninth month of pregnancy, having stumbled on a rutted track under a load of cassava roots. The fall caused her to hemorrhage, requiring an emergency incision (laparotomy) to extract the dead baby and repair the damaged tissue. Afterwards she was given antibiotics and within a week was sent home. Before long, she was back complaining of stomach pains. A second operation revealed a severe abdominal infection, although, the doctor says, the uterus was still healthy. After treating her, he prescribed more antibiotics and kept her under observation. Days later it was evident the infection was progressing. Opening her up again, he discovered the uterus had turned gangrenous. He performed a hysterectomy. Now, although physically recovering, the patient is listless and withdrawn. The ordeal is written in her face.

Abruptly aware of the figures looming over her, she starts, drawing in her legs protectively. The matron takes her hand asking what is wrong. The patient, she translates into English, thinks they have come to preside over her death. The nurse moves to reassure her. The group passes on.

Two beds away, another patient is convalescing from a Caesarean section. Her infant was stillborn, the result of a pregnancy-related condition, called eclampsia, that can catapult the mother into convulsions, coma, and death.

In an adjoining lying-in ward, the doctors talk with a third woman, age thirty-eight, who tearfully recalls the antepartum hemorrhage she suffered in the hospital and her baby's death when the placenta separated from the uterus.

The doctor in green acknowledges that the first patient was not given enough antibiotics. The second had never received prenatal care, which would have disclosed high blood pressure, and "waited too long to come to hospital." The third was "booked" ahead and not considered at risk: her three previous children were delivered normally.

While questions might be raised about the management of two of these cases, at least the women lived — even if their babies did not — because they reached a relatively well equipped and staffed health facility in time. Their counterparts going into labor in the remote villages of tropical Africa might have died, with no record of the double tragedy. They and their infants would have been buried quickly, their families bereft, with no mother to look after the other children.

After battling distances and bad roads, poor families must cope with the rising costs of medical care.

GRASPING THE REALITIES

Compared to what they face in other parts of Nigeria, the women of Ubiaja are lucky in having access to a public hospital and several private centers that provide prenatal care and are able to perform essential lifesaving functions or arrange transport to Benin City. Most African women live far from the paved roads leading to modern medicine. Private buses, called mammy wagons, come to the villages intermittently, and taxis, where they exist, can extort a high price for an emergency run. Drivers concerned about their car seats may refuse a woman who is bleeding, so she must be carried by any other means — bicycle, motorbike, wheelbarrow, cart, or hammock — which may only worsen her condition. "If you have an emergency situation," says a village woman, "you will smell pepper, because you have no means of getting to the hospital, especially at night."

After battling distances and bad roads, poor families must cope with the rising costs of medical care. The structural adjustment programs and external debt payments squeezing Ghana, Nigeria, Sierra Leone, and other West African countries have lowered their health budgets. Governments, abandoning free service, have adopted a "cash and carry" system for patients and hiked transport fares.

Over the years, many outlying hospitals and health centers have fallen into a dilapidated state, with equipment unrepaired, supplies scarce, and standards of good medical practice lapsing. Sterilization facilities for invasive procedures often do not exist or are not maintained. While steps are being taken to improve techniques for ensuring "clean" delivery by midwives and other health workers, postoperative infection remains a serious threat to women's lives. "In principle, the government accepts that health is a priority area," sighs Dr. John-Baptist Wilson, head of the department of obstetrics and gynecology at the University of Ghana Medical School in the capital city of Accra. "But our economic situation has dictated otherwise."

Accordingly, fewer women from the poorer sectors, including the urban slums, are delivering their babies in government hospitals, and more are arriving in a moribund state.

At Iurekpen General Hospital about sixty miles from Ubiaja, the electric generator and water pump are broken.

Water for general use is drawn from an open well that in the rainy season is augmented by runoff from roof gutters. The only toilets for patients and personnel are pit latrines. Like most district hospitals, Iurekpen has no operating theater; nor does it have a blood bank or capacity to screen for HIV, although it can match blood types for transfusions. The refrigerator in the lab is moistly hot; the anesthesia machine is also nonfunctioning. Recently, one whole wing was shut down by the government to save money. The adult and pediatric wards were combined, and patients with communicable diseases are now "isolated" at one end of the room. In May of 1992 there was an outbreak of what was thought to be Lassa fever in a local family, nearly all of whose members died. Three nurses treating the stricken also died of the viral disease.

In the past two years, public health systems have been beset by wage strikes. In 1992 there were two nurses' strikes in Ghana; the pharmacists also struck. Government medical facilities closed down in Nigeria during February and March of 1993. Where the emergency cases went, no one is sure.

During the oil-boom years, Ghana and Sierra Leone lost a precious percentage of their obstetricians and gynecologists to Nigeria, but since the recession set in, all three countries have watched their specialists exit for Saudi Arabia; those who have stayed behind hug the big cities, leaving the countryside underserved. "Accra has half the fifty or so obstetricians and gynecologists in the country. Kumasi has most of the rest," says Wilson.

Various programs to decentralize essential obstetric services are being tried in a number of African countries. One is to post an obstetrician to a district hospital. Evidence shows this will indeed prevent maternal deaths, but, given the shortage of specialists, it may not be practical for the present. Another route is to train nonspecialist doctors and nurse-midwives — the skilled cadres closest to the problems — in obstetric surgical techniques. In a demonstration program in Zaire, nurses were specially trained to perform Caesarean deliveries, laparotomies, and hysterectomies. Their case fatality rates for operations were about the same as those for physicians. The idea, however, is resisted in the medical community. "I have reservations about training nurse-midwives in manually removing a retained placenta," acknowledges Wilson, who holds the conservative view. "Because if it is not done right it may cause hemorrhage. For the same reason, I also have reservations about their doing vacuum extraction [to remove the baby or dead fetus]." Others, including Charlotte Gardiner, the former chief of maternal and child health within the Ghana Ministry of Health, argue that the need in underserved areas is so desperate there really is no effective alternative to training auxiliary personnel in these procedures.

But even when good-quality maternity care is accessible, whether through a mission, private, or public facility, African women by custom prefer to deliver at home, assisted by a traditional birth attendant (TBA), midwife, or relative. Hospital staff note that patients who come to the clinics for prenatal care will vanish toward the end of their term, not to be seen again until the next pregnancy or they are brought back as an emergency case.

In some ethnic groups women are expected to experience labor in stoic solitude; typically the birth attendant is called in only to cut the umbilical cord, wash the baby, and ritually bury the placenta. If they develop any one or more life-threatening conditions, like eclampsia, infection, obstructed labor, or hemorrhage, the first person to whom women will turn is the birth attendant; after that the herbalist, diviner, spiritualist, or other traditional healer. "The last place they will go," says Angela Kamara, "is to the health services."

Kamara knows her subject. A midwife from neighboring Liberia, she has dedicated her professional life to the promotion of maternal and child health in her home region. Currently based in Accra, Ghana, she is deputy director of the Prevention of Maternal Mortality (PMM) Network, a Carnegie Corporation-supported collaborative effort involving multidisciplinary teams from Columbia University's Center for Population and Family Health in the School of Public Health and eleven institutions in three English-speaking West African countries: Ghana, Nigeria, and Sierra Leone. Together over the past five years the teams, consisting of obstetricians, community physicians, nurse-midwives, and social scientists, have been conducting operations research in various African communities and health facilities. (See grants list on p. 19.) Their objectives: to discern the barriers to timely, qualified obstetric care and to develop affordable, enduring strategies for reducing high maternal mortality rates among those whom Kamara calls "poor, pregnant, and powerless."

◆ ◆ ◆ ◆

WHAT WOMEN SAY

Perhaps understandably, many women of West Africa regard the government hospital with mixed feelings. Birth attendants or other traditional healers are from the community; they speak the local language, charge modest fees or accept payment in kind, and, patients insist, can handle the common exertions of childbirth. Just as important, they provide strong emotional support during and following labor.

If a serious complication arises that is beyond the means of traditional medicine, it is recognized in principle that "the best thing should be to go to the hospital or look for a nurse if one lives nearby." As one lady pronounces, "There is no doubt that hospital treatment is good because it is God who guides the doctors." One whose life was saved testifies, "I had serious bleeding a day after delivery, but the TBA under whom I had the baby could not do much. I was rushed to the hospital where the doctor found that the placenta was not completely removed, and so he used something to remove it." Another offers, "All said and done, the hospital is the best place for the treatment of postpartum hemorrhage and other complications. That was where I had my last baby, my third child, and with the big size of the baby I had a very serious bleeding problem. But as soon as this started about one hour after delivery, the doctors and the nurses battled to save my life, by stopping the blood flow."

But women who may owe much to the formal medical system are frank about its deficiencies. "Labor and the complications of childbirth do not know office hours," declares one lady. "But the nearest health center may not be open at all at night, and there is no transport to the big hospital." On the cost of care, "They ask you to buy heaven and earth — and we do not have that kind of money." About the nurses, they "treat you rudely, and you dare not complain, otherwise you will be completely ignored and abandoned to groan in pain and die." Then a doctor might not be available, "so you have to wait and wait till you see death in your eyes." Recently, another testifies,"a woman died here because of bleeding, due to the fact that the doctor could not be found."

The women wait, only to be told that there is no blood for transfusions and that essential equipment, supplies, and drugs are lacking. Their husbands scurry around, sometimes in the dead of night, to purchase even the rubber gloves used to operate. Often, women say, there is no water or light in the facility. Comments one, "The water problem is such that, after delivery, if you have no relation, you are asked by the nurses to pad yourself and go to the stream for water." They complain that the wards and halls are not clean. "At times snakes are found in the hospital because the place is not tidy and there appears to be no cleaner there."

In the wards, moreover, patients have no privacy and will be examined by male strangers rather than familiar helpers (more disturbing to Muslim families than to others). In the labor room they will be delivered on their backs instead of in the customary squatting position, or possibly have a Caesarean, rather than a vaginal delivery, which in some African cultures is considered abnormal and stigmatized. Finally, in their concern about the quality of care, they admit, "We hear of many maternal deaths in the hospital."

THE PERILOUS ROUTE TO MOTHERHOOD

The facts of maternal mortality worldwide are elusive, because, notes Columbia University epidemiologist Deborah Maine, who is program director of the Prevention of Maternal Mortality Network, most women's deaths are "shrouded in silence."[1]

Compiling records from government statistics and small-scale intensive studies, the World Health Organization estimates that more than 500,000 women lose their lives each year from complications of pregnancy and labor, a figure that includes botched illicit abortions. Almost all of the fatalities occur in the impoverished regions of Africa and South Asia, where pregnancy-related complications are the leading cause of death among women of reproductive age. In Africa, the lifetime risk of a woman dying of obstetric causes is one in twenty-one; in northern Europe it is one in 9,980. In addition, untold millions become chronically ill or permanently impaired.[2]

Nigeria alone, a country exceeding 85 million people, accounts for about one in ten maternal deaths in the world. Estimates from hospital records are that the maternal mortality ratio there is 800 per 100,000 live births, compared to 7.4 in the United States (latest figs. available).[3]

In the Nigerian state of Cross River, the University of Calabar Teaching Hospital, one of the institutions in the Prevention of Maternal Mortality Network, shows 44 percent of maternal deaths linked to hemorrhage. Zaria state's Ahmadu Bello University Teaching Hospital, another network member, lists obstructed labor as the most common antecedent of maternal death in that region (the direct cause in about one-third of the cases is infection). The teaching hospital in Sokoto, Nigeria, a third network member, reports 31 percent of maternal deaths occurring among young women aged thirteen to nineteen years.

In Ghana, the situation is somewhat better. A Corporation-funded study in 1989 by the American College of Nurse-Midwives found the maternal death ratio in three Accra-area hospitals to be seventy times that of the United States. A survey of maternal mortality carried out by the PMM Network team in Kumasi, Ashanti region, counted forty-four deaths in the Ejisu district over a four-year period ending in 1989. The most common cause was hemorrhage

In the northern Sahel region of Ghana, where only 15 percent of mothers deliver in a health facility, Bawku Hospital, serving a population of 360,000 mainly subsistence farmers, reported a maternal mortality ratio of 1,700 per 100,000 live births in both 1988 and 1989. The majority of the patients died from hemorrhage and birth-related sepsis (infection), some of it acquired in the wards.

As Victoria Ward of the Columbia University team puts it, "Most women deliver successfully — by the crude standard of their own and their babies' survival. But for many motherhood is unsafe and positively dangerous."[4]

BELIEFS AND PRACTICES

Despite the casualties, Africans, like most people, expect pregnancy and childbirth to proceed uneventfully. Says Angela Kamara, "They do not always recognize when something is wrong — often until it is too late." A husband informed his wife is "at risk" does not see why she should deliver in the hospital because "she is not sick." Death, when it comes, is generally accepted as fated or, in some way, the woman's fault. It is not perceived that timely, qualified intervention could prevent most mortal outcomes.

Public awareness of the gravity of the problem is slow to come, in part because the deaths of women are scattered among dispersed communities, and communications are poor. It is only when the numbers are aggregated in hospital records and registers of the ministries of health that their significance becomes clear. And even then the figures may be misleading because the underlying cause might not appear on the death certificate, or obstetric cases may end up in the general or "gyne" wards and misclassified.

Another reason perhaps has to do with women's own dependent and inferior status, which helps to keep them ignorant and powerless in decision making even on matters related to their reproductive health and survival. Women who are secluded, for example, have to await their husband's permission to leave the compound for any reason. If the husband is away when an obstetric emergency arises and he is not found, his wife stays home. Under such conditions, women cannot easily voice their needs or fight to draw public attention to their health problems.

Certain local practices significantly affect the course of pregnancy and labor. Some practices, though they have been little studied, appear to do good if appropriately used, like eating herbs that contain oxytocin, which induces uterine contractions, or triggering vomiting to expel the placenta. But others may be downright harmful or ineffective at best. Young women fearing a "big baby" may avoid nourishing foods; protein-rich eggs and milk may be tabooed. Swollen legs and "fits" are seen as proof of a woman's infidelity or insubordination, instead of pregnancy-induced high blood pressure, or pre-

[redacted]

The path to motherhood is hazardous for women everywhere. . . .

eclampsia. Rather than tell her to lie down, a local healer may persuade her to "confess" and drink exorcising potions. Obstructed labor, thought in some places to be caused by "cold," may be treated by heating the woman's waist before a fire or having her take scalding baths, which can lead to burns, hypertension, and congestive heart failure. Heavy bleeding after delivery is widely viewed as cleansing. Not until a woman has lost as many as five pints of blood may relatives or the birth attendant scramble to get her to a hospital, where she may be deposited already dead or near death. Before that her legs may have been tied together in an attempt to stop the flow.

In the predominantly Muslim north of Nigeria, death following obstructed labor might seem merciful compared to the torture of living with vesico-vaginal fistulae (VVF). VVF are tears in the wall between the vagina and urethra caused by the stress of prolonged labor and the occasional disastrous use of the "gishiri cut" to widen the birth canal. Unless the damage is repaired, a delicate surgical procedure, the survivor will constantly leak urine, turning her into a social pariah. For such unfortunates, any hope of leading a conventional life is foregone.

All these beliefs and practices, which PMM Network project teams have confirmed from their interviews with community members and midwives, can delay the decision to seek care and expose a woman and her baby to needless suffering and even death.

◆ ◆ ◆ ◆

THE UNPREDICTABLE NATURE OF COMPLICATIONS

The path to motherhood is hazardous for women everywhere — not just for those in the developing world. No less a body than the World Health Organization agrees that "all pregnant women are at risk of developing life-threatening complications during pregnancy and labor."[5] At least 15 percent under the best of circumstances develop a serious complication requiring emergency treatment.

For the women of tropical Africa, pregnancy is inherently riskier. Girls are more likely to grow up undernourished or malnourished — beginning in their mother's womb — and to have anemia from bouts of malaria, lack of iron, or the sickle-cell trait. Childbearing can begin early and end late — among some groups it can begin well before the adolescent pelvis has matured. With short intervals between births and childbearing extending well into the thirties, older women are at greater risk of postpartum hemorrhaging, because the muscle walls have lost their elasticity and will not readily contract after labor.

But even if all these factors are considered — distance, cost, local practices, women's low status — they do not of themselves explain the drastically different outcomes of pregnancy for the women of poor and more developed countries. The answer, says Deborah Maine, lies mainly in women's lack of ready access to trained medical personnel equipped to handle obstetric emergencies. According to the World Health Organization, access to essential obstetric care is the "critical element" without which other elements, such as prenatal care, referral, and transport, cannot be fully effective.[6]

A significant number of African women possess one or more of the characteristics that increase their chances of developing a life-threatening complication of pregnancy and childbirth — stunted growth, extreme youth or age, a previous complication or Caesarean delivery, hypertension, multiple pregnancies, or anemia (severe anemia is associated with heart failure and hemorrhage). In theory, these conditions can be detected during the prenatal period and the women referred to a specialized unit to have their babies. Indeed, this "risk approach" has been widely adopted in some developing countries.

But, as Professor Christopher C. Ekwempu, former head of the obstetrics department at Zaria, Nigeria's, Ahmadu Bello University Teaching Hospital and a former PMM Network project leader, points out, "The largest number of maternal deaths tend to come from those so-called 'low-risk' or 'no-risk' women, who are often caught with very little facilities around for their management."

He adds, "It is now becoming obvious that the risk approach to maternity care is not the best option [for reducing maternal deaths] since many of the complications — hemorrhage, sepsis, eclampsia, obstructed labor, and at times illegally induced abortion — are unpredictable."

As Maine elaborates, most women designated at risk turn out to deliver "normally" (effectively creating a credibility gap among those referred to the hospital for delivery). On the other hand, "a sizable minority of women who were in good health prior to their pregnancy experience serious obstetric complications, for reasons that cannot be explained or predicted." By virtue of low-risk women's greater representation in the female population, more actual cases of obstetric complication occur among them than among women identified as being at high risk. This phenomenon is borne out in a study of women screened in the Kasongo health center in Zaire: in absolute numbers, low-risk women accounted for twice as many cases of obstructed labor as did high-risk women.[1]

Maine does not disagree that better prenatal care and screening, nutrition (beginning in the mother's own fetal stage), birth spacing education, and similar measures to improve the quality of girls' and women's lives would go a long way toward promoting their general health and in all probability cut down on the incidence of obstetric illness and death. As she is quick to note, "If only women who say they want no more children had no further births, an estimated 33 percent of maternal deaths in developing countries would be prevented." If more young girls postponed childbearing, there would be fewer arriving on the doorstep of the hospital. Family planning would also cut down on the number of illicit induced abortions that are linked to 15-25 percent of maternal deaths.

But, she contends, these preventive measures will never be enough. "Not only are some complications difficult to predict, but many do not develop until labor begins. There will always be the need to have back-up obstetric care for women at the time of delivery. The challenge is how to get it to them."

Says Maine, "The kinds of treatment we are proposing do not imply a focus on high-technology care in large hospitals. What we are trying is to take maximum advantage of the capabilities within existing health centers and small rural hospitals. This, we feel, will have a substantial impact on maternal mortality even in the absence of a full-service hospital."

"Sometimes it is easy to identify the pregnant woman with problems, but sometimes you can only hear women crying."

Preliminary steps have been to explore the problems pregnant women are having in their communities and the reasons for their delay in obtaining appropriate help when a complication arises. Between 1988 and 1992, team members and trained facilitators fanned out into selected villages, towns, and urban areas, conducting small focus-group discussions with women, community leaders, husbands, traditional birth attendants, midwives, and other key decision makers. Along with the community-based research, PMM members surveyed hospital and health center practices, and they sampled the views of nurses, physicians, and administrators about the treatment of patients from their arrival at the facility to the conclusion of intervention.

MEETING THE COMMUNITY HALFWAY

The Prevention of Maternal Mortality Network teams' tasks are to upgrade maternity services, particularly for dealing with obstetric emergencies, in ways that are practical and sustainable for each level of the health system in the West African sites — and then to increase women's access to and prompt use of the resources.

To make research into the determinants and prevention of maternal death more manageable, the PMM teams each focused on one major complication of pregnancy in their region, taking an in-depth look at its incidence and prevalence. The Accra, Ghana, and Sokoto, Nigeria, teams, for instance, chose obstructed labor, which occurs most frequently in teenage girls and older women and which villagers identified as the problem they were most concerned about. The Calabar, Lagos, and Benin teams in Nigeria, the Kumasi team in Ghana, and one of the two teams in Sierra Leone chose hemorrhage.

Their investigations brought to light many of the problems — from the patient's inability to find transportation or pay for services, disrespectful attitudes on the part of nurses, and shortages of medical staff, equipment, drugs, and other supplies, to low wages and poor housing for staff, bottlenecks and other flaws in patient management systems and record keeping, and unsatisfactory maintenance and repair — all of which serve to delay or block adequate treatment. In a PMM Network "time-motion" study of the treatment of maternal hemorrhage at Komfo Anokye Teaching Hospital in Kumasi, Ghana, researchers found that, while the longest interval was between the onset of symptoms and arrival at the hospital, much time was wasted searching for drugs, essential supplies, and blood before lifesaving interventions could take place.

Based on their findings and conclusions, which they are reporting in professional journals and conferences (see bibliography on p. 18), the PMM research teams are initiating programs of redress employing the techniques of institutional advocacy and community mobilization as well as direct action.

To improve obstetric services, team members are arranging the training of traditional birth attendants and other community health workers in providing obstetric first aid to stabilize the patient and refer her to a health center or hospital. They are also offering refresher courses for nurse-midwives and physicians staffing secondary and tertiary centers, which emphasize sensitivity training in order to develop more positive staff attitudes towards patients.

Other steps to improve service delivery being taken by PMM teams or generated by them are:

- Reducing the waiting times for hospital admission and treatment;
- streamlining patient record-keeping systems so that obstetric complications are accurately reported;
- renovating operating theaters for performing Caesareans and other obstetric surgery;
- installing revolving funds for drugs at hospitals to ensure continuity of supply;
- providing equipment and supplies for blood banks and transfusions.

All activities are being conducted in cooperation with the ministries of health and university authorities, whose support is crucial to the success and sustainability of the projects.

At the community level, teams and local facilitators are educating citizens to detect and act promptly on the warning signs of trouble. The health messages are conveyed by means of posters, radio, talks, songs, dance, and theater and at communal meetings, festivals, market days, and other special events where people can participate. The aim, stresses Angela Kamara, is not to attack people's beliefs but to change their knowledge and practices.

Teams are also encouraging community members to organize local transport schemes and blood donors' associations or raise money for a local fund from which patients and their families can draw to pay for services, among other activities. In one of the Sokoto, Nigeria, sites in the north, people have been so fired by the "awareness education" they have received they have proceeded on their own to build a health clinic that is now being used for vesico-vaginal fistulae repair.

The interventions are phased: Network members are trying first to ensure that health institutions are furnished with the equipment, supplies, and trained staff they need for carrying out essential obstetric services and that patient management systems operate as efficiently and effectively as possible. Once these improvements are in place, the communities can be mobilized to use the services.

"If the community is educated, then they will want the obstetric services," maintains Dr. John-Baptist Wilson. "But," he underscores, "the services must be available and be of a certain quality."

◆ ◆ ◆ ◆

"If the community is educated, then they will want the obstetric services. But the services must be available and be of a certain quality."

◆ ◆ ◆ ◆

From his own experience as head of the PMM Network team in Accra, Wilson has come to believe that improving prenatal care is not as cost-effective as improving obstetric services in health facilities and training community members to understand the warning signs of a difficult pregnancy or labor and send patients to the health facility. "Birth attendants especially need training in this. Many hold on to their patients until the end. We need to disabuse their minds of these cultural taboos, so women will make use of the health services. Nurses and physicians also need to be sensitized to cultural differences in their patients."

In the focus-group discussions held with residents of a peri-urban section of Accra called Ablekuma, where the PMM team is promoting maternity care reforms, Doris Richardson, a team midwife from the university's department of community health, and other midwives who know the community "made some discoveries." The district has a large population of Muslim refugees from Mali who are trying to uphold the customs of their country, with families living in compounds and the woman secluded. "Women from Mali wear long black dresses," Wilson relays. "In Ghana, this is synonymous with evil and death. So we don't accept someone coming to the hospital in black. The staff tries to force them to change their dress. The women don't like it. So they don't come to the hospital. This is a cross-cultural problem. We have tried to approach this in our training."

In the testing of such practical, affordable, and "culturally appropriate" models of health promotion and mortality prevention, PMM participants are hoping their governments will promulgate policies to see that innovations are adopted, scaled up, and supported over time. In the end, team members are betting, the payoff will be more women in the community taking advantage of the improved obstetric services and fewer maternal deaths and illnesses.

Wilson believes this will be possible. "Already," he says, "the Ghana Ministry of Health is making use of some of the findings from our research within the country."

Adds Kamara, "Our goal is to get whatever we do into the policymaking strata. In Sierra Leone, the teams consist of staff from the Ministry of Health and the university. In the Bo district, the team includes the chief medical officer of the region. The top people in government service are receptive to new ideas. They themselves are very innovative. The work of the network gets translated into policy almost immediately.

"In Accra and Kumasi, the Prevention of Maternal Mortality Network is working closely with the Ministry of Health. The ministry sees our project as part of its own national Safe Motherhood Program. So the Accra team's work is woven into what is already going on. Accra started its interventions in January 1992, but long before that it was injecting concepts into ministry policy thinking. The emphasis now is on sustainability of the interventions."

◆ ◆ ◆ ◆

HOW THE PMM NETWORK EVOLVED

The Prevention of Maternal Mortality Network is one of several nongovernmental programs identified with the Safe Motherhood Initiative, an international movement whose aim is to raise the issue of maternal mortality higher on government policy agendas and to marshall the political will for broad ameliorative action.

The initiative itself was prompted by pressure from concerned researchers and other professionals, who observed during the height of the child survival campaigns of the 1980s that the worthiest efforts to promote maternal and child health in developing countries were doing little to reduce mortality and morbidity among mothers. Prominent among these advocates were Allan Rosenfield, now dean of Columbia's School of Public Health, and Deborah Maine at the Center for Population and Family Health. In 1985 they published an article about "the neglected tragedy" of maternal death with the subtitle, "Where is the M in MCH?" In their recommendations, Rosenfield and Maine urged obstetricians to exert leadership in reducing maternal mortality in less developed countries and called for the World Bank to put maternity care on its priority list for development loans.

Two years later the bank, the World Health Organization, and the United Nations Fund for Population Activities cosponsored a groundbreaking International Safe Motherhood Conference, held in Nairobi, Kenya. Out of that event grew a collaboration among the bank, several U.N. organizations, and private institutions to foster operations research on maternal mortality and in other ways to advance the goal of cutting maternal deaths in half by the year 2000.

The driving mission of the Prevention of Maternal Mortality Network is to engage the capabilities of leading physicians, midwives, and social scientists within Africa in conducting their own research into the magnitude and causes of maternal mortality and morbidity in their regions and to take responsibility for advocating or implementing programs to promote maternal health.

Observes Maine, "In the mid-1980s, there was an urgent need in Africa for community-based research on maternal mortality. Most studies up to that time were descriptive only, and most were hospital based. They did not include the large proportion of maternal deaths that take place outside the hospital."

Furthermore, she says, the studies were not designed to identify the factors contributing to maternal death or to evaluate preventive measures.

"Interventions, to be effective, had not only to be medical but social."

In 1988, through the encouragement of Carnegie Corporation, Columbia's Center for Population and Family Health solicited African institutional interest in collaborating on the development of research strategies that, says Maine, would "look beyond medical factors to some of the other issues that influence whether a woman survives childbirth." The idea was to develop interventions that "need not rely on purchasing expensive vehicles and equipment, nor on constructing additional costly facilities, but on creatively mobilizing and adapting already existing resources." The Columbia group had in mind working with six universities across East and West Africa; after sending out requests for proposals, they wound up with eleven partners in three countries of West Africa alone.*

To inform the planned research, the center staff in 1990 conducted a multidisciplinary literature review pulling together existing knowledge and program results for dissemination to the research and policy communities, particularly in Africa. The result was the document, *Too Far to Walk: Maternal Mortality in Context*. This synthesis report was keyed to the "three phases of delay" that block the effective treatment of an obstetric complication in many developing countries: 1) delay in the decision to seek care (lack of information about complications, lack of women's autonomy), 2) delay in reaching appropriate care (bad roads, no affordable transportation), and 3) delay in the provision of adequate care (shortages of qualified staff, clinical mismanagement, lack of essential drugs and supplies, and the like). The "three delays" provided the theoretical and structural underpinnings of PMM Network research and interventions.

Although the Columbia team's initial African contacts were with obstetricians, the aim was to draw other disciplines and medical ranks into the research process. Explains Deborah Maine, "Although three-quarters of maternal deaths in developing countries were due to direct obstetric causes, the more distant determinants in the community also had to be accounted for. Interventions, to be effective, had not only to be medical but social."

In the program, each team has at least one obstetrician, nurse-midwife, community physician, and social scientist. The need for these four disciplines to work together is evident, says Angela Kamara. "For example, if services are upgraded and patients are still not using the services, the social scientist with field experience is the one best positioned to find out why. The social scientist is also knowledgeable about mobilizing the community. Social scientists, however, might not give the right health messages. This is where the physician and the nurse-midwife come in."

"The idea," says Adetokunbo O. Lucas, a Nigerian and former program director at the Corporation who was one of the main architects of the PMM Network concept, "is to match beliefs and culture with technical aspects. If social scientists go alone without taking into account the medical aspects, then they can't meet the scientific objectives."

The Columbia group initially convened a project development workshop in Ibadan, Nigeria, bringing all the participants together into a consultative process and introducing them to the research concepts and the network structure. Since then, workshops have been held semiannually or annually at different network sites. There, team members trade ideas, experiences, and insights, profit from the knowledge and advice of Columbia staff members and resource persons, and become versed in the methodology of operations research.

Recalls Lucas, "During the earlier workshops, cross-disciplinary interactions were obviously difficult. Obstetricians did not communicate easily with the social scientists. Nurse-midwives often seemed diffident in expressing their views. And it was generally difficult to define common grounds of interest.

"By the fifth workshop the situation was radically different. The discussions flowed freely, and team members had much to discuss and debate. A sense of comradeship had developed within and between teams."

From the beginning, Columbia staff members have stayed in touch with the teams through periodic site visits, the workshops, and correspondence. To be closer to the projects, Kamara in 1992 moved from New York to set up the network's West African office in Accra, where she keeps a busy travel schedule.

◆ ◆ ◆ ◆

THE TORTOISE AND THE HARE

Not surprisingly, carrying out a development program in the shifting political and economic currents of Africa has turned out to be arduous, though rewarding. Electronic communications between regions, not to mention continents, is difficult to impossible; even the telephone links between major cities are unreliable. High inflation and periodic devaluations have eroded the value of local currencies and grant money.

Political upheavals, as in the military coup in Sierra Leone during May of 1992 and religious conflicts in northern Nigeria, have canceled workshops and site visits. Between the military coup and the spillover of civil war in Liberia, three villages in Sierra Leone that were the base of one of the projects were destroyed, with the inhabitants scattered or killed. The lethal outbreak of Lassa fever around Iurekpen General Hospital in Benin, Nigeria, ruled out work there in mid-1992. Countrywide strikes of health workers have also caused delays in the implementation phase. Cumbersome bureaucratic procedures and protocols in the universities have been another impediment.

But perhaps most frustrating to progress has been the turnover of membership in the interdisciplinary teams. Each has lost at least one member, and many have lost several to the lures of study and other opportunities abroad or better jobs within the countries, or because they have been reassigned by their governments. Most team members are weighed down by competing responsibilities. Hospital and health center staff members, too, are frequently reassigned, entailing new introductions to the PMM program and new agreements for mutual cooperation. These are the development facts of life.

Both the anticipated and the unforeseen have had a disruptive effect on all the project sites, giving rise to what Deborah Maine philosophically calls "the tortoise and the hare syndrome." Some projects making a swift start have bogged down for a while; others that seemed to hold less promise have slowly built on careful planning to become viable.

To the extent that Columbia staff members and their African colleagues are able to plan for the unexpected, they are doing so. Says Maine, "To ensure continuity and the multidisciplinary nature of the work, we have tried to make the team members two deep — like shark's teeth — so that someone on the periphery of the project is ready to step in if a member leaves. Each team member therefore is asked to have an official 'associate,' and to bring them to the workshops. This is working out very well."

In the coming years, the network teams will address the costs and benefits of the different interventions, how health education and mobilization in the communities can be reinforced over time, how maintenance, repair, and replacement of equipment and supplies can be assured, how the approaches taken by the PMM teams can be integrated into the regular public health system, and other issues of effectiveness and sustainability.

◆ ◆ ◆ ◆

AN EARLY PROGNOSIS

Columbia's Center for Population and Family Health has emerged as one of the policy leaders in the Safe Motherhood Initiative. Maine and her associates, African and American, in addition to publishing are advising several governments and United Nations agencies in developing maternal mortality reduction programs, drawing on their experience and the analytical framework they have developed. Among other contributions, they have helped to create the program monitoring guidelines that are increasingly used as the international standard against which progress in maternal mortality prevention programs is being evaluated in the field.[10]

Five years have elapsed since the Prevention of Maternal Mortality Network came into being. It still has three years to go before its intervention schemes are completed. In an early look at the program, Joan Haffey, program director of the international development organization, Program for Appropriate Technology in Health, has written that, as a prototype in the Safe Motherhood Initiative, the network experience can inform future efforts. She believes that "what the teams are building . . . just may improve a woman's chance of surviving childbirth and change the way public health and research professionals organize to design interventions."

There are, in fact, two kinds of models that are being tested in the PMM program. The first is the model for reducing maternal mortality. The second is the model of human resource development. "The team approach and the network were set up to have Africans provide technical assistance to one another — i.e., to recognize and use expertise within the team, across disciplines and hierarchical boundaries," says Maine.

The network's value may never be able to be measured in dramatic declines in maternal deaths or even in appreciable changes in illness and disability, at least directly. Even so, Maine believes that "if the number of women getting lifesaving care increases, and their survival rate stays the same or improves, then I think we can assert that lives are being saved." ■

— AVERY RUSSELL

The Challenges of Famine Relief

Emergency Operations in the Sudan

Francis M. Deng and Larry Minear

Glossary

AID	United States Agency for International Development
FANA	Food Aid National Administration
FAO	United Nations Food and Agriculture Organization
ICRC	International Committee of the Red Cross
LWF	Lutheran World Federation
MALT	Management and Logistics Team (a unit of WFP)
NGO	Nongovernmental organization
OEOA	Office for Emergency Operations in Africa
OEOE	Office for Emergency Operations in Ethiopia
OLS	Operation Lifeline Sudan
RRC	The Sudan Government's Relief and Resettlement Commission
RTO	Road Transport Organization
SPLA	Sudan People's Liberation Army
SPLM	Sudan People's Liberation Movement
SRRA	Sudan Relief and Rehabilitation Association
UN	United Nations
UNDP	United Nations Development Program
UNDRO	United Nations Disaster Relief Office
UNEOS	United Nations Emergency Operation for the Sudan
UNHCR	United Nations High Commission for Refugees
UNICEF	United Nations International Children's Emergency Fund
WFP	United Nations World Food Program
WHO	United Nations World Health Organization

THE BROOKINGS INSTITUTION
Washington, D.C.

Introduction

With the collapse of ideologies, alliance systems, and governmental structures that divided much of the world for forty years, the international community has acquired both the opportunity for and the burden of creating better arrangements. Traditional objectives of security and economic prosperity can, in principle, be approached in more cooperative ways. Consensus for human rights and human needs can, in principle, be pursued beyond the level of political rhetoric.

The severe economic austerity that has become endemic in many parts of the world makes these aspirations both urgent and difficult. Throughout Eastern Europe and the new states succeeding the Soviet Union, an attempt is under way to create consensual forms of government and market economies at the same time. This effort, requiring a social transformation of unprecedented magnitude, does not as yet command plausibly adequate resources. Economic output in the former communist states is declining from a base that was already too meager to sustain a modern society. That problem is shared, moreover, in many parts of the world with very different political histories.

This situation imposes large demands for the international transfer of resources to mitigate uneven economic development and occasionally to respond to overriding humanitarian concerns. As an international economy slowly forms, so also does a consciousness of international community and acceptance of the ultimate necessity of achieving more widely distributed prosperity. The resources realistically available for assistance are very scarce, however, and their effective application is correspondingly important. As the international community gathers the will to act, knowledge of how to do it becomes a major consideration.

All this makes it particularly important to learn from relevant experience. The period of the cold war overlapped a worldwide process of decolonization. International institutions emerged that are dedicated to providing developmental assistance across sovereign jurisdictions and cultural differences. A record has been accumulated that is full of very instructive lessons, lessons that have been learned at the cost of many failed initiatives but that also enjoy the benefit of some constructive discoveries.

A particularly critical segment of this record concerns experience with providing emergency food relief to populations caught in circumstances of life-threatening famine. Such situations reflect the most extreme breakdown of social order and present the most compelling imperatives for international action. They also make effective action unusually difficult. Though the international community has always had adequate food to prevent mass starvation, distributing it to threatened populations has presented major practical difficulties deriving from the circumstances that cause the famine itself. The individuals at greatest risk are often also the least accessible. The process of giving them vital commodities tempts thieves and weakens indigenous producers. Emergency intervention even for the most compelling of reasons can readily have perverse effects on a society in crisis.

The recent historical record contains ample evidence of such effects, but also guidelines for mitigating them. As the international community faces the formidable and unavoidable task of responding to the needs of Eastern Europe and the former Soviet Union, it must bring accumulated experience to bear. Episodes of emergency famine are clearly possible. Even if unpredictable fortune proves to be less harsh, the experience with emergency relief operations informs the general process of international assistance.

This study focuses on two famine emergencies in the Sudan during the 1980s and the response they generated from inside the country and from the international community. The first famine, triggered by prolonged drought, affected mostly the western and eastern parts of the North during the years 1983–86. The second famine affected mostly the inhabitants of the southern Sudan, where a civil war of great ferocity has been raging intermittently since 1955; it halted in 1972 and broke out again in 1983. The conflict-related famine has been particularly severe since early 1988. The salient feature of both emergencies was the reticence and denial that characterized the response of the government in Khartoum and aggravated the emergencies. This

attitude reflects two sets of factors that can be classified as regionalism and ethnicity. Each has political implications.

The regional factors include the country's size (the largest in Africa), its varied ecological and environmental conditions, its sparse population, and its rudimentary communication and transportation systems. All these factors are manifested in and compounded by disparities and inequities in the distribution system.

The ethnic factors include the racial, cultural, and religious diversity across the country. The most significant is the dichotomy between the Arab-Muslim North and the indigenously African South, which has a Christian elite. Diversity is by no means limited to that dualism, however. Differences within these categories are also profound and pronounced. These regional and ethnic diversities reflect vast distances from Khartoum in physical, political, and socioeconomic terms that explain the separation, if not alienation, of the national leadership from the rural populace.

These spatial and mental distances contributed to a vacuum of moral responsibility reflected in the government's persistent reluctance to provide relief to the affected population. The international media, initially stimulated by the dire conditions of the Ethiopian refugees fleeing into the Sudan, helped to alert the world in 1984 to the Sudan crisis. The international community then moved in to fill the moral vacuum and to pressure the government to be more responsive to the tragedy.

Once the government took the necessary steps, an unprecedented international relief operation was launched to compensate for the earlier neglect and to provide the government with the needed technical capacity to arrange for and distribute food. Many diverse donors, humanitarian organizations, and on-the-ground relief workers were involved in the emergency, with the United Nations and its specialized agencies coordinating the efforts. The experience of the emergency operations mounted in response to the drought-generated emergency laid the groundwork for the even more challenging international response to the conflict-related famine several years later.

The data and commentary that compose this volume have their origins in two recent studies of the emergency relief operations. The first was an evaluation conducted by one of the coauthors, Francis M. Deng, in 1986 at the request of the United Nations Office for

Emergency Operations in Africa (OEOA). The second was a case study of Operation Lifeline Sudan, conducted in 1990 by a team of independent researchers headed by the other coauthor, Larry Minear.

The first study, which took a detailed look at the UN-coordinated response to the drought emergency of 1983–86, sought to review the international community's experience while it was still fresh, distilling from it lessons that could strengthen the effectiveness of emergency relief activities in similar situations.

The OEOA was created on December 17, 1984, by the UN secretary-general in an effort to bring a higher level of political visibility and organizational coherence to UN relief efforts in Africa, which had hitherto taken a more country-by-country approach. The OEOA was set up, said one of its managers, "very much as the peacetime equivalent to putting the UN on a wartime footing."

The OEOA was based in New York with a liaison office in Geneva. It was directed by Bradford Morse, administrator of the UN Development Program, assisted by Maurice Strong as executive coordinator. Both men not only commanded great respect within the international system but also had far-reaching connections in the public and private sectors. Their remarkable contribution was perhaps most apparent in the fund-raising momentum generated by the OEOA within and outside the UN system.

The OEOA used such eminent organizations as the Inter-Action Council of the Former Heads of State and Government to mount a massive effort that climaxed in the March 1985 Geneva conference on the African emergency, at which the world demonstrated a generosity that surprised even the optimists. The generosity of the international community was commensurate with the magnitude of the disaster; the total amount mobilized for OEOA operations before the end of 1986 was $4.6 billion.

By the time the conference was convened, the OEOA estimated that some 30 million to 35 million people in twenty countries in sub-Saharan Africa faced starvation and death. When the OEOA closed on October 31, 1986, good rains had returned to most of the area, the food crisis had eased, and relief needs were abating. Serious emergencies continued only in Mozambique, Angola, Ethiopia, and the Sudan, where civil strife rather than the weather was the main culprit. During its two years of existence, in addition to helping raise the $4.6 billion in emergency assistance, the OEOA accelerated multilateral

and bilateral relief operations in the region. The monitoring that had been performed by the OEOA was transferred to a newly created position, that of director of emergencies, reporting to the secretary-general.

To assess the OEOA's effectiveness in the Sudan, the evaluation during the latter part of 1986 sought out more than fifty persons who were or had been directly involved in the relief effort, both inside and outside the Sudan. Those interviewed included UN officials at headquarters and in the field, national and regional Sudanese government officials, leaders of the insurgent Sudan People's Liberation Movement, representatives of foreign governments and of nongovernmental organizations in the Sudan, university professors, journalists, and Sudanese at the local level. The names of those interviewed are listed in the appendix.

A companion study of OEOA effectiveness in neighboring Ethiopia was carried out at the same time by Ambassador Anders Forsse of Sweden. His study is referenced a number of times in this volume. The two evaluations were completed in late 1986.

During the evaluation of the response to the drought-generated famine in the North, conflict-related tragedy was simmering in the South but had not yet reached the boiling point. For that reason, the evolving civil war, which at the time had at most a limited effect on relief operations in the North, was only alluded to in the OEOA study.

Three years later, the magnitude of the conflict and its human consequences had reached unprecedented proportions. In March 1989 the international community launched another major relief initiative, Operation Lifeline Sudan. The initial Lifeline undertaking, which concentrated its efforts between April and September 1989, was the subject of the second study.

The review of Lifeline was carried out by an independent team of four African and three American researchers: Tabyiegen Agnes Abuom, Eshetu Chole, Koste Manibe, Abdul Mohammed, Jennefer Sebstad, Thomas G. Weiss, and Larry Minear. During the period from March 1990 through June 1990, the team interviewed about two hundred persons, some of them the same people who had been sought out for the earlier study. The focus of the initial evaluation had been on the response to the drought that in 1983–86 affected primarily large areas in the North. The later case study centered on the emergency in the South, which, while aggravated by drought, had its roots in the country's resurgent civil war. This volume recapitulates parts of the case study of Operation Lifeline Sudan that illuminate the problems of providing famine relief.[1]

This work thus places under a single cover the OEOA evaluation, which covers the years 1984–86, and the later case study of Operation Lifeline Sudan, which treats the years 1988–89. It also takes note of the roots of the drought-induced famine in 1983, the period between the major international relief initiatives, and the extension of Lifeline operations through 1990 and into 1991. It thus assesses famine and emergency relief operations in the years 1983–91.

The international emergency relief operations treated in this volume, and indeed their counterparts elsewhere in Africa and around the world, represent the best efforts of a wide circle of actors. Included, in addition to the people who needed such assistance themselves, are governmental organizations, nongovernmental groups, and individuals. The Sudan experience in 1984–86 and again in the heyday of Lifeline in 1989 was a triumph of humanitarian idealism and global solidarity that is rightly a cause for appreciation by the recipients and for satisfaction by those who provided such aid.

Acclaim notwithstanding, the analysis of the four challenges presented in this volume suggests that the experience was not without contradictions and ambivalences. Whatever the shortcomings of the relief operations, however, they developed during an emergency in which saving lives was the top priority. Any criticism, therefore, is intended not to question the need for emergency relief operations, but to improve such activities in the future. Past relief operations, critically and thoughtfully reviewed, may become the basis for more effective future activities. Indeed, the international public is coming to expect and to demand better performance.

Two methodological observations are in order. First, looking back at the crises, we often lack the original sense of urgency, sometimes bordering on panic, that characterized the desperate scramble to save lives. While nonoperational issues may loom larger in hindsight, this analysis does not intend to minimize the urgency that made it difficult to attend to broader issues at the time.

Second, much of the material in this volume is drawn from extensive interviews with major participants during the periods under review. Those interviews inform the conclusions reached and are frequently quoted in the text. Our general approach, particularly in the OEOA review, has been to reproduce such comments—many of which were shared in confidence—without attribution. Quotations and observations pertaining to Operation Lifeline Sudan are documented in the original study and referred to in the notes in this volume.

Finally, a word about the organization of the book itself. Chapter 1 presents the crises in the context of the salient facts about the country: its geography, its demography, and its regional politics, which affected the two emergency situations. It offers some observations on the underlying causes of famine, the attitudes of national governments, and evolving international perceptions.

Chapter 2, which treats drought-related famine during the mid-decade, and chapter 3, which examines conflict-related famine thereafter, discuss four problems exemplified in the responses to each crisis: the external nature of famine relief; the context in which relief is provided; the coordination of relief activities; and the ambivalence of the results of relief.

Looking to the future, chapter 4 suggests ways in which the international community, learning from the problems of relief operations in the Sudan, may strengthen such interventions in the future. The chapter also recognizes the increasingly positive international climate marking the end of the cold war, in particular the recent humanitarian intervention in Iraq, as an indicator of an emerging trend.

For a number of reasons, this review of emergency relief operations has a special timeliness. First, the emergency in the Sudan has continued apace during 1991–92, with an estimated 7 million to 9 million people still vulnerable to famine. Efforts by national authorities and the international community to assist them are lagging. In fact, in April 1992 the United Nations suspended relief operations altogether.

Second, recurrent food shortages in the Sudan and other sub-Saharan African countries have led to calls for recreating the OEOA or establishing some other structure in the United Nations with similar functions. A group of more than forty nongovernmental organizations wrote to UN Secretary-General Pérez de Cuéllar in June 1991, encouraging reestablishment of the OEOA. "We believe current famine conditions in the Horn of Africa and other African nations are potentially worse than those in 1984–86," they stated.

In response to the worsening crisis in the Sudan, Ethiopia, and Somalia, the secretary-general in July 1991 announced the strengthening of the unit for special emergency programs within the Department for Special Political Questions, Regional Co-operation, Decolonization and Trusteeship, to which the residual OEOA functions had been entrusted in late 1986. Once again, the world community recognized a need to move beyond ad hoc responses to crises in individual countries through an approach that would give higher visibility to the humanitarian crisis and greater coherence to international efforts.

Third, the United Nations is concerned with improving its response to emergencies. The Economic and Social Council discussed the problem in July 1991, the General Assembly discussed it in September and December 1991, and the issue is likely to engage the General Assembly in the years to come. Of special concern are refugees whose flight from persecution carries them across national borders and returnees and persons displaced within their own national borders who lack international protection and assistance.

The heads of state from seven major industrialized countries, meeting in mid-July 1991 in London, underlined the importance of these issues. "The recent tragedies in Bangladesh, Iraq and the Horn of Africa," observed the Economic Summit communiqué, "demonstrate the need to reinforce UN relief in coping with emergencies." The heads of state called for "moves to strengthen the coordination and to accelerate the effective delivery of all UN relief for major disasters." Boutros Boutros-Ghali, who became UN secretary-general on January 1, 1992, has a clear mandate to improve the structures for emergency humanitarian operations around the world. In early 1992 he appointed Swedish Ambassador Jan Eliasson to the new position of under-secretary-general for humanitarian affairs, following up on a resolution (46-182) approved by the General Assembly in December 1991.

Finally, there is much talk of a new international order in which the politicization that skewed the responses of governments and infiltrated the work of the United Nations during the cold war gives way to approaches that are less ideological and more directed toward need. By overriding Iraqi sovereignty to provide humanitarian assistance and protection to the Kurds, the UN Security Council has paved the way for the current discussion of a new humanitarian order in which governments are held—by force, if necessary—to higher standards of respect for human life.

Although the humanitarian content of an eventual new order has

yet to be delineated, more effective responses to urgent crises such as those described in this volume will test the effectiveness of any new policies and institutional mechanisms. Much remains to be learned from recent emergency operations in the Sudan to guide the framing and implementation of a more effective international humanitarian response.

CHOICES
THE HUMAN DEVELOPMENT MAGAZINE

P O I N T

CAN AFRICA AFFORD A GREEN REVOLUTION?

FREDERICK BROWN

With what could be the worst famine in 50 years now gnawing at many African countries, it may strike some as incongruous to discuss prospects for bringing the Green Revolution to that continent.

Yet that is precisely the kind of talk one is likely to hear these days from the man whose high-yielding varieties of wheat sparked the Green Revolution in countries such as India and Pakistan in the 1960s. In a recent Washington interview, Norman Borlaug conceded the situation now facing many African countries is bleak indeed. But he insists there is still room for hope – especially in the second tier of countries below the Sahara.

Whether these countries succeed, he says, will depend on whether their leaders adopt certain badly needed policy reforms. Also, on whether they get the kind of help they need from institutions such as the World Bank and the International Monetary Fund.

Back in the 1960s, Dr. Borlaug and his colleagues at CIMMYT, the maize and wheat improvement centre in Mexico, developed the high-yielding varieties of wheat that brought the Green Revolution to those formerly starvation-prone Asian countries. In 1970, Dr. Borlaug was awarded the Nobel Peace Prize in recognition of his lifelong efforts to combat hunger around the world. Now 79, he is president of the Sasakawa Africa Association (SAA), founded in 1986 by Japanese shipbuilding magnate Ryoichi Sasakawa. Its goal is to find long-range answers to the problems plaguing African agriculture. Today it has ongoing projects in Benin, Ghana, Nigeria, Tanzania, Togo, Zambia and Zimbabwe.

SAA coordinates its work with former US President Jimmy Carter's Global 2000 Inc., and with the Paris-based Centre for Applied Studies in International Negotiations, which tries to reduce political instability and the difficulties it creates for African agriculture.

Drawing on the resources of international agricultural research centres like CIMMYT, SAA workers provide participating farmers with a package of recommendations on the best seeds, the best dates and rates of planting, the best weed control and the best fertilizers to use for a given location. The main emphasis is on maize and sorghum, two of Africa's major food staples.

To date, a total of 150,000 African farmers have been reached by SAA/Global 2000. According to Dr. Borlaug, participating farmers have demonstrated that, barring a major drought, if the proper seeds, methods and fertilizers are used, production can be doubled, tripled or quadrupled. Furthermore, this can be achieved, he says, even with the most rudimentary equipment. Most farms in sub-Saharan Africa are smaller than one-half hectare, and most farmers have only small hand tools such as hoes and machetes to work with. Even with such handicaps, surveys show crop yields for SAA/Global 2000 projects have increased on average 2.5 times, though yield increases five times previous averages are not uncommon.

Dr. Borlaug says results have been promising in Ghana and Tanzania – two countries he hopes can lead the way for other African countries. He was particularly impressed with efforts now under way in Ghana to introduce a new high-lysine corn that many scientists believe could be a major weapon against malnutrition in countries where maize is a food staple.

Within a year, if the right policies are enacted, both Ghana and Tanzania could be poised for the same kind of breakthroughs experienced 30 years ago in India and Pakistan.

Says Dr. Borlaug: "We are almost to the point where we can say to the leaders of these countries, 'This is what is possible, but this is what must be done in order to achieve it.'" But success will only come if farmers have the right fertilizer available and if they can obtain credit to buy it. Furthermore, he says, crop prices must be maintained at an attractive level so farmers will have an incentive to produce.

"If the price of the harvest is maintained at some level approaching the international price, this thing can take off just like it did in India and Pakistan," he says.

Dr. Borlaug acknowledges there are differences as well as similarities between the situations that faced India and Pakistan in the 1960s and those that face African countries today. The South Asian countries started with a large bank of trained agricultural scientists – something Africa doesn't possess. On the other hand, extension services in the two Asian countries were very weak in the days before the Green Revolution, and were generally regarded with some contempt by scientists.

One major difference between Africa's problems and those faced by India and Pakistan is the dearth of livestock in Africa. This is the result of trypanosomiasis, a disease commonly known as sleeping sickness, which has decimated livestock herds in much of the continent.

Deprived of draft animals, most African farmers have been unable to move beyond their reliance on small hand tools and thus have missed an important first step in the development process. What's more, they have also had to do without the natural fertilizer and fuel that animals provide farmers in other parts of the world.

Making up for that lack of natural fertilizer is crucial, says Dr. Borlaug. Loss of topsoil from deforestation and erosion is an especially serious problem in Africa. He insists any solution to Africa's agricultural problems must include a large input of chemical fertilizer – a position that puts him in conflict with some environmentalists.

Because of Africa's shortage of farm animals, Dr. Borlaug dismisses those who oppose the use of chemical fertilizers as dreamers. "It's not so simple as it looks to many of these people of great wisdom who sit in academia pontificating about the ills of Africa," he says.

For the same reason, Dr. Borlaug sometimes finds himself at odds with the World Bank, which has been generally opposed to subsidies of any kind. The Nobel laureate says granting subsidies to city dwellers to buy food is usually not a good idea, but fertilizer subsidies are another matter since they greatly increase food production.

Such subsidies, he adds, need not be a giveaway. They can be provided in the form of loans to be repaid after the harvest is sold. Dr. Borlaug says the repayment record for projects his organization is involved in has been excellent. In Tanzania, for example, 90 per cent of loans made to SAA participants in the 1989-90 season were repaid.

Transforming African agriculture is going to be painfully slow, says Dr. Borlaug. Africa's situation differs in another respect from that faced in India, Pakistan and Bangladesh in the 1950s and 1960s. In those countries, because there was little new area for cultivation, the only answer was to make the available land produce more food.

By contrast, there is plenty of new land to cultivate in Africa, but the means for developing it are limited. Then too, there is an appalling lack of infrastructure, including roads, in much of Africa, which makes moving produce from the farms to the markets very difficult.

As for the ongoing drought in Africa, Dr. Borlaug believes that it is part of a recurring cycle of global climate change. Thanks to improvements in technology, he says, the negative effects of such events are gradually being mitigated – one example being the 1930s drought that turned much of America's Midwest into a dust bowl. In 1988, another severe drought in the same region had far less impact due to changes in technology.

African farmers must also learn similar "tricks of survival," he says. For example, one lesson that paid off in India and Pakistan was that of maintaining adequate reserves of grain in case of crop failure. While some economists contend such reserves tie up capital that could be invested in badly needed infrastructure, Dr. Borlaug argues the experience of India and Pakistan proves that building up such reserves is prudent.

Food security is only one of the dividends. By holding back part of their grain after a good harvest and releasing it gradually, Dr. Borlaug says farmers can guard against falling prices that can reduce or even wipe out their earnings. This is a lesson he says Indian and Pakistani farmers learned early.

Because lack of crop storage facilities is a serious problem in Africa, he says greater efforts must go into developing low cost storage using cheap, local materials. SAA/Global 2000 already has one such project under way in Ghana.

Is a Green Revolution what is needed in Africa? In recent years it has become fashionable to point out its shortcomings. Among the complaints: that Green Revolution technologies more often help richer farmers in developing countries, while encouraging over-reliance on chemical fertilizers. Another criticism is that it places too much emphasis on economic considerations at the expense of the environment.

Dr. Borlaug has responded to some of these criticisms by saying that they come from academicians who have never lived in developing countries.

On the question of who has benefited most from the Green Revolution, he says that in India most of the gains have been made by farmers working small, four- to six-acre farms who have seen their wheat yields increase by 300 to 400 per cent. But the biggest gains, he says, have been reaped by Indian consumers who now have access to more and cheaper food.

As a result of Green Revolution technology India's wheat production increased from an average of 10 million tonnes in the early 1960s to just under 50 million tonnes last year. That, Dr. Borlaug points out, represents 65 per cent of caloric intake for 300 million people.

Dr. Borlaug also strongly challenges critics from the environmental movement, dismissing the concerns they raise about agricultural chemicals as "hysteria." Where, he asks, is the evidence that chemicals have been dangerously infiltrating the world food supply as a result of pesticides, insecticides and herbicides? Are these chemicals, he asks, any more dangerous than the toxic and other harmful natural compounds that have been part of the human diet since the beginning of agriculture?

To those environmentalists who object to Dr. Borlaug's sweeping dismissal of their concerns, he voices a concern of his own: he argues that the greatest threat to the environment is not agricultural technology, but unrestrained population growth eating away at gains being made by science. ■

Frederick Brown, a former correspondent for Voice of America *in Africa, the Middle East and South Asia, is a freelance writer living in Silver Springs, Maryland.*

WITH GROWING FOOD SECURITY PROBLEMS AND CONTINUING ADVANCES IN BIOTECHNOLOGY, MANY AFRICAN COUNTRIES ARE POISED FOR WHAT MAY BECOME A SECOND "GREEN REVOLUTION." BUT IS IT THE RIGHT STRATEGY? IN THE FOLLOWING ESSAYS, TWO OPPOSING SIDES OF THE ISSUE ARE PRESENTED, IN A DEBATE THAT REFUSES TO SUBSIDE.

VANDANA SHIVA

In the 1950s, as Indian scientists and policy-makers were developing self-reliant and ecological alternatives for the regeneration of agriculture in India, another vision of agricultural transformation was taking shape at American foundations and aid agencies. The vision was based on the increased use of credit and purchased inputs such as chemical fertilizers and pesticides. It was based not on self-reliance, but dependence; not on diversity but uniformity.

It has often been argued that the Green Revolution strategy was the only one available for increasing food supplies. International agencies and Third World governments had no option, we are told. Yet the inevitability of the Green Revolution option was built on neglecting other avenues for increasing food production that are more ecological, such as improving mixed cropping systems, the quality of indigenous seeds and efficiency in the use of local resources.

My own work on the conservation of indigenous genetic resources has shown that native varieties and traditional farming systems are often higher yielding than the Green Revolution package. The only difference is that they give multiple yields of diverse crops.

Contrary to popular opinion, the Green Revolution's reliance on seed-fertilizer technology is counter-productive when looked at from the viewpoint of resources. Indigenous varieties of both rice and wheat have been shown to have comparable yields to Green Revolution varieties and require substantially less water and fertilizer.

While an increase in productivity was the primary objective of the Green Revolution, productivity actually declined when looked at it terms of resources and energy. The main increase achieved in the early phases in Punjab in India was at the level of financial returns. In my opinion, the main motive for the Green Revolution was profits – profits for agribusiness and profits for farmers. Over the long term, however, as the demand for external inputs increased, it ultimately resulted in diminishing returns for farmers. In less than two decades, the Green Revolution has become financially and ecologically unviable. However it did succeed in the production of surpluses of specialized crops in a specific region for a short period of time, based on high inputs, high subsidies and high support prices. These subsidies and support prices have contributed in a big way to India's debt, and now the same strategy is being recommended for Africa.

The chemicals for the Green Revolution came from multinational companies and the credit from multilateral banks. Over time the reliance on chemicals kept increasing. In 1980-81, the consumption of chemical fertilizers in India was 5.5 million tonnes. By 1992 it had risen to 13.5 million tonnes.

The World Bank provided the credit to introduce this capital-intensive approach to agriculture, which cost over 11 billion rupees from 1966 to 1971, more than six times the amount allocated to agriculture by the Government of India during the previous five years. Most of the money went to pay for imported chemicals and seeds and to provide subsidies and credit. The result was debt and a balance of payments crisis. This crisis is now being used by the World Bank as justification for a structural adjustment programme.

335

GREEN REVOLUTION TECHNOLOGIES HAVE LED TO INCREASED YIELDS OF MAIZE IN GHANA.

CIMMYT Photo

NORMAN BORLAUG AND TRAINEES AT CIMMYT IN MEXICO.

Vandana Shiva continued

through which it is forcing a withdrawal of the very subsidies it had earlier introduced.

In line with the Bank's recommendations, the Government of India agreed to raise fertilizer prices by 30 per cent to reduce state expenditure on subsidies. However, after large-scale protests across the country, the price was increased by only 10 per cent in 1991. In August 1992, subsidies were eliminated entirely and fertilizer prices doubled overnight.

With subsidies removed, the Green Revolution loses its artificially maintained economic advantage and becomes a totally uneconomic proposition for capital-poor countries like those of Africa.

However, the most important reason for the non-sustainability of the Green Revolution is its ecological impact. Dr. Borlaug's high-yielding seed varieties were engineered for high uptake of fertilizer, and their higher water requirements lead to increased vulnerability to drought. Hence, they are totally inappropriate for drought-affected Africa. Risks of crop failure are also increased when locally-adapted seeds grown in mixed cropping systems are replaced by introduced varieties grown as monocultures. The destruction of biological diversity was a very significant impact of the Green Revolution in India. Genetic erosion will also be the consequence of the Green Revolution in Africa.

As Dr. Borlaug states, the focus of the Green Revolution in Africa is on maize and sorghum. Green Revolution maize has already increased Zimbabwe's vulnerability to drought. Local varieties of millet are more appropriate than high-yielding maize hybrids because they are more drought-tolerant, they store better, and they require fewer capital inputs. Groups such as ENDA (Environment and Development Action) have been successful in bringing half of Zimbabwe's farmers into the indigenous seed supply network as a drought-coping strategy.

In Ethiopia, the Plant Genetic Resources Centre is working with farmers to conserve genetic diversity and supply farmers with seeds that give good yields without requiring intensive inputs. The Green Revolution logic is the reverse – it erodes diversity, increases costs for farmers and magnifies ecological risks, especially in drought-prone environments. The drought-creating strategy of the Green Revolution is the last thing Africa needs.

There are lessons to be learned from the Green Revolution's most celebrated success – the Indian Punjab. Dr. Borlaug repeatedly refers to the Indian miracle. Paradoxically, after two decades of the Green Revolution, Punjab is neither a land of prosperity nor peace. It is a region riddled with discontent and violence. Instead of abundance, Punjab has been left with diseased soils, pest-infested crops, waterlogged deserts and indebted and discontented farmers.

Control over nature and people were essential elements of the Green Revolution strategy. Ecological breakdown in nature and political turmoil were the results. ■

Scientist and environmental activist Vandana Shiva is director of the Research Foundation for Science, Technology and Natural Resource Policy in Dehradun, India. She is the author of Staying Alive: Women, Ecology and Development *and* The Violence of the Green Revolution *(Third World Network 1991).*

WORLD BANK NEWS

Volume XII, No. 19

May 13, 1993

AIDS Threatens African Development

The spread of the human immunodeficiency virus (HIV) threatens to undermine all aspects of Africa's economic development during the 1990s and beyond, a top World Bank official said May 11.

HIV, the virus that causes AIDS, has already exacted a large human toll in Africa. So far, the disease has infected an estimated 7 million African adults and claimed the lives of an estimated 1.2 million more. But as well as enormous human suffering, AIDS will also impose severe economic hardships and hard choices on Africa, said Edward Jaycox, Vice President of the World Bank's Africa Office.

"...uDs epidemic is a serious health problem in Africa, with broad implications for every sector of each economy," said Jaycox.

African governments can help prevent AIDS, Jaycox stressed. But if the spread of HIV continues at current rates, AIDS will create havoc in all sectors of African economies, including health care, education, social welfare, industry and agriculture.


Edward Jaycox

AIDS kills people during their most economically productive years. By robbing countries of able-bodied workers, AIDS will reduce economic productivity and keep average incomes down just as Africa tries to recover from the economic declines of the 1980s, added Martha Ainsworth, an economist in the Human Resources Division of the Bank's Africa Technical Department.

Ainsworth, author of a World Bank background study on AIDS and African development, says research on the impact of AIDS is still in its early stages.

"We're still trying to understand how it will affect development," she says, but adds that it's clear AIDS will have long-term effects. Also, while some countries are more severely affected than others, AIDS will slow down the growth of per capita income overall and generate new pockets of poverty across the continent.

Jaycox and Ainsworth presented the results of the World Bank study at an AIDS conference in Abidjan, Cote d'Ivoire, hosted by the African Development Bank and supported by the Bank. The meeting aimed to build on a Declaration on the AIDS Epidemic in Africa, adopted by African Heads of State at last year's Organization for African Unity summit in Dakar, Senegal.

AIDS will impose a high economic cost on households, the basic decision-making units in African economies, according to Ainsworth. As a person gets sick from AIDS, the family has to devote much of its work time and income to caring for that person. Losing family members reduces the number of income-earners in a household, and as family incomes fall, parents may decide to keep children at home to work instead of sending them to school. Women often bear the brunt of the AIDS epidemic because they are more susceptible than men to HIV infection and they are more likely to be saddled with the burden of taking care of a sick family member.

When added up, those shocks to the household may affect national economies, said Ainsworth. Many families may switch to less labor-intensive crops to deal with the labor shortage, and that situation could deprive economies of crops for export, thereby cutting government revenues.

Balancing care for people who are ill with diseases other than AIDS and for people infected with HIV will put growing pressure on hospitals. Already, many non-AIDS patients are being crowded out of some African hospitals. In Kenya, AIDS patients may occupy 40 percent of hospital beds while a hospital in Zaire now admits only the most desperately ill non-AIDS patients.

Education will also suffer from the AIDS epidemic. Deaths of teachers will drive up re-training costs and make schools less effective. Enrollments may drop. A World Bank study in Tanzania estimates that by the year 2020, up to 27,000 teachers will have died from AIDS and primary school enrollment will fall by 22 percent. Training costs for new teachers will total $37 million.


Martha Ainsworth

AIDS will also strain African social welfare systems by producing millions of orphans. A recent study in a hard-hit Ugandan district showed that 10 percent of children under the age of 15 had lost one or both parents to AIDS. Ainsworth said the rising number of orphans will force government policymakers to consider helping the children pay school fees, further draining scarce funds. But it isn't clear whether it will be the fees or the demand for child labor that will keep children out of school.

Industries, especially ones that use skilled laborers, will also suffer from the impact of AIDS as the pool of labor shrinks. In Zambia, the government has been trying to attract local professionals and technicians to work in the country's mining industry. But AIDS is killing many of Zambia's professionals, so the country may again be forced to hire people from other countries to fill these posts. As skilled workers die, mining may become less efficient. That bodes ill for Zambia where mining makes up 85 percent of total exports.

AIDS will also hurt agriculture, the mainstay of African economies. As AIDS strikes, a larger share of the rural labor force drops, and agricultural production will fall.

Ainsworth said African governments can help reduce the impact of AIDS through policies to prevent the disease and to cope with its impact, based on the individual needs of their countries. Prevention programs include education about HIV, promotion of condoms, and treatment of sexually-transmitted diseases (STDs), which increase a person's susceptibility to HIV infection. Policies to cope with the impact of AIDS should focus on low-cost means of caring for patients and providing counseling, social and legal services to patients and their families. Governments can also undertake research on the impact of AIDS as the basis for designing cost-effective programs. □

A brochure about the Bank study on AIDS and African Development is free to journalists who write to the World Bank, Room J-5214, Washington, D.C., 20433, U.S.A.

Oxfam America News

PARTNERS

Global Action

Simple Technology Yields Dramatic Benefits

Diana Fried

Ethiopia's vast countryside offers so much potential for self-sufficient farming, yet media reports consistently portray this rich and varied nation as a land of dependency and starvation. True, many in Ethiopia, the Horn of Africa and other parts of the African continent face grave danger, but tragedy tells only part of the story.

Oxfam America has seen parts of Ethiopia flourish over the last decade, where a variety of agricultural efforts, both basic and complex, have had dramatic effects. In the Inewari plateau, for example, a community of farm families has become self-sufficient thanks to a simple plow and very hard work.

Though faced with an array of agricultural challenges, these farmers knew the most serious problem was the region's dark, black, high-clay soil. The soil, though fertile, becomes hard and cracked during the dry season, but turns waterlogged when the often-torrential rainstorms break early in the growing season. Seed would either float away with the runoff or rot in the waterlogged soil.

The community had developed a broad-bed farming method which preserved the crops, but at the expense of back-breaking labor. Typically, the entire family would spend days in the field creating high-crowned beds and wider furrows by hand. This channeled the rain off the top of the beds, leaving the seeds higher and drier.

MICHAEL SHERIDAN/OXFAM AMERICA

I spent time with Alemu Wondemagen and his family as they demonstrated the making of broad beds by hand. The traditional *maresha* plow cuts furrows in the land, and the women and the children walk behind the plow building two- to three-foot beds. The family can plant crops earlier and take advantage of a longer growing season; but only after days of incredibly difficult labor.

The International Livestock Center for Africa (ILCA), a nonprofit Ethiopian agricultural research and development organization and an Oxfam America partner since 1985, built on the concept developed by these farmers. ILCA designed a "broad-bed maker" plow that could replicate the beds made by many hands—but using the labor of just two people instead of an entire family. Based on input from local farmers, ILCA's staff has refined the design over the last several years, making it simpler and more effective.

Two farmers, each of whom brings a maresha plow and an oxen, can build a broad-bed maker plow for about $40. They link the two maresha plows together with a light frame and a chain, setting the plow blades about three feet apart, and attach a metal wing to each plow. The wings push dirt towards the center, creating a high mound between the furrows. The chain drags behind, smoothing the bed into a high-crowned shape.

The plow comes in a package designed by ILCA, which includes fertilizer and a variety of high-yielding wheat seeds that can survive the heavy rains and can be planted earlier in the season. This simple technology has enabled farmers to double their crop yields, and has had a significant effect on their lives.

ILCA had developed a relationship of mutual respect and good communication with the farmers—a relationship that has as much to do with the project's success as the research and design.

Alemu said that for the first time in his life his family has become self-sufficient in food production. By selling part of the surplus food to market, the family can buy clothing, shoes, and other household and farm items. He has paid back a loan that he got from the project for fertilizer. "Our production is very high because of this new technology," he said. "Now, I not only have enough food for my family, but I also have a surplus to buy clothes, salt, coffee, and other essentials which I never had before."

Fitewoke, Alemu's son, teaches other farmers how to use the broad-bed maker plow, as part of ILCA's peer-training program. ILCA, like many of Oxfam America's project partners in other regions, has found that "modeling success" with peers produces the most lasting impact. Alemu's success is quite evident: not only has he doubled his crop yield, he also has seeds left over for next year's planting, as well as a reserve of food for times of drought. His family's livestock feed off the excess, reducing the demand on already over-grazed pastures.

The development of the broad-bed maker plow has freed women to concentrate on other activities, instead of following plows making furrows. They still must walk many miles to retrieve water for their households, and collect large amounts of cow dung for cooking fuel, since few trees grow in the area. And, grinding corn still takes hours for every meal. However, some of the women now spend more time spinning wool, which they sell in the market.

Perhaps most importantly, the children can spend more time in school—and enjoy a bit more of their childhood.

Diana Fried directs Oxfam America's video program. This article is an edited transcript of a video report, "Ethiopia Project Visit." Oxfam America supporters can order a free copy of this and other videos—see box at right.

Department of Political Affairs
Centre against Apartheid

United Nations New York, 1992

A New South Africa in the Making
Role of the United Nations

I. An overview of the United Nations system and technical cooperation for development

by the United Nations Centre against Apartheid

A. The development context

1. International development assistance

1. Development assistance involves the use of public funds for the purpose of promoting economic development in other sovereign countries. This assistance, a main objective of "foreign aid", has today become an important feature of the relationship between industrialized and developing countries.

2. Developing countries seek capital for productive investments leading to economic growth. Their people also need to know how to put resources to the best use. Development assistance describes the process of transfer to a developing country of capital in the form of loans and grants; and also of "know-how", in the form of human expertise. The effort involved to improve local knowledge, skills and attitudes by this transfer of expertise is known as technical cooperation.

3. Technical cooperation offers to recipient countries an opportunity to redress shortcomings in the education, training and advancement of nationals. In the case of former colonies, particularly those in Africa, technical cooperation could speed up the process of localization of the public services and the private sector.

4. All countries prefer to have jobs at all levels filled by their nationals. Industrialized countries utilize such devices as work permits to discourage the employment of foreigners. For developing countries, technical cooperation is intended to hasten the indigenization of jobs through, paradoxically, using expatriate services in the short run to train nationals.

5. Such cooperation offers a particular advantage to countries that are making fundamental changes aimed at the advancement of all their peoples. A post-apartheid State would propose to redress past inequalities and to upgrade the knowledge and skills of the entire population. Technical cooperation can provide a special basis for constructive international engagement with South Africa.

6. Ever since its establishment in 1945, the United Nations has been concerned with the promotion of the economic development of its Members. The Charter of the United Nations speaks of the intention of Member States "to employ international machinery for the promotion of the economic and social advancement of all peoples". From its beginning, the General Assembly of the United Nations has encouraged its Secretariat and the specialized agencies and other organizations of the United Nations system to provide technical assistance to Member States who seek their specialized advice.

7. This paper describes the key aspects of the United Nations system of technical cooperation as it exists today. It also describes the arrangements through which United Nations technical cooperation supports a country's development plans and the characteristic mechanisms employed. It indicates contributions available from United Nations executing agencies and provides an overview of the contribution that the United Nations system can make to building human and institutional capacities.

2. Establishment of the United Nations development programme

8. In 1949, the General Assembly established the Extended Programme of Technical Assistance (EPTA) to respond to growing demand from United Nations Member States. Later, in 1958, a Special Fund was established to undertake larger, more complex programmes relating to technical education and management training and the surveys of basic resources. Projects supported by the Special Fund were executed by the appropriate specialized agencies of the United Nations system.

9. EPTA and the Special Fund were merged in 1966 to form the United Nations Development Programme (UNDP), with its own Governing Council reporting through the Economic and Social Council to the General Assembly.

In 1970, the General Assembly adopted a consensus on the operational activities carried out by United Nations organizations under the aegis of UNDP. The consensus established, *inter alia*, provisions relating to the United Nations development cooperation cycle. UNDP country programming was to be based on national development plans and the system of indicative planning figures (IPF) established for each recipient country.

10. In 1975, certain guidelines entitled "new dimension in technical cooperation" were adopted by the Governing Council. UNDP was to encourage Governments and institutions in receiving countries to assume responsibility for implementing projects. The assistance provided by UNDP should promote increasing self-reliance, particularly with regard to the managerial, technical and research capabilities required to formulate and implement development policies and plans.

11. Today, UNDP, headquartered in New York and directed by an Administrator who is accountable to the Governing Council, provides support and guidance to a global developmental network that draws on the expertise of agencies and organizations, with over 110 resident representatives (43 in Africa). A standard basic assistance agreement signed with each recipient Government governs its relationship with UNDP. Likewise, the conditions and responsibilities governing relationships are contained in a standard basic agreement between UNDP and each of the agencies which executes its programme.[1]

12. UNDP-assisted projects are projects of the countries concerned whose Governments are responsible for providing the necessary support as well as specific contributions in cash and in kind. Governments usually designate a central coordinating authority, normally a particular Ministry. The UNDP Resident Representative works closely with this coordinating authority and with those to whom its authority may be delegated to help ensure that ministries, departments and localities concerned are fully involved in the identification, execution and follow-up of various projects.

13. Recipient Governments are also being entrusted with executing UNDP-assisted projects, with the responsibility for the organization of UNDP financial inputs and their effective utilization in combination with the Government's and other available resources.

14. The United Nations specialized agencies provide the external input package of expertise and technical support for which UNDP meets the costs, including overhead costs. UNDP increasingly uses the country programming process as a means of coordinating technical assistance activities funded from a variety of sources, where there is a willingness and agreement to do so among recipient and donor Governments. This means the use of country programming as a framework for operational activities of the United Nations system as well as activities supported by other multilateral and bilateral sources.

15. UNDP depends on voluntary, not assessed, contributions for funding its world-wide effort of technical cooperation. The Governments of industrialized and developing countries alike promise payments at an annual pledging conference.

3. Special concern of the United Nations with the economic development in Africa

16. The economic growth and welfare of newly independent countries in Africa remains a major concern of the United Nations. From the 1960's and every year since 1980, there have been General Assembly debates and resolutions on the economic situation in Africa. The economic growth and overall development of African countries had indeed proceeded remarkably well in the 1960's. However, the late 1970's and early 1980's saw declines in the rates of growth.

17. In conjunction with the Economic Commission for Africa (ECA), the Organization of African Unity (OAU) proposed in 1985 the African Priority Programme for Economic Reform (APPER) to respond to the critical economic situation. Features of APPER were incorporated in 1986 into a five-year United Nations Programme for African Economic Recovery and Development (UNPAAERD). This programme called, *inter alia*, for the continuation of policy reforms by African States, to be supported by increased flows of development resources from Member States. The organs of the United Nations development system were enjoined to increase and improve their cooperation with African States.

18. When UNPAAERD ended in 1991 the overall African economic situation, though improving in many respects, still required more time, efforts and resources to regain development momentum. Accordingly, in December 1991, the United Nations agreed to a second programme, entitled the "United Nations New Agenda for the Development of Africa", which runs until the year 2000. This programme aims at accelerating the transformation, integration, diversification and growth of the African economies. In the context of the "democratization of development", Africa committed itself to pursue the 6 per cent rate of annual growth which so many States had achieved in the 1960s, through measures which included additional attention to agricultural production and to private enterprise. Africa also reaffirmed commitments concerning health, education, population and the status of women which were embodied in the international targets to which African States subscribed. The New Agenda also takes note of the 1991 treaty leading to the establishment of a continent-wide economic community.

19. Under the New Agenda, the international community and particularly Africa's main development partners pledged to supply "adequate resources" to complement domestic development efforts, to seek "durable solutions" to Africa's external debt problems and to take steps to improve access for African exports. The United Nations development system was again specifically enjoined to devise and execute programmes in support of the New Agenda. A post-apartheid South Africa could be among the beneficiaries of this concentrated United Nations effort.

B. Objectives of United Nations technical assistance

20. Over the years, the technical cooperation offered by the United Nations system has been redefined in practice as understanding grew of the nature of the development process and as more practical experience was gained. Technical cooperation seeks to reinforce the self-sufficiency of countries and to augment the country's intellectual capital.

1. Poverty reduction

21. By the 1970s, it became apparent that high rates of economic growth did not necessarily reflect advancement for the population as a whole and gains did not always "trickle" down to the poorest. This indicated a greater focus of development assistance on public welfare, which was reflected in three ways: (*a*) at the national level, greater attention was provided to the poorest countries, those designated by the United Nations as least developed countries (LDCs), the majority of which are in Africa; (*b*) more investment assistance was to be supplied to recipient countries, in ways that could spread benefits more equitably; and (*c*) sources of both capital investment and technical cooperation sought ways to help directly low-income groups.

22. Accordingly, emphasis has been given to projects that benefit the poor, involve their active participation and give attention to people's basic needs, such as health, literacy and adequate nutrition. (Participation has been identified by the International Labour Organisation (ILO) as another basic need.) Experience has been gained in targeting programmes at poverty alleviation. Experience has also shown that commitment of the Government to participation by its poorer citizens is crucial to success.

2. Enhancement of the role of women in development

23. Likewise, the United Nations development system has increasingly come to recognize the essential role of women in development. Women are now seen to be as active agents as men in the development process, are expected to provide an equal input into the preparation of programmes and are entitled to be specific beneficiaries. This understanding, much expanded during the United Nations Decade of Women (1970-1980), is reflected in the technical cooperation now provided by United Nations agencies, as well as by other multilateral and bilateral donors.

3. Human-centred development

24. More recently, UNDP has drawn up indices of human development that can serve as a guide to the allocation of development resources. These indices indicate changes in such key human factors as life expectancy, infant mortality and access to education that truly measure "development". The "enlarging of individual choices" is added to the list. This concentration on human-centred development further emphasizes technical cooperation.

4. Sustainable development

25. Finally, States Members of the United Nations pursue individually and collectively such universal objectives as the preservation of the world's environment and the achievement of sustainable forms of development. At the project level, technical cooperation is increasingly available to Governments searching for appropriate policies and technologies to preserve the environment, such as better ways of exploiting forests, for using renewable sources of energy, and other means of ensuring an economic development which would be sustainable for generations.

C. Methods of United Nations technical cooperation

26. Technical cooperation begins normally with as thorough an assessment of a recipient country's needs as possible. This assessment can arise from past experience and from an ongoing dialogue with the recipient Government. Development programmes and the need for supplementary assistance are discussed with the country's principal devel-

opment partners in appropriate forums. One such forum, for which UNDP supplies support and organization, is the round table. This is a conference organized periodically outside the recipient country which is attended by representatives of the country and its principal development partners. (Another such process is the consultative group in which the World Bank plays the leading role in organizing government/donor discussion.) These round tables are intended to promote understanding and support of the Government's development plans and to assist in securing commitment of support from donors. Follow-up meetings as required are held locally to translate general agreement into specific and operational programmes and projects whose technical assistance components can be established and detailed.

27. In recent years, UNDP has been helping Governments to determine their technical cooperation needs through the mechanism of the National Technical Cooperation and Assessment Programmes. These programmes, conducted with UNDP expertise, assist Governments in collecting data required for careful assessment of technical cooperation needs in various sectors, within an overall Government policy framework. The recipient country requirements of technical cooperation, in conjunction with other forms of development assistance, should arise clearly from these discussions and mechanisms.

1. UNDP country programming cycle

28. With a clear understanding of priorities and policies, a detailed programme of technical cooperation can be established. The country programme is the recipient Government's responsibility. UNDP actively assists in its preparation, and enables Governments to draw on the expertise available from other agencies in the United Nations development system. The country programme is intended to become a useful point of reference for the coordinated application of technical cooperation from all sources and not only that of the United Nations system. The programme can last from three to seven years and wherever practicable runs in concert with the overall national development plan period.

29. A country programme document is submitted to the Governing Council of UNDP for funding. The document essentially consists of a number of proposed projects with a financial summary of the cost involved to all parties. The Governing Council commits support for the country programme up to a total amount, which is called the indicative planning figure (IPF). The figure is arrived at by a complex formula, which takes into consideration anticipated future contributions to UNDP, its ongoing obligations on the one hand and on the other, the recipient country's gross national product (GNP) and its population together with other supplementary criteria. IPF also takes into consideration resources anticipated to be committed directly by bilateral donors, or through regular and special funds of other United Nations organizations in the development system, including resources to be made available by the United Nations Population Fund (UNFPA), the United Nations Children's Fund (UNICEF) and the World Food Programme (WFP).[3] Once approved by the UNDP Governing Council, or under its authority delegated to the UNDP Administrator, the programme commences and is continuously supervised throughout its life cycle by the Government and UNDP, using programme indicators established to facilitate this purpose. An in-depth final evaluation is undertaken, which can improve or correct the elements of the next cycle.

2. Country project cycle

30. Within the country programme, individual projects follow a similar cycle of preparation, execution and review. The project is the basic "unit of implementation" of UNDP. It is a set of planned activities aimed at achieving defined development objectives. Every UNDP project, regardless of its size, has a project document, the result of systematic examination of its potential contribution to development. Indeed, the first step in preparing the project is a clear definition of its development objective. Its elaboration is a complex process for which UNDP and the appropriate executing agencies supply expertise. The final document follows a standardized pattern: (*a*) context; (*b*) programming project justification; (*c*) development objective; (*d*) immediate objective (objectives and activities); (*e*) inputs; (*f*) risks; (*g*) prior obligations and prerequisites; (*h*) project review, reporting and evaluation; (*i*) legal context; and (*j*) budget.

31. The programme/project is essentially the Government's responsibility. UNDP and the executing agencies have complementary responsibilities. UNDP provides appropriate assistance and the executing agency chosen by the Administrator is responsible for the management-related tasks within its competence. A first stage of project approval takes place at UNDP Headquarters as part of the Administrator's accountability for the effective use of UNDP resources. Final approval of the programmes or projects within the country programme is given by the Governing Council at its annual meetings.

32. Once assistance is approved, UNDP and the executing agency involved provide the project personnel, equipment and training resources indicated. The personnel could include expatriate staff selected for their specific expertise

and/or qualified United Nations volunteers and associated experts. Their mission includes the training of local counterparts. The counterparts are appropriate local staff selected by the Government in a timely manner to work with the United Nations team. The leader of the combined group is designated project coordinator. He may be a government official or one of the expatriates according to the project document. Through on-the-job exchanges and training, and formal courses and fellowships, national staff will be equipped to achieve the programme's objectives and to continue to function effectively by the time expatriate help is withdrawn. Indeed, a measurable objective of technical cooperation projects is the ability of local staff to perform effectively without external support.

33. UNDP might itself undertake execution through its Office for Project Execution when the project is of a multidisciplinary nature or can be individually managed without the requirement of expert guidance.

34. Provision also exists for government execution of projects, which is a preferred mode of United Nations technical assistance, due regard being made to effectiveness and quality of the programme. The Government, as executing agency, may choose in such a case to enter into agreement with another United Nations executing agency, which then becomes the cooperating agency. (Under special circumstances, one can envisage the central authority wishing to delegate its responsibilities to regional local governments.)

35. The project cycle is not complete without a performance evaluation and a tripartite review. The review by the Government with the executing agency and UNDP compares objectives with results. Lessons are incorporated into the design of new projects and the next country programme cycle. Other United Nations agencies executing technical cooperation projects within their specialized competence, which are financed from sources other than UNDP, have developed their own appropriate methodology.

3. Mechanisms of technical cooperation

36. There are at least eight ways in which the United Nations system contributes towards technical cooperation. The first is research that is intended to provide the bases for policy-making. Qualified persons recruited internationally or locally can be engaged by the United Nations to research local issues, for example population, on which development policies can be based.

37. Related to this are studies, the second area. Again qualified persons can be engaged to undertake studies that would indicate the feasibility of investment or provide the basis for future programming. An initial programme for South Africa might include a large component for studies, the findings of which would help indicate priorities, and guide the preparation of future programmes.

38. A third area is represented by technical consultancies, the necessary specialized input to ensure the proper execution of projects such as that provided by consulting engineers, for example, who monitor progress of capital projects. Such investment-related consultancies form part of the loan costs of the project, which is typically the case with World Bank projects. Consultancies may be obtained through the United Nations system on a grant basis.

39. A fourth area is training courses. These are organized for nationals to refresh or upgrade their knowledge and skills or to prepare them for new functions and responsibilities. United Nations technical cooperation can support their organization and execution through, for example, classes for trainers, seminars for senior civil servants and conferences of teachers or scientists. Training can be held at local institutions, which can be assisted through staff upgrading, stipends for participants, textbooks and other educational materials and vehicles.

40. The fifth area of technical cooperation, study fellowships abroad, can be provided for nationals who, in the performance of their duties, will benefit from this overseas experience. Fellowships can include advanced studies, particularly for those who will be in a position to upgrade the skills of others on their return home. Fellowships vary from a short study tour in a developed or developing country to attachments to appropriate institutions abroad. The United Nations provides fellowships at its own institutions, for example the Turin Centre. Over the years, a network of contacts has been built up between the United Nations system and training institutions which enables United Nations fellows to be correctly placed.

41. Institutional linkages represent a sixth area of technical cooperation. The United Nations system has helped to form beneficial linkages between institutions in developing countries and overseas bodies in a position to offer specialized technical assistance. For example, staff of the London School of Tropical Hygiene have been associated with United Nations programmes and projects in a range of developing countries. In some cases, appropriate "twinning arrangements" between institutions in a donor and a recipient country can be facilitated. A familiar relationship of technical cooperation is that between an agricultural college in the United States and an agricultural college in the third world. The relationship can be mutually beneficial.

42. Local institutional building, the seventh area, offers a particularly effective form of technical cooperation. United Nations agencies can help in the establishment of local training and development institutions aiding in design, the shaping of doctrine, and the upgrading of its permanent local staff. Suitable experts recruited worldwide work with

nationals from an early stage and leave when the institution has been set on a firm footing. A case in point is the East and Southern African Management Institute (ESAMI). The East African authorities requested UNDP to establish a staff college for the east African Corporations within the then existing east African community. United Nations project staff were instrumental in securing $1 million of bilateral funds (from Norway) for the construction of the Institute's buildings near Arusha on a site presented by the Government of the United Republic of Tanzania. The UNDP regional project assisted ESAMI through the provision of advisers. Its project manager also served as the Institute's first director. The Institute, now autonomous, has flourished and provides training and consultancy services for a range of private and public institutions in Ethiopia, Kenya, Malawi, Somalia, Uganda, the United Republic of Tanzania, and Zambia.

43. Finally, the provision of expert services by the United Nations represents the characteristic factor in all these forms of technical cooperation. The essential feature of such technical cooperation is the foreign expert/local counterpart relationship. This relationship is not exactly that of a tutor to a student. However, the intention remains that the former will speed the day when the latter could be equipped in every way to take over completely. The United Nations system secures expert services by offering terms of service similar to those of regular United Nations staff, and can, in most cases, compete effectively in the recruitment of first-rate personnel. Selection is not limited to nationals of developed countries. The United Nations system has developed extensive rosters of staff whose abilities are proven quantities. It must always be anticipated that up to a year may pass between the selection of an adviser and his arrival at the duty station.

4. Principal areas of technical cooperation offered by United Nations agencies

44. Within the constraints of available funds and guided by their overall policies, the United Nations system offers technical cooperation to developing countries in a wide range of areas. UNDP provides about two thirds of the funding for the United Nations system on a grant basis. The remaining one third is raised by agencies themselves through contributions made directly. On the direction of its Governing Council, UNDP makes about 80 per cent of its funds available for technical cooperation to LDCs. As a result, about one third of all funding from UNDP goes to Africa, where there is the greatest concentration of LDCs though the total population of the Continent is smaller than Asia, which also receives one third. The remaining third is shared by countries within Latin America and the Caribbean, the North African and Arab States, and, increasingly, Eastern Europe, where former donor countries have now become recipients of UNDP technical cooperation. UNDP also administers specific operational funds of technical cooperation.[2] In most cases, these funds respond to perception of special opportunities such as technical cooperation among developing countries, and come from specified voluntary contributions or through special funding arrangements established with particular donors.

45. Technical cooperation contributes to a wide variety of areas related to development. Some of these are listed below alongside the names of the principal executing agencies, which include UNDP, the appropriate department within the United Nations Secretariat and also the World Bank. (The World Bank executes projects on technical cooperation for UNDP in its areas of specialty. The technical cooperation accorded by the World Bank can lead to programmes and projects which will eventually be financed by the World Bank on loans and concessional loan terms.) The following grouping of areas and listing of agenciesare indicative only. In certain cases projects are jointly executed.

Advisory/training areas	*Executing agencies*[1]
Administration and management	
Public administration	UNDESD
Local government	UNDESD
Public enterprise management	UNDESD
National capacity assessment	UNDP
Public finance	UNDESD, World Bank
Economic management	World Bank
Private sector development	UNDP, World Bank
Improving food production	
Agriculture	FAO
Forestry	FAO
Fisheries	FAO
Research and extension	FAO, World Bank
Pasturage and dry land use	FAO, UNDP (UNSO[2])
Environmental protection	UNEP
Food production	FAO
Food distribution	WFP
Living conditions	
Housing	UNCHS
Environment	UNEP
Grass-roots organizations	UNDP, NGOs
Rural development	FAO, IFAD, ILO
Remunerative employment for women	UNDP, UNIFEM[3]

Advisory/training areas	*Executing agencies*[1]
Promoting economic growth	
Private sector development	World Bank, UNDP
Productive employment	ILO
Industrial development	UNIDO
External trade and commodity agreements	UNCTAD
Transport and communications	ECA
Economic policy and planning	World Bank, UNDP
Popular participation	UNDP, agencies, ECA, NGOs
Studies and research	World Bank, UNCTAD, FAO, ECA, UNIDO, UNDESD
Tourism	World Tourism Organization
Shipping, ports	UNCTAD, IMO
Regional economic cooperation	UNDP, ECA, UNCTAD
External debt	World Bank, UNCTAD, ECA, UNDESD
Health	
Public health and primary health care	WHO, UNICEF
Essential drugs	WHO, UNICEF
Health policy	WHO, World Bank
Health services personnel	WHO
Population policies	WHO, UNFPA, World Bank
Maternal and child health	WHO, UNICEF
Public education	
Innovation in rural and science education	UNESCO
Teacher training	UNESCO
Educational systems	World Bank/UNESCO
Human resources assessment	UNDP
Early childhood development	UNESCO, UNICEF
Non-formal education	UNICEF
Applying science and technology to development	
Weather forecasting	WMO
Civil aviation	ICAO
Atomic energy	IAEA
Desertification/water resource use	UNDP, UNSO,[2] UNCTAD, FAO
Telecommunications	ITU
Transportation	UNCTAD, IMO
Resource mobilization	
Pre-investment studies	UNDP, NGOs
Capacity assessment	UNDP
Capital and investment assistance assessment	World Bank
Round tables	UNDP
Consultative Groups	World Bank (African Development Bank, in Africa)
Donors meetings	United Nations
Private resources	UNDP, NGOs

46. Aspects of the above deserve some general comments. The emphasis on administration and management through the improvement of systems and the training of local staff has remained strong throughout the years. Now its scope has become broader. Increasingly, attention is given to economic management because it is perceived that the economic policy environment has strong effects on other areas of development assistance.

47. The provision of technical cooperation for employment, industry and communications has been guided also by policies and targets set internationally. These include the targets of the four International Development Decades beginning in the 1960s, the first and second International Decades for Industrial Development and the first and second Transportation Decades in Africa. Likewise, technical cooperation responds to accepted international norms and objectives. These include the WHO goal of "Health for All by the Year 2000" and the successfully attained WHO/UNICEF target of universal child immunization by 1990.

48. Technical cooperation is particularly concerned with the applications of science and technology to development through training in such areas as satellite sensing, meteorology and international standards of civil aviation. Nearly all areas of technical cooperation now make increasing use, demonstration and dissemination of electronic data processing. However, this does not involve just the transfer of practices of industrial countries to developing countries. Technical cooperation can also include assistance in developing appropriate technologies, helping to design systems which start from local resources in materials, skills and manpower.

D. Some technical cooperation factors

1. Resource mobilization

49. The recipient Government may at an opportune time organize a donors' conference at its capital, at United Nations Headquarters or at another suitable location. Such a conference can be co-sponsored by the United Nations or by the World Bank. This donors' conference enables the Government to present its development strategy, with its programme and projects, in order to indicate the external support which is required to attain its development objectives. Once a consensus is reached with donors on strategies, it becomes easier to agree on the financing of related programmes and projects.

50. United Nations services are available to assist countries in elaborating technical cooperation aspects of these programmes and projects. This involves a discussion of priorities, an analysis of benefits anticipated by the country and the costs to the recipient country, including the opportunity costs of choosing one set of projects over the other. It also involves the discussion of the availability of external resources from the United Nations system and from multilateral and bilateral donors with which the United Nations system can to some extent serve as an intermediary. Studies and pre-investment projects can demonstrate the feasibility of programmes and projects to be financed by bilateral or other sources.

51. The nature and quantity of a donor country's contribution reflect the political will to support a particular recipient's efforts at development. Translating this political will into specific pledges very much depends on the perceived urgency, quality and effectiveness of the programme and projects under review. The experience of the United Nations system in this regard enables it to offer countries the kind of technical cooperation required for effective presentation of development strategies and thorough preparation of the projects and programmes submitted for discussion at a donors' conference.

2. Technical cooperation coordination in the field

52. As soon as circumstances permit and with the host Government's authorization and support, UNDP establishes an office in a developing country. The office is headed by a UNDP Resident Representative. The officer may also have representative functions on behalf of the Secretary-General of the United Nations and will be accordingly designated Resident Coordinator for United Nations operational activities. He or she also serves as local representative of a number of United Nations programmes, such as UNIFEM.

53. Many other United Nations agencies also establish offices in a developing country, each headed by a representative. The UNDP Resident Representative becomes the *primus inter pares* among these representatives. Not the least of his or her functions is securing synergy in the efforts of the United Nations agencies, and facilitating their cooperation with the Government and the overview on the part of the coordinating authority optimizes the assistance that these agencies can offer. Strengthening the capacity of the Government to manage the flow of resources is an important part of the coordination offered by the resident UNDP mission.

54. Furthermore, with respect to other sources of assistance and in particular technical cooperation, the Resident Representative can assist the Government in its relations with other multilateral and bilateral donors. However welcome multiple external sources of assistance can be, many Governments have difficulty in dealing effectively with a large number of donors, each with different priorities, methods of operation and systems of reporting. To the extent that the United Nations can assist Governments in establishing development plans and securing adherence to these plans on the part of donors, the Resident Representative and the representatives of the agencies can prove extremely useful allies to the Government.

3. Technical cooperation through non-governmental organizations

55. Resources raised by NGOs abroad and channelled to locally run operations in developing countries have become an increasingly large part of development assistance. Such aid may indeed be the fastest growing sphere of concessional resources from industrialized countries. Disbursement for NGOs in Africa exceeds $1 billion a year. Country members of the Development Assistance Committee (DAC)* contribute public funds to support NGO activities overseas.

* These principal donor countries are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Sweden, Switzerland, United Kingdom of Great Britain and Northern Ireland and United States of America. These are among the countries that reliably and voluntarily pledge the greatest amounts for United Nations development programmes. One third of total bilateral assistance from these countries now goes for technical cooperation; this is a threefold increase from the 1960s.

Indeed NGOs now receive from such official sources as much as 30 per cent of their funding for overseas work. To a certain degree, NGOs have become additional executing agencies for bilateral and multilateral programmes. The proportion of government contribution is viewed carefully by NGOs who do not wish to compromise their independence and their non-partisan nature or to impair the confidence they have earned in developing countries.

56. Donor countries and United Nations agencies recognize the particular NGO advantage in being able to respond flexibly to needs. NGOs tend to work closely with their beneficiaries, a factor that makes them indispensable in anti-poverty programmes. NGOs also help attract aid funding to community-based development projects.

57. Many of the NGOs active today in Africa, such as Catholic Relief Services and OXFAM, begin with emergency relief activities. Thereafter, these and other NGOs continue to work with local communities to further self-reliant development. Concerned with continuity, NGOs have now begun to give attention to the institutional development necessary to sustain local initiatives.

58. The NGO community was explicitly recognized as a partner within the United Nations programme of action for African Economic Recovery and Development. The landmark Arusha Charter for Popular Participation in Development (1990) was the outcome of the tripartite conference in the United Republic of Tanzania, where the international and African NGO community participated on equal terms with representatives of Governments and of United Nations agencies. The Charter provides in Africa the point of reference for popular participation in development, and for technical cooperation activities that support and benefit from popular participation. The NGO community is specifically encouraged to pursue activities in the context of the Agenda for Development in Africa (1991-2000).

59. The United Nations system is establishing an effective working relationship with NGOs, particularly in respect to grass-roots approaches to development. Such approaches prove very appropriate for activities whose principal beneficiaries are disadvantaged groups. They apply to programmes for the poor in rural areas as well as in marginal urban areas where people are involved in projects of self-help. NGOs contribute useful insights to the establishment of policy, can respond and support community initiatives, and effectively help execute small-scale projects. Governments increasingly appreciate the potential of community-based development activities and the ability of NGOs to complement their own activities.

60. The United Nations system can help Governments to introduce participatory approaches. A portion of the national IPF may be used for innovative pilot programmes that give local groups the incentive to plan activities for their needs, within the context of the overall government development framework. UNDP is authorized to provide technical assistance to strengthen local NGO capacities, especially when the NGO is helping the Government to implement a UNDP-supported project. UNDP and other agencies also strengthen local NGO bodies or consortia through training programmes and related services. The United Nations system can facilitate meetings between the Government and NGOs to enable the latter to contribute its views and experience to the making of policies and to secure NGOs' cooperation and support. In many African countries, NGOs have proved useful in keeping under consideration the social impact of structural adjustment. In South Africa, UNICEF has been able to contribute assistance through an umbrella organization of local NGOs, the National Child Rights Committee.

61. Although they do not serve as executing agencies for UNDP programmes, NGOs can, in consultation with the Government, be asked to carry out activities on behalf of an executing agency or under subcontracting arrangements. Governments can also subcontract with NGOs for services in a government-executed project. An international NGO may co-finance a project with UNDP or another United Nations agency and collaborate appropriately in its execution. At UNDP headquarters, a division for NGOs advises the Administrator on the development of grass-roots initiatives and helps to identify countries for special efforts.

E. Conclusion

62. The United Nations system of technical cooperation outlined above does not remain static. All its partners—the recipient countries, the donor countries, the international agencies—have kept the system under continuous review and are constantly making changes and improvements. The existence of a number of funds such as those that the UNDP Administrator administers[2] reflects new concerns and approaches as well as a continuous search for supplementary means.

63. Every aspect of the characteristic delivery mechanisms of United Nations technical cooperation, notably the expert/counterpart relationship, remains under examination and requires continuous attention and support to achieve its potential. Alternative approaches are being pursued. The main concern in these and other areas remains effectiveness.

64. Donors and recipients as well as international agencies have become sensitively aware of the magnitude of the costs involved in overall technical cooperation.[3] Technical cooperation now amounts to one third of all official development assistance from DAC countries. Viewed from that perspective, technical cooperation represents a rising proportion of the offerings from donor countries. It is also far

from being a "free good" to recipient countries which make a heavy contribution in personnel, accommodation and other services. It has been observed that the return on capital investments has been relatively low in recent years in many African States; these have every incentive to seek the highest possible return from the investment in human capital formation which technical cooperation represents, and to take the steps necessary to see that their capacity building expectations are quickly fulfilled.

65. Furthermore, substantial and recurrent claims on the public purse of donor countries cannot continue without a measure of public acceptance. Acceptance is sustained only when encouraging results can be seen. The eventual benefit anticipated by donor and recipient countries alike is a situation where developing countries show marked improvement in the condition of their peoples to the point where a considerable and increasing proportion of their populations is sufficiently economically independent to constitute orderly and secure communities. The establishment on every continent of a preponderance of stable, progressing and democratic societies, equipped with the conditions for self-sustaining economic growth and human development, offers the best promise of a world of peace and prosperity among nations. This is the ultimate justification for international development assistance and its key element, international technical cooperation.

Notes

[1] Executing agencies for UNDP

African Development Bank
Arab Fund for Economic and Social Development
Asian Development Bank
Caribbean Development Bank
Economic and Social Commission for Asia and the Pacific (ESCAP)
Economic and Social Commission for Western Asia (ESCWA)
Economic Commission for Africa (ECA)
Economic Commission for Europe (ECE)
Economic Commission for Latin America and the Caribbean (ECLAC)
Food and Agriculture Organization of the United Nations (FAO)
InterAmerican Development Bank
International Atomic Energy Agency (IAEA)
International Civil Aviation Organization (ICAO)
International Finance Corporation
International Fund for Agricultural Development (IFAD)
International Labour Organisation (ILO)
International Maritime Organization (IMO)
International Telecommunications Union (ITU)
International Trade Center
Islamic Development Bank
United Nations Centre for Human Settlements (UNCHS)
United Nations Conference on Trade and Development (UNCTAD)
United Nations Secretariat,Department of Economic and Social Development (UNDESD)
United Nations Educational, Scientific and Cultural Organization (UNESCO)
United Nations Emergency Programme (UNEP)
United Nations Industrial Development Organization (UNIDO)
Universal Postal Union (UPU)
World Bank
World Health Organization (WHO)
World Intellectual Property Organization (WIPO)
World Meteorological Organization (WMO)
World Tourism Organization

Non-executing agencies:

United Nations Children's Fund (UNICEF)
United Nations Population Fund (UNFPA)
World Food Programme (WFP)

It should be noted that although UNICEF, UNFPA and WFP are not executing agencies of UNDP, they cooperate closely with UNDP and with each other both at Headquarters and in the field under close review through a Joint Consultative Group on Policy, as agreed in a memorandum of cooperation that their executive heads signed with UNDP in 1984. To the extent that they can provide training together with supplies and advocacy, UNICEF and other such agencies are also involved in technical cooperation.

Operational funds and programmes administered by UNDP

United Nations Capital Development Fund (UNCDF)
United Nations Sudano-Sahelian Office (UNSO)
United Nations Revolving Fund for Natural Resources Exploration (UNRFNRE)
United Nations Development Fund for Women (UNIFEM)
United Nations Volunteers (UNV)
Special Measures Fund for Least Developed Countries (SMF/LDC)
Short Term Advisory Services (STAS)
Technical Cooperation among Developing Countries (TCDC)
UNDP Energy Account
United Nations Funds for Science and Technology for Development (UNFSTD)
Transfer of Knowledge through Expatriate Nationals (TOKTEN)
Other Special Trust Funds

[3] A report on technical cooperation in Africa was prepared in 1989 jointly by UNDP and the World Bank for the Inter-Agency Task Force, which monitored the progress of the United Nations Programme for African Economic Recovery and Development. It provided, *inter alia*, information for the monitoring group on the magnitude of technical cooperation available in Africa while raising important issues concerning its effective use.

Given the limitations of the human resource base of most African countries, particularly those in sub-Saharan Africa, the report observes, it could be anticipated that technical cooperation has a continuing major role to play in helping to develop human and institutional capacities. The study reveals the magnitude of the effort. It considers a total cost of $3 billion a year to be indeed a conservative estimate of the total amount of technical cooperation funding in Africa for just the year 1987. This represents an increase of 50 per cent over the 1984 figure and does not include the costs of technical cooperation which accompanies capital investments or the cooperation provided by volunteers and NGOs.

Looked at from another perspective, technical cooperation amounts to $6 per capita overall in Africa each year. This figure may be compared with average central government expenditure for education of $9 to $10 a year, and for health of $2 to $3 per year.

In terms of sector distribution, technical cooperation intends to be concentrated in agriculture, education and to a certain extent in health, followed by transport and communication. Industry receives relatively little technical cooperation.

It is estimated that the number of advisers and consultants financed on technical cooperation programmes in Africa exceeds 80,000. Comparison is inevitable with the number—70,000—of skilled Africans reported to be settled in the countries of the European Economic Community.

Measured in terms of expenditures, the greater part of technical cooperation provided through United Nations executing agencies is for longer term resident advisers rather than short-term consultants. The situation is evolving however. The numbers of short-term advisers is on the increase as is the number of local consultants and those coming from other developing countries. Formal training accounted in 1988 for $40 million from UNDP, that is to say, 10 per cent of UNDP assistance to Africa that year. The proportion for training is projected to increase to 14 per cent by the beginning of the 1990s. (The majority of funds provided by the World Bank for technical cooperation goes to short-term consultants, and training accounts for between 20 and 25 per cent of expenditures.) The report notes however that the proportion of technical cooperation funds spent on training in Africa is much less than that in the case of Asia, where 35 per cent of the Bank's funding of technical cooperation goes for training.

Donors and recipients alike are concerned with the overall effectiveness of technical cooperation. From the donors' side, there is a recognition that they do not always employ as rigorous a criteria to technical cooperation programmes and projects as to capital investments projects. This seems to be the case when the programmes are motivated by the special interest of donors. To the extent, notes the report, that technical cooperation is "supply driven", this leads to duplication among donors and the use of foreign consultants and advisers when local staff may be adequate and available. On the recipient side, there is, likewise, acknowledgement that local officials may turn to expatriates in place of their own nationals for a variety of political and social reasons, especially when engagement of the former brings vehicles, computers, office equipment and other items difficult to obtain locally. There is what the report calls a "fundamental dilemma" here for senior African managers who find it easier to secure foreign advisers (without incurring salary costs) than to offer remuneration sufficient to attract or retain skilled local staff.

Excessive reliance on technical cooperation can become counter-productive if it undermines the indigenous effort to use local capacities. Donors and recipients have reached some consensus on ways to make technical cooperation more effective. They believe there should be greater articulation of technical cooperation in terms of capacities to be developed among nationals rather than of inputs to be provided by donors. There should be more emphasis on short-term consultants and on advisers who come only on periodic visits. There should be more attention to specific training programmes beyond the notion of on-the-job training provided by experts to counterparts. There should be greater beneficiary participation, women included, in the design and execution of technical cooperation. There should be a thorough analysis of local manpower availability before the recruitment of expatriate personnel. There should be stronger technical cooperation monitoring, supervision and evaluation as well as a strengthening of national structures responsible for the programming and management of technical cooperation. Finally, the report says there should be greater use of national experts and consultants as well as of less costly models of technical cooperation such as those afforded through NGOs.

DEMOCRACY in ACTION
Journal of the Institute for a Democratic Alternative for South Africa
Vol 7 No 2
15 April 1993

NGOs get tentative thumbs-up

REPRESENTATIVES of several United States foundations who conducted a fact-finding tour of a range of South African non-governmental organisations (NGOs) late in 1992 have released a report which describes the sector as 'strong and vibrant'.

However, they caution that due to the country's still tentative political future, and given the legacy of apartheid, there is a dearth of comprehensive development planning and expertise.

'The decades of isolation from the international community have left South Africans lacking confidence in the merits of their own development efforts and experience.'

Although the group brought an outsiders' perspective, we could do well to heed some of their observations and recommendations about the culture and practice of NGOs in South Africa.

The delegation was impressed by the self-help ethos among the historically dispossessed and the symbiosis between NGOs and communities, adding that these were areas where the world could learn from South Africa.

The keen awareness of the concept of accountability among South African NGOs was also noteworthy, but there were 'some questions as to how much of the talk reflects good intentions and how much can be translated into practice'.

The NGO sector in South Africa tended to be strongest in the area of 'welfare' – often providing services which should be the responsibility of the local authority. This raised questions about whether NGOs should continue such work or become development agencies. A further option was to develop the concept of 'advocacy' – pressurising government and local authorities into providing services and development programmes.

The concept of 'advocacy' was largely absent from South African NGOs. Although there was a long tradition of political activism in South Africa, the absence of any tradition of democratic government meant that there was little appreciation of 'public policy advocacy'.

The visitors suggested that given the extensive American experience in this field, South Africans could benefit from discussion on the potential 'advocacy role' of the philanthropic and NGO sectors.

'By delaying focusing on the nuts and bolts of development planning NGOs run the risk of losing the initiative'

Advocacy was of particular importance when trying to influence government development policies. However, the group noted that while South Africans seemed very comfortable debating definitions of 'development' and 'empowerment', discussion around the characteristics of a national development policy remained tentative.

They warned that 'by delaying focusing on the nuts and bolts of development planning in South Africa', NGOs ran the risk of losing the initiative.

'South Africa's isolation from the international development community has created a level of unrealistic idealism among South African development leaders about the extent to which indigenous NGOs can compete with and/or shape the operating procedures of major international development organisations.

'There is little insight among South Africans into the experience of other developing countries at the hands of international agencies and very little understanding of the workings of the international development industry.'

According to the US delegates, the major impetus for South African economic development will undoubtedly be government-driven. This raises questions, already being considered in certain circles, about the role a new democratic government will allow existing NGOs.

Such a new government will be under pressure to deliver substantial results quickly, whereas the existing NGO sector in South Africa is currently best equipped to tackle small, localised projects. International donors will also be impatient for rapid results, but, say the US delegates, an initial 'gush' of international development funding which might materialise at the appropriate political moment may not be sustained beyond a few years.

A bigger question was how the advent of bilateral donor arrangements (ie government-to-government aid) would affect the local NGO development sector. Some scenarios suggest that NGOs could collectively constitute themselves as fiscal intermediaries between government and the NGO sector. Another option was for the NGO sector to organise itself into a collective voice in government development planning.

The new buzz word in South African NGOs, noted the visitors, was 'capacity building'. They said it was also a favourite among funders because training courses were 'neatly packaged' activities which were easily quantifiable and which donors felt comfortable funding.

However, the group asked whether capacity building was only a matter of providing more skilled personnel for NGOs or whether it was primarily a question of vision. For example, an organisation could have excellent administrative capacity but lack the capacity to envisage the necessary steps to become a player in the national development arena.

A further question was whether capacity building referred only to NGOs or whether it extended to the communities within which NGOs worked. The delegates noted that 'community mobilisation and education – so-called civil awareness – around development seemed to be an equally important ingredient.

'Perhaps the more fundamental question is whether South African NGOs still have the time to develop the necessary capacity or whether they may be sidetracked by an over-hasty government and the domineering ethos of international aid agencies.'

Yet another consideration was whether current NGO leaders would be absorbed into the civil service with the advent of a new democratic government, which was not necessarily seen as problematic by the visitors.

They repeatedly remarked on the number of 'incredibly impressive' women who were playing key roles within NGOs yet who seldom headed the organisations. The group noted that private US foundations could be influential in this regard by looking beyond first-tier NGO leadership in order to advance new leaders and, particularly, women.

Traditionally 'indigenous philanthropy' has come from a handful of major South African corporations. But, the report notes, 'despite the pockets of extraordinary wealth in South Africa, there is no established tradition of individual philanthropy, principally because the South African tax codes have never favoured this type of activity'.

APPENDIX

Zimbabwe and Russia are just two of the countries that face the challenge of balancing economic reform with local development needs. Although Africa and Eastern Europe are separated by thousands of miles, the special development problems of both regions are likely to be the focus of attention during the coming decade.

CASE STUDY #1—ECONOMIC ADJUSTMENT IN ZIMBABWE

Zimbabwe, a relatively "young" country, emerged in1980 from white-ruled Southern Rhodesia. At independence, Zimbabwe inherited a state-run economy, in which whites controlled all of the industry and large-scale agriculture. Robert Mugabe, head of the Zimbabwe African National Union-Patriotic Front (ZANU-PF), one of the parties that had led the way to independence, was elected the nation's first president. Within seven years, Mugabe was able to merge his party with the only opposition party, effectively creating a one-party state. The centrally controlled economy of former Southern Rhodesia fit with the philosophy of the Mugabe government, which espoused a Marxist-Leninist political philosophy. Over time, however, the economy evolved into a moderate form of state capitalism.

Today, Zimbabwe boasts one of the most diverse and successful economies in sub-Saharan Africa. The country has a more industrialized and diverse economy that any other in the subregion save South Africa, and has grown at an average annual rate of 3.5 percent. Zimbabwe's industries include manufactured products (chemical, petroleum, and metal products; textiles; transport equipment; and electrical machinery) and raw minerals (gold, nickel, coal, asbestos, and copper). The country is agriculturally self-sufficient (except in times of drought), owing in large measure to the small-scale black farmers who produce most of the country's food. White farmers, who still hold vast tracts of land, are largely producers of tobacco for export.

THE ESAP: A MACRO VIEW

Despite this relative dynamism, economic growth has not kept up with population growth, and high unemployment is a problem. The economy would have to grow at 10 percent to absorb the people currently unemployed as well as a large number of graduates leaving Zimbabwean universities every year. In addition to the unemployment, tight government controls have limited access to the foreign capital necessary to modernize and expand key industries so they can become competitive in the global economy. The seemingly inevitable emergence of an apartheid-free South Africa is also an economic concern of Zimbabwe's: Although the opening of the South African economy could offfer a huge market for Zimbabwean goods, Zimbabwe's products are not as efficiently produced as are South Africa's, and it is feared that Zimbabwean industry might be swallowed by the massive and more efficient South African economy.

Like many other developing countries, Zimbabwe has undertaken an economic restructuring plan aimed at guiding it to a free market and spurring economic growth. Begun in cooperation with the International Monetary Fund (IMF) in 1991, Zimbabwe's Five-Year Economic Structural Adjustment Plan (ESAP) involves the measures that are common to most restructuring schemes: the dismantling of foreign investment restrictions, currency reform, price decontrol, privatization of state-owned companies, budget-deficit reduction, and cuts in the civil service. The existing Zimbabwean economy seems sufficiently diversified to weather these reforms.

The cornerstone of the ESAP is trade liberalization. The government has moved from a highly centralized system, which allocated foreign exchange for imports, to an open general import license (OGIL) procedure. By allowing end-users to import directly the items they use in production, the government has done much to eliminate middlemen and official red tape. Eventually, about 90 percent of all imports will be handled in this manner, with tariffs being used instead of a cumbersome, centralized system to control demand. The loosening of import restrictions will in turn force local manufacturers to modernize, the better to meet increased competition from foreign products. It is hoped this will lead to higher-value, export-oriented standards of production for Zimbabwean industry.

In the short run, however, finding the capital to modernize Zimbabwean production facilities remains a problem. To address this problem, the ESAP relaxes direct foreign investment codes in Zimbabwe and moves to guarantee the security of foreign investment. Central in the promotion of foreign investment has been the establishment of the Zimbabwean Investment Center in the capital city of Harare. The center expedites project applications and has the authority to approve projects of up to $4 million within 90 days, as compared t the 18-month delay that investors previously endured. In an additional attempt to attract new investment, the government has liberalized foreign exchange regulations and offered incentives to export-oriented ventures. Export firms are guaranteed access to the necessary foreign currency to conduct business (formerly, access to foreign currency was allocated on the basis of permits), and foreign investors are guaranteed full repatriation of dividends after five years of pro-rated repatriation.

Micro and Small-Scale Enterprises and the ESAP

Unlike most restructuring programs, which are designed by the IMF and the World Bank, Zimbabwe boasts of the "homegrown" character of its ESAP. Designed by Zimbabwean planners in conjunction with Fund and Bank counterparts, the program aims to lessen the negative impact that such plans usually have on the average citizens. A social "safety net" was included in the plan to aid (and limit the suffering of) those who will be most affected by reforms. The government has taken steps to ensure there is broad-based understanding of the program and its implications. This is done through discussions at the village level and in schools to prepare Zimbabweans for the economic sacrifices likely to come with the ESAP, and to explain the program's intended long-term benefits.

The restructuring program fails, however, to address some key elements of the Zimbabwean economy and society—prominently, the street vendors and other small business people who make up the bulk of the country's "informal" economy in urban areas and their counterparts (both commercial and agricultural) in rural areas. Wood carvers, seamstresses, street vendors, peasant farmers—all are part of this parallel economy. However, the

A young carpenter receives skills training through a vocational development program in Kenya. Similar efforts could benefit small- and informal-sector business people in Zimbabwe and other parts of Africa. (CARE photo by Raymond Kohut) owners of micro- and small-scale enterprises (MSEs), urban and rural, are lumped into vague categories because of definitional problems and the lack of data concerning their economic activities.

A survey in 1991 showed that MSEs provide employment for over a fourth of the Zimbabwean population. Fully 70 percent of these fell into the manufacturing category, but the fastest-growing sector at this level was comprised of people involved in wholesale food, beverage, and tobacco production and trade. The majority of MSEs are run by women and are located in rural areas, where the majority of Zimbabwe's population lives. It is estimated that 52 percent of these businesses provide at least half of the household income; and with high unemplovment rates, more people are turning to this sector.

These people constitute a substantial portion of the economy, yet their impact on and benefit from the ESAP's free-market reforms has never been studied, since emphasis is placed on the industrial sector. The ESAP is geared largely toward macroeconomic development in Zimbabwe, but there is reason to question its direct benefit to the general nonindustrialized population. It is informal-sector producers who will bear the burden of currency devaluation and the elimination of price controls; their ability to take part in a new free market must be considered. If afforded help, they are likely to become an important source of income, and will also provide for a more equitable distribution of the country's overall income.

Present regulations and limited access to capital keep these businesses locked into the informal sector. A quarter (25 percent) of all MSEs surveyed in Zimbabwe reported having financing problems. To obtain formal financing in Zimbabwe, a firm must be formally registered with the government. Upon registration, however, a firm is subject to a 50 percent corporate tax, restrictive labor laws, and zoning requirements. Without the registration the MSE is not only prevented from obtaining formal financial services but also from obtaining foreign exchange, which many need to purchase raw materials and spare parts. By restructuring the environment in which these enterprise operate, economic statistics could be made more readily available and a clearer picture of the performance of the overall Zimbabwean economy would emerge.

Determinants of Economic Growth

In judging the economic growth of a developing country, such as Zimbabwe, economists often emphasize the industrial sector, overlooking the contribution of small-scale urban manufacturers and the rural agrarian segment of the population. Lack of attention is not intentional but arises from definitional problems and a lack of data. Such elements as basic food needs, education, and health care are all part of a country's inherent wealth, and affect traditional measures of growth, including such leading economic indicators as Gross Domestic Product (GDP) and per capita income.

Studies have shown that statistical correlations, although imperfect, exist between investment in people in all segments of the population (human capital) and a growth in GDP. One need look no further than the developing countries of Southeast Asia for evidence of the correlation. The governments of these countries invested heavily in education and health care and are now enjoying the benefits of a growing private sector driven by high-tech industries. Indeed, the most significant factor in human-capital development is a country's investment in education. The World Bank has found that, in some cases, increasing the average amount of labor force education in one single year has caused a corresponding 9 percent increase in GDP.

Various measures of education include gross literacy rates, school-enrollment ratios, and female educational attainment rates. The latter in particular is emerging as an important indicator of economic-growth potential. World Bank data show a decrease in infant mortality as the level of female education increases. Aside from reducing the tragic drain on human capital that high infant mortality causes, a rise in female education levels could prove a significant catalyst to sustainable growth in Zimbabwe and throughout Africa. In Zimbabwe, 67 percent of all micro- and small-scale businesses are run by women with generally low education levels. Since future equitable distribution of Zimbabwe's wealth will depend significantly on economic production in the informal sector, even moderate gains in female education could strengthen the performance of these enterprises and, in turn, the overall economy.

A fixed set of social welfare statistics that serve as correlative indicators of economic growth has not been established for Zimbabwe, and is lacking for many other developing countries as well. Perhaps there is no one set of data that can encompass the cases of all developing countries, but country-specific cases could be drawn up if pertinent social data were identified. By determining key growth determinants, a more realistic picture of country-wide economic growth could emerge.

Conclusion

The ESAP has enabled policy planners to restructure the formal environment of the Zimbabwean economy to realize greater gains through free-market economic activity. The liberalization measures are focused on the industrial sector, with the primary goal that of attracting foreign investment to drive economic growth. These steps are critical if Zimbabwe is to realize its development potential. However, if future economic success is measured solely by the growth of the industrial sector, a biased picture of the economic development of Zimbabwe as a whole could develop. A more equitable picture would need to incorporate data on the progress of informal-sector (micro- and small-scale) businesses and on the progress of the rural nonindustrialized population. At present, no formalized set of data exists for producers at this level, despite the real significance of their contribution to economic activity in Zimbabwe and its underlying impact on the long-term success of the ESAP.

Given the presence of several U.N. development agencies in Zimbabwe and their involvement in different facets of the nation's economic and social development, the United Nations could play a key role in creating a comprehensive economic model in Zimbabwe. The U.N. family of development agencies has the access and the capability to obtain the information necessary to help build an indigenous model that would take into account not only such formal economic indicators as productivity, GDP, and per capita income, but also growth in the micro- and small-enterprise sector and such social factors as education levels and mortality figures. Industrial-sector information is available to UNDP and UNIDO, for example, through their ties to the Ministry of Finance, the International Monetary Fund, and the World Bank. UNDP as well as UNICEF work extensively throughout the country on development projects and could provide the means of analyzing the micro- and small-enterprise sector and the various social factors that affect the quality of life for urban and rural people within it.

—*Richard Randall*

WORLD BANK NEWS

African Petroleum Sector Loses Millions of Dollars Annually

Sub-Saharan Africa could save more than $1.4 billion every year if the region changes the way it does business in petroleum, says a new report commissioned by the World Bank and financed by an Italian trust fund.

The vital sub-Saharan petroleum industry is plagued by inefficiency, says the study, *Rationalization of Supply and Distribution of Petroleum Products in sub-Saharan Africa.* But with the right reforms, the region could stop losses which yearly claim up to 15 percent of the $10 billion in oil production.

That could help the 46 countries in the region make oil products yield more tax revenues, pay for badly needed services and provide a strong engine for future economic development, says Eleodoro Mayorga Alba, the study's task manager and energy specialist in the World Bank's Africa Technical Department.

"There is great potential for savings in the petroleum markets in sub-Saharan Africa," says Mayorga Alba. "Because oil products play such a big role in African economies, savings in petroleum could bring a big boost to development there."

Sub-Saharan Africa can save most of the lost revenue by changing government policies and shifting business away from government monopolies to private companies. Greater regional cooperation and a more pro-investment environment would also help.

Petroleum is losing big money in three areas; procurement, refining and distribution the study shows.

Half of the savings, nearly $700 million, can be found in procurement alone. Currently, most countries lose money when they obtain petroleum because government interference slows the process, while poor credit ratings, lack of foreign exchange and high transportation costs drive up purchase prices.

Workers complete tubing on offshore oil platform in Benin.

By changing policies and making the right investments, though, procurement can be made more efficient, says the study. It suggests that oil should be procured through competition and not by public monopolies, costs for transporting petroleum across neighboring countries should be lowered and that products should be standardized to benefit from economies of scale across countries and to avoid unnecessary investments and waste.

Another $550 million can be found in refining. Most refineries in the region are small, have inefficient setups, lack skilled staff and do not use incentives to make operations more efficient. The average refinery in sub-Saharan Africa works at only 63 percent of capacity, compared to more than 85 percent elsewhere, says the study.

To receive the windfall, the region should make refining open to competition and link prices to international levels. That would cut subsidies, reduce artificially high prices and force existing local refineries to close or to compete with alternative sources.

Tackling distribution problems could also yield $180 million in savings. Currently, roads, ports and waterway routes for transporting petroleum are rundown. Also, investments in the sector are not encouraged. Countries can also take in more revenues by changing distribution policies and investing in infrastructure.

Mayorga Alba recently returned from sub-Saharan Africa where conferences were held among governments and oil company representatives to discuss the study.

"The sub-Saharan African governments are starting to be realistic about petroleum," says Mayorga Alba. "They know that inefficient practices are a drain on their economy and they feel they cannot survive. A commitment is finally emerging on what to do to make petroleum supply more efficient. The World Bank should maintain its support to continue the ongoing dialogue and to pressure for more rapid change in this vital sector."

Petroleum is key to sub-Saharan Africa's economic well-being and ranks as either the first or second most important revenue-earners for most countries in the region.

Rationalization of Supply and Distribution of Petroleum Products in sub-Saharan Africa is free to journalists who write on company letterhead to the World Bank, Room J 4066, Washington, D.C., 20433, U.S.A. Fax: (202) 477-2979. □

Managing the wetlands

During the last 50 years, major rivers such as the Limpopo in southern Africa, have been drying up. More recently, the flow of others, like the Zambezi in central Africa, appears to be decreasing. This could be the thin edge of a greater desiccation, warns *Patrick Dugan*, if efforts are not made to better manage the river basins and wetlands of the continent. Here he outlines the philosophy behind the IUCN's approach to Africa's freshwater problem.

Current patterns of freshwater use in Africa cannot be sustained if the continent's population continues to grow at its present rate. Between 1960 and 1990, the population doubled to 450 million. Unless there is a rapid reduction in family size, it will double again in 21 years. So that by 2010 it will have passed the billion.

To survive and develop, these billion people will need water. But Africa is a semi-arid continent, with erratic rainfall overlying a mosaic of fragile ecosystems. Its people are already feeling, most acutely, the shortage of freshwater. The situation is made more difficult by the continent's size, its poor communications and its large number of countries, not all of which live on good terms with their neighbours.

The people of Sub-Saharan Africa, in 46 countries, are also heavily dependent on agriculture. It supports 66 per cent of the population and provides essential exports. Its healthy development is a key to slowing rural-urban migration, which threatens to overwhelm the capacity of the cities to absorb the migrants. But productive agriculture, in turn, is totally dependent on a regular supply of freshwater.

That water is finite. It will never increase, and without due care it may decrease. Major rivers like the Limpopo in southern Africa, and the Save/Sabi which flows through Zimbabwe and Mozambique to the Indian Ocean have dried up and now flow only seasonally. There are indications that the flows of the Chari-Logona, the Nile and the Zambezi have also been decreasing. This could be the thin edge of a greater desiccation if Africa's river basins continue to be mismanaged and if current projections of global climate change are correct. Growing desiccation, in turn, would increase the pressure on the natural wetland ecosystems.

With the exception of the White Nile and the Zaire rivers, African rivers discharge seasonal floods every year, in complex and unpredictable patterns. The floodplains generally become larger as they move downstream to the deltas. On the Niger, for example, the flood peak moves slowly downstream taking over 100 days to travel some 1,760 kilometres. The Senegal floodplain in West Africa covers some 5,000 km² in flood, but shrinks to only a tenth of this size in the dry season.

Even in semi-arid regions like the Sahel, there are extensive wetlands, such as the inland delta of the River Niger in Mali, the Sudd wetlands of southern Sudan, or the Okavango Delta in the Kalahari Desert.

Nearly all such areas are home to large human communities, and nearly all have become the focus for 'development projects'. Some of these have attempted to enhance rural lives. More often they are designed to meet urban-industrial demands. They commonly involve large dams and hydro-electric projects built with little regard for the wishes or needs of the local inhabitants. As a result their success rate has not been encouraging.

The economic value of such wetlands is often overlooked. The Niger Inland Delta, for example, supports a population of 550,000 people, and in the dry season provides grazing for a million cattle and a million sheep and goats. Some 80,000 fishermen use the delta and it supports 17,000 hectares of rice cultivation, or half the total rice production in Mali.

In fact, wetlands have a strategic importance out of all proportion to their size. They replenish ground water and sustain dryland grazing systems, among many other functions. gation, to which local communities apply many carefully-developed techniques, cropping on both rising and falling floods.

Such natural irrigation can be very productive. About half a million people are supported by floodplain cropping along the Senegal floodplain which runs for 600 km downstream of Bakel, and is up to 30 km wide in places. Many local families also keep cattle and catch fish.

River basin planning, which impinges on such areas, has been applied both within countries – through schemes such as the Botswana National Water Development Plan – or in international drainage basins, such as the Senegal, Chad, Gambia and Niger basins. This is development planning on the grand scale and frequently involves foreign experts, on the assumption that the northern industrialized world 'knows best'. In practice many such schemes fail entirely to understand the wisdom of

People & the Planet is a joint publication of the United Nations Population Fund, the World Conservation Union and the International Planned Parenthood Federation. It is published by Planet 21, an independent, non-profit, publishing company, in association with a wide range of international organizations which have an interest in various aspects of population, environment and development, and with funding support from the Swedish International Development Authority.

local management practices, and some are environmentally disastrous.

The 360-km Jonglei Canal, aimed at speeding waterflow through the Sudd swampland of southern Sudan, halted since 1980 by the civil war, has its defenders. But it would have had a damaging impact on the 400,000 pastoralists living in the area, as their lands dried up from the siphoning off of some 20 million m^3 of water per day for irrigation projects in Egypt and northern Sudan. This is not to mention the half million wild grazing animals, including some 300,000 large rare antelopes (Tiang), which depend on these wetlands.

River basin planning has been widely adopted in Africa, with examples ranging from the Volta River Authority – where the Akosombo Dam created the largest artificial lake in the world, displaced 84,000 people and covered what was formerly some of the most productive agricultural land in Ghana – to the Aswan High Dam in Egypt, the Tana and Athi River Basin Development in Kenya and the Niger Dams Authority in Nigeria. International projects include the huge Central African Power Corporation, concerned with the Kariba and Cahora Basa dams on the Zambezi.

Such projects are not only large and expensive. They are also frequently flawed. Nigeria, with the most extensive system of river basin planning in Africa, has exposed the worst excesses of stifling bureaucracy. As the Nigerian geographer, A T Salau, has written, "most of the new river basin authorities have not collected enough data to warrant the large-scale developments they envisage". There has been a lack of trained staff to appraise the work of foreign consultants. The result can be haphazard and risky development, very far from the ideal of controlled, efficient and integrated planning that is needed. "It has", says Salau "to some extent, foreclosed alternative ways of improving rural welfare and productivity."

There is an inescapable logic to the concept of integrated planning for sustainable development, which is the central theme guiding IUCN's Wetlands Programme. "It is not the principle of planning water resources in an integrated way that is at fault, but the grandiose scale of the plans that have been put forward in Africa," says William A Adams in his study *Wasting the Rain: Use and Misuse of Rivers and Wetlands in Africa.*

It is the lure of complete control over nature by a centralized technical planning body that has so often failed, says Adams. Understanding the interactions of human uses, and the ways in which they relate to the natural variations in river flow, is vital to any sustainable future in Africa, he adds.

Even now, dam design is dominated by hydrology, engineering, geology and economics. Disciplines like sociology, anthropology or development studies are rarely given a professional role to play, and if they are it is too often a token one.

Many of the dams built on African rivers have had serious, even disastrous environmental impacts. "It is truly tragic that the dams that Africans are enduring debt to build have such serious side-effects," says Adams. Such massive engineering projects affect the human use of the floodplain, through for example, grazing. They affect the breeding of fish and fishing economies, they upset the natural balance between the various resource users, creating a context for disputes.

Indeed, the idea that water resource development should involve the building of large dams and large-scale irrigation schemes is outmoded. It has been shown that the massive costs do not justify the modest, or even negative returns.

The dominant desire to control natural processes and to transform economic activity ignores the serious limits to our understanding of the African environment. Technical advisers, engineers and governments consistently fail to understand the resource-use systems they are affecting, and particularly, the way in which they are inter-linked. And the planning procedures which until now have been used, are frequently incapable of producing projects that use money effectively, improve the environment and raise the living standards of the rural poor.

There is another way. The IUCN Wetlands Programme has begun a series of initiatives in partnership with African governments which builds on the principles of the World Conservation Strategy, *Caring for the Earth.*

In Uganda, it has helped develop a National Wetlands Conservation and Management Programme. A similar effort is under way in Tanzania. In Nigeria, the Wetlands Programme is supporting the Hadejia-Nguru Wetlands Conservation Project. This is an attempt to promote integrated and sustainable use of the floodplains along the Hadejia and Jama'ara rivers against pressures of upstream water abstraction and demands for canalization downstream.

In all such cases. IUCN puts the focus on the way natural systems work, the way people adapt to them, and the strategies necessary to enhance the productivity of the resources in ways that maximize human benefit. ■

Dr Patrick Dugan was, until recently, Head of the IUCN Wetlands Programme, based in Gland, Switzerland. He is now Director of Regional Affairs at IUCN.

EASTERN EUROPE AND THE FORMER SOVIET UNION

Testimony of Ambassador Strobe Talbott before the Appropriations Committee/ Subcommittee on Foreign Operations, U.S. Senate, April 21, 1993.

"US Aid to Central and Eastern Europe: A Call for Imagination," Statement of Robert L. Hutchings before the Appropriations Committee/Subcommittee on Foreign Relations, U.S. House of Representatives, U.S. Department of State Dispatch, U.S. Department of State, April 26, 1993.

LaFollette, Karen. Soft Assistance for Hard Russian Reform (Executive Summary), Foreign Policy Briefing, The Cato Institute, June 3, 1993.

Marnie, Sheila. "Economic Reform and the Social Safety Net," RFE/RL Research Report, Radio Free Europe/Radio Liberty Research Institute, April 23, 1993.

Bush, Keith. "Light at the End of the Tunnel?," RFE/RL Research Report, Radio Free Europe/Radio Liberty Research Institute, May 14, 1993.

Casey, Margaret. "Twin Challenges Confront Economies in Transition in Eastern Europe," IMF Survey, The International Monetary Fund, May 31, 1993.

Litvack, Jennie I. and Christine I. Wallich. "Intergovernmental Finance: Critical to Russia's Transformation?," Finance and Development, The International Monetary Fund and The World Bank, June 1993.

"Entrepreneurs Alive and Well in Poland," World Bank News, The World Bank, July 8, 1993.

Karlsson, Mats. "The Baltics: Economic Survival and Transformation," Economic Reform Today, The Center for International Private Enterprise (CIPE), Winter 1993.

Brada, Josef C. "Take Two: The Czech Republic," International Economic Insights, Institute for International Economics, May/June 1993.

"IMF Board Approves Russian Loan," Excerpts from a press conference held by Michel Camdessus, Managing Director of the International Monetary Fund, July 1, 1993, IMF Survey, The International Monetary Fund, July 12, 1993.

"Slow Pace of Reform Hinders Bulgaria's Economic Recovery," Excerpts from interview with Kyle Peters, Senior Economist in the World Bank's Europe and Central Asia Region, World Bank News, The World Bank, April 15, 1993.

"Ukraine: Challenges for a Former Soviet Republic," Address of Roman Popadiuk, United States Ambassador to Ukraine, at the 23rd Annual Leadership Conference of the Center of for the Study of the Presidency, New York, October 24, 1992, Presidential Studies Quarterly, Center for the Study of the Presidency, Spring 1993.

Doherty, Carroll J. "Voices of Restraint Grow Louder Amid Cries for Military Action," Congressional Quarterly, May 1, 1993.

Testimony of Ambassador Strobe Talbott
before the
United States Senate
Foreign Operations Appropriations Subcommittee
April 21, 1993

Mr. Chairman and distinguished members of the Committee: Thank you for the opportunity to begin a dialogue on the President's policy toward Russia and the other new independent states.

Before discussing the specifics of that policy, I want to take a moment to compliment Chairman Leahy for his consistent leadership in support of Russia and the other NIS. He was one of the first to speak out in favor of assisting these nations, and more recently, he called on the President to take bold action to help secure the forces of democracy in Russia. It is clear the President listened. His suggestion that we utilize the Food for Progress program to help Russia was part of the Vancouver package.

The task of your Subcommittee, Mr. Chairman, is to draft legislation, just as the task of our Administration is to craft policy. But on the issue before us in this hearing, what we are

really doing -- what we are doing <u>together</u> -- is nothing less than helping to shape history.

There have been three great struggles in this century. The first was World War I, a conflagration that ignited the Russian Revolution of 1917; the second was the world war against fascism and imperialism of 1939-1945; the third was the cold war against Soviet communism and expansionism.

Now a fourth great struggle is underway in Eurasia. It pits those who brought down the Soviet communist system against those who would like to preserve its vestiges if not restore its essence. It pits those who are determined to build a proud future against those who are clinging to a cruel and shameful past. In short, it pits reform against reaction.

We have a stake in the outcome of that struggle. Until now, many American's have been led to see our stake primarily in terms of what we do <u>not</u> want to happen: We do not want economic distress and political turmoil to trigger a civil war that could rage across eleven time zones; we do not want a nuclear Yugoslavia in the heart of Eurasia; nor do we want to see the rise of a new dictatorship that represses its people, threatens its neighbors, and requires the United States and its allies to return to a Cold War footing.

Mr. Chairman, while those concerns are entirely valid, I believe we need to think of our objectives in much more positive terms: An investment now in the heroic effort of these new democracies to restructure their economies will pay dividends down the road. A Russia, a Ukraine, a Kazakhstan fully integrated into the international economy will be a reliable source for raw materials and manufactured products, a reliable market for American goods and services, and a reliable partner in diplomacy and in dealing with global threats to human welfare and the environment.

In other words, Mr. Chairman, our policy should not be only to prevent the worst that can happen, but should focus on nurturing the best. Russia is undergoing a transformation in its very nature as a state. We, therefore, should undertake a corresponding transformation in the role we play. Having successfully led an international coalition against the Soviet Union for nearly half a century, we must now lead a strategic alliance with post-Soviet reform.

A strategic alliance implies a policy intended to serve us, and our allies, for a long time. And so ours must.

Yet while taking the long view, our Administration has also had to act quickly. The beginning of this Administration has coincided with a crisis in Russian politics. Exactly one month after President Clinton's inauguration here in Washington, President Yeltsin threw down the gauntlet in Moscow before a parliament that is dominated by reactionaries.

Four days from now, on April 25, Mr. Yeltsin faces a referendum in which the Russian people will express their views on his leadership, on his economic policies and on whether there should be new presidential and parliamentary elections.

We all hope that the referendum will strengthen the reformers' ability to pursue their course. We want the Russian people to understand that the world stands with them as they make the transition from communism to democracy and free markets.

But we recognize that April 25 may not be conclusive, either for better or for worse. And the referendum alone is unlikely to end the struggle between competing interests and conflicting visions.

Both on April 25 and in the months, and years, that follow, the showdown between the reformers and the reactionaries will be waged largely over the issue of which camp represents the interests of the Russian people. One of the main reasons that President Yeltsin is embattled today is that too many Russians identify reform with hardship -- with skyrocketing prices, falling living standards, and deteriorating social order.

Unless the reformist government is able to build a broader and more active constituency for its policies in the months to come, those policies -- and that government -- will be in jeopardy.

Thus, the Administration has had to move boldly, in a way that reflects our sense of urgency yet demonstrates our commitment to the long haul. In what we have done already, and in what we are asking you to do now, as you go about drafting foreign-aid legislation in the weeks ahead, the United States must advance two objectives:

First, we must do what we can from the outside to make the benefits of reform visible and tangible to the people on the inside -- that is, average Russians -- and to do so as soon as possible.

Second, we must find targets for support that will last, that represent trends we hope will become irreversible, so that we are supporting an on-going process that can survive the buffeting of political and economic setbacks.

While the first of these objectives is short-term and the second is long-term, they are, we believe, entirely compatible. Indeed, they are mutually reinforcing.

We believe that both objectives are evident in the four steps the Administration has taken in support of reform: the $1.6 billion initiative that President Clinton unveiled in Vancouver on April 4; the $28.4 billion package of multilateral measures to which the G-7, led by the United States, committed itself last week; the additional $1.3 billion in bilateral programs that the Administration announced at the same time; and, finally, the $704 million FREEDOM Support Act component of the FY '94 budget.

Let me say a bit about each.

At the conclusion of the Vancouver summit two weeks ago yesterday, the President announced a plan for accelerating, intensifying and redirecting existing programs so that their benefits will be apparent to the Russian people this year. Moreover, the Vancouver package is intended to meet the key needs that the Russian reformers themselvesMDNM have identified: in the areas of energy and environment, housing, exchanges, private-sector development, and trade and investment activities.

The Vancouver package also included $700 million in concessional loans for food sales, which permit a resumption of U.S. food exports to Russia.

It has been President Clinton's determination from the outset to use U.S.-Russian bilateral cooperation as a catalyst to multilateral support for Russian reform.

In that spirit, ten days after the Vancouver summit, Secretary of State Christopher and Secretary of the Treasury Bentsen traveled to Tokyo for a meeting of the Group of Seven. The Tokyo meeting delivered a clear message of support for Yeltsin and the reform movement. That support took the form of a commitment on behalf of the G-7 to help Russia restructure key sectors of its economy, divest iteself of inefficient state enterprises, finance critical imports and stabilize its currency.

Significantly, the Tokyo meeting was the first joint meeting of finance and foreign ministers in the history of the G-7. It was intended to underscore the connection between politics and economics in Russia: market reform is likely to succeed only in a pluralistic society governed by the rule of law; democracy is more likely to thrive in a vibrant economy.

Tokyo also demonstrated two vital themes in this Administration's policy: first, that we, the United States, are in partnership with our fellow industrial democracies; second, that we, the industrial democracies, are in partnership with the Russian reformers who are trying to transform their country into an industrial democracy in its own right. Just as the contents of the Vancouver package reflected the discussions between Presidents Clinton and Yeltsin, so the contents of the Tokyo package reflected what Foreign Minister Kozyrev and Deputy Prime Minister Federov told Secretaries Christopher and Bentsen and their assembled G-7 colleagues: namely, that Russia needs Western help to maintain the pace of reform.

Minister Federov and his colleagues were actively involved in the discussions leading up to Tokyo. They helped shape a number of the elements of the multilateral package. Their involvement focused the G-7 effort on developing a realistic set of short- and medium-term objectives for reform. Ministers Fedorov and Kozyrev participated fully in the second day of the G-7 meetings. The G-7, in turn, made clear to the Ministers that it is up to the Russians themselves control inflation before our support can be effectively used.

The Tokyo G-7 package includes approximately $4 billion in fast-disbursing funds from the International Monetary Fund and World Bank. These are targeted at the primary objectives of reigning in the credit policies of the Russian Central Bank and providing critical imports to slow the economic contraction. Disbursements could be made in a matter of weeks. They would allow the Russian government to undertake some of politically tough measures necessary to stabilize the economy.

These initial steps would, we hope, yield substantial progress in the campaign against inflation. The government could then translate success on that critical front into a more comprehensive economic stabilization program. The G-7 has agreed to support $10 billion over the coming year for this endeavor.

This includes $4 billion for a new IMF standby program and a renewed commitment to a $6 billion currency stabilization program.

Unlike last year's G-7 program to support Russian reform, this year's program sets what we believe to be realistic standards for Russian performance. The Russian economy must walk before it can run. Each incremental step must be matched by prompt, demonstrable benefits to the Russian economy -- and to the Russian people.

The third component of multilateral support is directed toward reforms in specific sectors of the economy. While long-term viability depends on the success of the stabilization program, efforts in sectors like energy and agriculture, can compliment and enhance the stabilization program by increasing foreign exchange earnings and making improvements in the local market visible to the general population. In Tokyo, the G-7 leaders committed $14 billion to this effort, most of it in the form of new export credits.

The U.S. has already made a significant contribution in this area. In Tokyo we announced with the Russians an agreement on a

$2 billion EXIM framework for export credits in the oil and gas industry. The U.S. equipment and services financed under this agreement will substantially increase Russian exports and foreign exchange earnings. At the same time, there will be benefits here at home. The first tranche of $500 million in guarantees alone will support thousands of jobs in U.S. companies that were hit hard by the recent recession.

We also laid the groundwork at Tokyo for a number of what we believe to be promising additional multilateral measures.

We hope to persuade the G-7 to join us in providing assistance for the safe dismantlement and destruction of nuclear weapons in keeping with the terms of international agreements. We were pleased that the Japanese announced last week that they will contribute $100 million toward this end, but we think more needs to be done by them and by other G-7 members. We agreed in Tokyo to establish a working group on how to expand the nuclear-weapons dismantlement program by the July G-7 summit.

The second new proposal put forward by the United States at Tokyo was for the creation of a Special Privatization and Restructuring Fund. This fund -- which is an American idea

strongly endorsed by the Russian reformers -- would help ease the economic and social consequences of privatizing some of the more than 20,000 medium- and large-scale enterprises.

The fund would help make the newly privatized firms self-sustaining with loans to modernize plants, retraining for workers, and technical assistance to managers who are making the adjustment to operating in a market economy.

The Russian economy and society are cursed by huge -- and hugely inefficient -- state-owned enterprises that utterly dominate entire cities. The Special Privatization and Restructuring Fund would be used to help municipal governments in these one-company towns cope with the consequences of breaking up and selling off these monoliths. Outlays from the fund could be used to invest in local infrastructure to support the smaller, newly privatized companies and the communities of which they are a part.

To be effective on ground, this program must be carefully targeted, phased, and monitored. The funds would be directed toward enterprises and communities that are selected as the most promising and deserving.

368

The U.S. proposed in Tokyo that the G-7 create a Support Implementation Office. The office would be headed by a person with strong administrative and managerial capabilities, as well as experienced in Russian affairs, and with a small staff of technical experts. This office would also be responsible for working with the Russian reformers to remove bureaucratic obstacles to implementation of G-7 programs, and for ensuring that Western funds are spent effectively.

At Tokyo, the U.S. told the G-7 that the Administration would seek from Congress $500 million for the Privatization Fund as a "challenge grant," to be matched by at least $1.5 billion in contributions from other countries, as well as up to $2 billion in co-financing by the World Bank and the European Bank for Reconstruction and Development.

Here again, Mr. Chairman, please note one of the central elements of our policy: The U.S. is not only demonstrating its leadership -- it is using that leadership to leverage from the international community considerably more money than we are putting on the table ourselves.

The G-7 has agreed to establish a working group on the Special Privatization Fund, with a view toward making a decision by the July summit.

Finally, Mr. Chairman, let me say a bit about the new package of U.S.-Russian bilateral initiatives that President Clinton announced simultaneously with the G-7 meeting.

You will recall that at Vancouver, the President indicated his intention to go beyond the $1.6 billion program he announced there. He would, he said, seek additional funds for certain high-priority areas after he had a chance to take into account what he had heard from President Yeltsin -- and what he learned from further consultations with Congress. The congressional consultations have begun in earnest, and I regard my appearance before you here today as part of that process.

The Administration is committed to seeking approximately $1.3 billion in additional bilateral assistance to support reform in Russia and the new independent states. Those funds would be used to strengthen programs in the priority areas of energy and environment, housing, the private sector, exchanges, trade and investment, and humanitarian assistance. How exactly the $1.3 billion will be apportioned is still a matter we are discussing. Our discussion will, as I just indicated, depend in signficant measure on our deliberations with you and your colleagues, both on the details of the package and on the appropriate funding mechanisms.

While I cannot, therefore, get into a detailed breakdown of the package, I can say a bit more about the areas on which we intend to concentrate.

In energy and environment, a substantial portion of the funds would be used to finance improvements in nuclear-reactor safety. With nearly two dozens water-cooled nuclear power plants, there is an urgent need for additional assistance to upgrade the safety systems and protect against potentially catastrophic accidents.

We also hope to expand significantly our efforts to improve oil production and restore oil and gas pipelines that are an environmental hazard and that waste precious resources. Other industries are also major polluters and desperately need the benefits of U.S. technology.

In Vancouver, President Yeltsin identified housing for returning and demobilized officers as a top priority. It is in our interest as well as his to see the continued withdrawal of the troops of the former Soviet armed forces from neighboring countries, especially the Baltics. The success of continued political reform is, in part, dependent on the military staying out of politics and allowing the democratic transformation to continue.

Expanded U.S. support could finance the construction of several thousand housing units for returning officers. This initiative seeks to include the U.S. private sector and American private and voluntary organizations in building houses and developing the local construction capacity.

There is also a need to expand efforts to help Russia's farmers and institutions create a market-driven food system. If more U.S. agribusinesses are linked with Russian partners, it will help break marketing bottlenecks and make delivery systems more efficient. Expanded programs would respond to the ever growing demand to help small businesses and entrepreneurs overcome the enormous obstacles that are the vestige of a command economy.

The funds we are requesting for the FY '94 FREEDOM Support Act will be weighted toward states other than Russia in the hopes that many will have followed Russia's lead in reform.

In conclusion, Mr. Chairman, my overall point is that as you and your colleagues examine the specifics of our policy, I think you will see that they reflect our determination to support reformers wherever they are to be found, whether in capitals like Moscow or Kiev or Bishkek, or in the farthest reaches of those countries, large or small; whether in the Kremlin or the parliament or the regional governments or municipalities, down to the grassroots.

We have also concentrated, to the greatest extent possible, on the non-governmental sector. Since we are trying to nurture the growth of the private sectors in the new independent states, it is natural that we should enlist the American private sector. That is another a common denominator of the initiatives we have put forward.

In general, Mr. Chairman, when we speak about U.S.-Russian economic "engagement" and "partnership" instead of "assistance" and "aid" -- when we speak about building a "strategic

partnership with Russian reform" -- we are not resorting to euphemisms. We are expressing what we believe to be a fundamental aspect of our policy. All the programs I have outlined for you today are intended to benefit both Russia's people and our own.

with members of this Committee and other members of Congress before making final decisions on the components of the additional request. I would welcome your views on the areas I mentioned as priorities as well as programs you think we missed.

I should add that Ambassador Thomas Simons will shortly be assuming the post of coordinator of our assistance programs to the new independent states. After serving for several years as Ambassador to Poland, he has a great deal of experience in helping former communists countries make the transition to democracy and market reform. He knows what works and what doesn't, and he has the proven leadership and management skills to ensure that the many agencies involved remain focussed on key objectives and are complimentary to each other. I expect Ambassador Simons to work closely with members of this Committee and its staff in shaping our program and carrying out his duties.

Ambassador Simons will coordinate U.S. assistance programs, including those funded under the FREEDOM Support Act, which was passed last year and on which we intend to build. As you know, we have requested $704 million in the FY '94 budget to continue

many of the successful programs under the FREEDOM Support Act into next year. Those funds will be used in the same key areas I have just outlined.

Before making myself available to your questions, let me make a final point. Much of what the Administration has done so far -- and much of what I have said here this morning -- has been focused on Russia. That is appropriate, given the sheer size of the country as well as the magnitude of the problems it poses, and of the opportunities it represents. However, this Administration's efforts will be directed at reform in all of the new independent states. A significant share of the grants and credits announced in Vancouver and Tokyo will be directed toward the other countries. A number of the multilateral programs announced in Tokyo, like the new IMF facility, will be available to these countries as they move along the path to reform. Substantial amounts of our own Nunn-Lugar nuclear-weapons dismantlement funds will also be used in Ukraine, Belarus and Kazakhstan. So will funds from whatever dismantlement program emerges from the G-7.

Additional funding would also be used to dramatically increase the number of people-to-people exchanges. There is no substitute for making training and first-hand experience in America available to people who lived their entire lives under a system that discouraged creative initiative and independent thinking. It is our hope that thousands of students, teachers and budding entrepreneurs could be given the chance to study and train in this country. They would take back not just facts and know-how, but a view of a successful democracy and free market based on a real experience.

To expand bilateral trade and investment, the Administration would also intend to provide additional credits and guarantees through the Export-Import Bank and the Overseas Private Investment Corporation. Beyond the oil and gas sector already being targeted, the EXIM Bank and OPIC could use additional funds to support financing in areas like mineral extraction, telecommunications and air-traffic control and defense conversion. With U.S. companies and exports directly supported by these programs, the mutual benefits are obvious.

Still, there must be a continuing component of humanitarian assistance as well. Americans have always responded generously to medical emergencies around the world, and the need in Russia is acute. The recent Congressional delegation, of which several of you were a part, saw the appalling lack of supplies for hospitals. Some of the funds we are requesting in the follow-up bilateral package would be used for supplying vaccines and responding to critical shortages of medicines, especially those that will help children.

But in this area, too, we are guided by the adage: give a man a fish and you feed him for a day; teach him how to fish, and you feed him for a lifetime.

Our hope is that over time, Russia and the other new independent states will move away from a reliance on foreign donations. To that end, we want to provide technical assistance to build up local capacity for the manufacture of basic pharmaceuticals, particularly in areas outside of Moscow.

Let me reiterate that I have purposely not attached specific dollar figures to the programs I have mentioned here because we hope over the next few weeks to have continuing consultations

US Aid to Central and Eastern Europe: A Call for Imagination

Robert L. Hutchings, Special Adviser
For East European Assistance

Statement before the Subcommittee on Foreign Operations of the House Appropriations Committee, Washington, DC, April 19, 1993

I am pleased to have this opportunity to testify, for I believe that the US assistance program for Central and Eastern Europe is one of the most important activities [that] our country undertakes. Three and a half years after the democratic revolutions of 1989, the countries of this region are in the midst of deep recession, with rising unemployment and social tensions threatening the political consensus behind these painful economic and political transitions. Yet there have been spectacular successes as well: a dynamic new private sector in Poland, now accounting for more than half of GDP; an upsurge in US and other Western investment in the Czech Republic; and an impressive expansion of Hungarian trade with new partners in the West.

In the Balkans, progress has been more halting and uneven, owing partly to the economic and political spillover of the conflict in [the] former Yugoslavia. Yet, despite these strains, Bulgaria, Albania, and Romania have maintained their commitment to free market democracy under very difficult circumstances. The Baltic states, too, are making steady progress despite the many problems associated with the withdrawal of Russian troops and the disruption of traditional trade relations.

The success of these new democracies is of enormous importance to US interests. As the first to attempt the transition from communism to democracy, they can be an example to Russia, Ukraine, and others facing even greater difficulties. Russians need to see that this transition can be made successfully and peacefully. A democratic and prospering Eastern Europe, with a combined population of some 135 million, is also becoming an important market for US goods and services—and a gateway to the vast potential markets farther east. Finally, successful progress toward stable democracy in Eastern Europe is key to ending the continent's postwar division and building a peaceful, democratic order across Europe that assures security at lower cost to ourselves. The bleak alternative to this vision is being played out before our eyes in the former Yugoslavia.

US and other Western assistance obviously cannot assure success nor guarantee that there will not be "another Yugoslavia." But our help can make a difference—sometimes a decisive one. As our assistance program enters its fourth year, we can say with confidence that our help has already made a difference—in providing capital and other assistance to Poland's new entrepreneurs, for example, and in helping the Czechs navigate their ambitious program of mass privatization.

The Administration's request for FY 1994 is $409 million for programs authorized under the SEED [Support for East European Democracy] Act, roughly the same as last year's appropriated amount. This will mean a tight budget, particularly in light of the increased number of recipient countries and the still-growing needs in the region. However, with the anticipated completion, or near completion, of the capitalization of the first two Enterprise Funds for Poland and Hungary during the current fiscal year, we will then have somewhat greater flexibility to augment some of our smaller programs elsewhere. Two general areas where we intend to expand our assistance in the region are public sector reform and environmental assistance, both of which are areas of high interest to this committee.

As the committee has pointed out, the early predictions of a 3- to 5-year "sunset" for this program have proved much too optimistic. We, nonetheless, continue to see this program as a transitional one, even if the sunset will take longer to arrive than was anticipated during the heady days of 1989. Without trying to be too specific or engaging in false precision, I would forecast roughly steady needs in the more advanced countries of Central Europe for another 2 to 3 years, followed by a gradual phasing down. The rest of the region is harder to forecast, but it is clear that needs will rise before they begin to taper off, with the net result that it will be some years before the overall assistance needs in the region diminish substantially. Even after the "sunset" has finally arrived, we may want to maintain modest cooperative programs to ensure the survival and sustainability of certain partnerships and exchanges, but these countries would, at that point, effectively have "graduated" from SEED assistance.

I would like to depart from the usual practice whereby Administration officials chronicle only the virtues of their policies or programs. I would like to focus on our weaknesses, too, in the interest of strengthening our dialogue This Administration is committed to that kind of dialogue, and the introduction to this year's SEED Act Implementation Report reflects our readiness to admit mistakes, share with you the dilemmas that we have not yet been able to answer, and engage in full and open discussion.

Let me begin by identifying what I see as the major strengths of this program:

First, it is quick, responsive, and flexible. It is willing to take risks.

Second, it has developed innovative ways of delivering assistance—the Enterprise Funds, the International Media Fund, the Citizens Democracy Corps, and others—that have helped cut through bureaucratic delays.

Third, through these and other programs such as the ABA's [American Bar Association] Central and East European Legal Initiative and the MBA Enterprise Corps, the US assistance program has built a public-private partnership that enables us to use scarce public funds to leverage large private sector assistance.

Fourth, it engages the strengths of multiple agencies, including those that are charged with advancing US commercial interests.

Fifth and most important, it is based on close cooperation among State, USAID [US Agency for International Development], Treasury, NSC [National Security Council], and other key agencies, so that foreign assistance is an integral part of broader foreign policy interests and linked to domestic policy as well.

Now the deficiencies—and here I should mention that those which worry me most are not always those that are called to my attention by the Congress. I believe it is worth exploring why this is so, also in the interest of strengthening our dialogue.

- First, we are still too slow and risk-averse. These countries are in the midst of profound and revolutionary change. Their needs and priorities are in constant flux, and we must keep up if we are to be relevant to their transformations. G.K. Chesterton once said that anything worth doing is worth doing badly, by which he meant that there are some things so important, some tasks so urgent, that we should be prepared to take risks and be prepared to make mistakes. I try to keep this in mind when an East European minister makes a request that was not even on his agenda 2 months before. If we allowed ourselves the luxury of studying a problem until we satisfied every possible concern, the need will have passed before we decide what to do about it.
- Another weakness is program proliferation. We are simply trying to do too much with too little money. We are making some headway in paring down our programs and focusing them more tightly, but, as we all know, it is easier to start a program than stop one. I hope that our country strategy papers—which I will describe in a moment—will help us build greater discipline into every program [that] we undertake or consider.
- Coordination remains a weakness. Within our government, we have developed remarkably good cooperation among the 18 agencies involved, and coordination between Washington and the field is improving steadily, but international coordination leaves much to be desired. There is too much duplication and competition among donors and too little coordination of activities so that we can make the best and most effective use of our collective resources. We have no magic formula to offer and certainly do not want to build yet another international bureaucracy to try to solve the problem, but we are taking some practical steps that we hope will improve coordination. We are working to improve coordination among the major players—the IMF [International Monetary Fund], World Bank, EBRD [European Bank for Reconstruction and Development], EC, the United States, and others—and then to improve coordination in the region itself on select sectors. We have been pushing for these steps in various forums and will present further, specific suggestions at three meetings next month: a G-24 [Group of 24] senior officials meeting and combined G-24/World Bank meetings on Bulgaria and Romania. Our feeling is that we may be able to achieve more by lowering our sights and focusing on limited but sharply defined areas where coordination is most urgently needed.
- Of course, there are also specific weaknesses regarding individual projects and activities. Given the size and complexity of our assistance program, it could hardly be otherwise. This committee has expressed particular concern with some aspects of the operations of the Enterprise Funds. We take these concerns very seriously and want to work with you to resolve them. At the same time, I hope that these efforts do not cause us to lose sight of the funds' great success in helping develop the new private sectors in the region.

Some of the weaknesses I have identified—and this committee may help me identify others—are products of the experimental nature of an assistance program that has evolved and is still evolving. Already, we have passed through three stages. In 1989 and 1990, we sought "targets of opportunity" and put a premium on getting programs up and running as quickly as possible. It was politically essential to do so—to show US engagement and support at that critical moment. In 1990 and 1991, we put in place the "building blocks" of the program. These included the four Enterprise Funds, partnership programs in various sectors, and large institutional contracts that are administered regionally but deployed according to each country's specific needs.

Beginning last year, we developed more detailed country strategies—tightly argued, real-world statements of our priority objectives and the programs we have, or intend, to advance those objectives. These documents, prepared with the country team and USAID representative in the lead and in full consultation with host governments, are helping us achieve a greater degree of rigor in our work, improve transparency and predictability, enhance host country participation, and develop better communication among Washington agencies and between Washington and the field. In short, the process of developing these papers—the ongoing interaction on the substance and aims of our assistance program—is at least as important as the products themselves.

Let me elaborate on this dimension of the program's evolution, which I know is of special interest to this committee. In the early stages of the program, some of the successes we achieved may have come at the expense of the full participation of embassies and host governments. This was at a time when we were rushing to launch programs, many of which were by nature experimental, and when USAID offices were embryonic and host governments disorganized. Now, with 3 years' experience, USAID offices better staffed, and host governments more clear about their own priorities, the program has evolved. The role of USAID representatives has been clarified and strengthened, and we are developing a new balance of responsibilities between Washington agencies, embassies, and host governments.

Here is how this process is working in practice. Last fall, I led an interagency delegation from State, USAID, Treasury, and NSC to Poland, the Czech and Slovak Republics, and Hungary, stopping in Brussels on the way for consultations with EC officials. These were intensive discussions, over the course of 3 to 4 days in each country. They included meetings with the ambassador, the USAID representative, and the entire country team; large group meetings between the US delegation—together with the ambassador and USAID representative—and senior officials from all the key host country ministries; and a series of more detailed meetings with individual ministries according to schedules worked out in advance with the governments concerned. We reached agreement on the strategies and priorities of US assistance, engaged in a no-holds-barred critique of the assistance program, and agreed on an action plan for addressing problems that we could not resolve on the spot. Regular visits like this, along with the more detailed country strategy papers we are developing, are helping us define the agenda for an ongoing, substantive dialogue among Washington, our embassies and USAID representatives, and senior officials of each host government.

The program is evolving organizationally within the Department of State as well. As Assistant Secretary [of State for European and Canadian Affairs] Oxman explained during his confirmation hearings, the office I direct will be under his authority in the Department's overall reorganization. The Administration, beginning most immediately with Mr. Oxman and myself, is committed to implementing this move in a way that preserves the program's effectiveness and interagency character while also strengthening overall policy integration within the Department.

In conclusion, Mr. Chairman, let me return to Central and Eastern Europe—to matters of substance rather than process. In that thrilling fall of 1989, when our assistance program began, no one knew what lay ahead. No one forecast the split of Czechoslovakia; no one knew how these unprecedented democratic transitions would unfold; no one divined how quickly communism would unravel in Russia itself. We engaged as fast as we could and learned as we went. We were willing to take risks because of the importance and urgency of the task at hand, and we adapted the program to changing circumstances.

Now, 3¼ years later, we are wiser, perhaps, but no more able to predict what the next few years will bring. These countries are still in the midst of profound and essentially unpredictable change; the economic transitions are in some cases well advanced, but the revolutionary transformation of these societies is only beginning. Democracy has scored amazing advances, but nowhere is democracy secure. Our commitment to this region must remain steady, but our policies and programs should stay nimble, with strong political leadership exercising the imagination and flexibility that these turbulent times demand. ■

CATO INSTITUTE

FOREIGN POLICY BRIEFING

No. 25 June 3, 1993

SOFT ASSISTANCE FOR HARD RUSSIAN REFORM

by Karen LaFollette

Executive Summary

The difficulties Russia faces in its transition to a democratic market system have prompted Western leaders to pledge massive amounts of financial aid to Moscow. If the West intends to help President Boris Yeltsin and assist Russian economic reforms, however, it should refrain from sending large-scale aid. Rather than encourage democracy or capitalism, aid is likely to undermine the reform and prolong the transition to a market economy. Moreover, foreign aid transfers will not introduce the policy changes that the Russians themselves must implement--widespread privatization, deregulation, trade liberalization, and tax reform. Although the West can help Russia by lowering trade barriers, ending restrictive overseas investment rules, and forgiving or restructuring Russia's debt, Western leaders should realize that they cannot determine the course of events in Russia.

The International Monetary Fund, the World Bank, and other Western advisers have given Russian reformers harmful advice that threatens to jeopardize Russia's transition. If Russian reforms are to succeed, rapid and widespread privatization, coupled with an end to government subsidies to money-losing industries, is needed.

Karen LaFollette is a research associate with the Institute for Political Economy.

RFE/RL
RESEARCH
REPORT

Economic Reform and the Social Safety Net

Sheila Marnie

The former communist countries inherited extensive social security systems that now require both restructuring and trimming so that they can provide effective protection to the new poor of the reform period, while functioning within tighter budgetary constraints. Many aspects of the previous social security systems were wasteful and will have to be phased out in the reform period. However, reform also implies the withdrawal of many indirect forms of support, such as price subsidies. A carefully designed and targeted social safety net can protect the vulnerable from such changes while helping to retain popular support for reform.

The creation of a social safety net is generally considered to be an integral part of economic reform. The idea is that the poorer, more vulnerable social groups should not suffer excessive hardship during economic restructuring and that some mechanism should be in place to ensure that basic needs are met during the reform period. Since economic reform is expected to lead to rising unemployment, a drop in real income, price hikes, and, consequently, new cases of poverty, it is advisable to have a social safety net in place to protect the low-income groups. While there is broad agreement on the need for some kind of safety net, there appears to be less consensus over what form it should assume, of what it should consist, and how it should operate.

The term "social safety net" tends to be used loosely. In a narrow sense, it refers to a minimum income guarantee; that is, "a scheme which ensures that everyone's income is brought up to a specified minimum level."[1] This narrow sense of the term suggests a "last-resort measure" bridging the gap between a person's income and the specified minimum income. In a broader sense, however, the term can mean "a series of measures designed to reduce the pain of unemployment for the individuals concerned and to protect minimum living standards of consumption and access to social services for everyone in society, independent of their earning capacity or ownership of assets."[2] This usage of the term embraces all social security benefits; a last-resort, minimum-income guarantee; and the need to ensure the operation at an acceptable level of institutions providing basic health and educational services.

Most former communist countries already have extensive systems of social security benefits, but these will need to be restructured to meet the requirements of the transition period. The communist systems tended to be quite generous in their coverage and eligibility rules but were often very wasteful. The existing systems of entitlements will have to be rationalized: benefits may have to be scrapped or targeted more carefully, and some new ones will need to be introduced. For example, unemployment benefits will replace the practice under the communist regime of providing low-wage, low-productivity jobs as a form of universal income support. In general, the idea is to move away from the general "cradle-to-grave" type of welfare provision to more carefully targeted social assistance.

Putting in place a social safety net is not, however, as simple as it might seem. One of the main problems is that the former communist countries have not inherited a flexible, efficient administrative structure or a corps of experienced managers. It will be difficult to make the new support systems fully operational in the near future. If, for example, a minimum income guarantee is introduced, some way of identifying those people with incomes below the minimum level

---

[1] A. B. Atkinson, "Social Safety Nets and the Experience of Western Market Economies" (paper presented at the Conference on the Labour Market, Employment, and Social Implications of Transitions in Eastern Europe, sponsored by the Organization for Economic Cooperation and Development and the International Labor Organization, Paris, September 1991).

[2] See chapter 9 of the World Bank Country Study, *Russian Economic Reform: Crossing the Threshold of Structural Change* (Washington, D. C.: The World Bank, 1992).

7,76

will have to be found and, presumably, some form of income testing introduced. This is not an easy task in a Western context; but in former communist societies, which inherited not only extensive social security systems but also inflexible, cumbersome state bodies to administer them, there is a real danger of an even larger bureaucracy's becoming involved in the administration of still more social funds. Benefit entitlement programs will have to be carefully designed: they must ensure that hardships are minimized for the more vulnerable social groups; in this way, they can contribute to maintaining the population's support for the reform process. On the other hand, they should not discourage people from working and should promote entrepreneurship—both vital elements of successful economic reform. Benefit programs must provide security but at the same time discourage dependence on the state. In the past the population tended to view state benefits as a kind of universal right.

In drawing up benefit entitlement programs, financial constraints must also be taken into consideration. Governments will need to find resources to finance the creation of social safety nets in a period when international lending institutions, such as the International Monetary Fund, are making aid conditional on the reduction of budget deficits and government expenditures. Financing social welfare programs will also depend on the governments' ability to collect tax revenue.

The freeing of prices can lead—as has been the case in Russia—to high rates of inflation, unless it is coupled with a tight monetary policy. If this happens, fixed transfer payments, such as pensions, soon become worthless and cannot provide adequate protection from the adverse effects of reform. The reaction of the Russian government and parliament, which are seeking to keep social unrest in check and retain popular support, has been either to increase benefits periodically or to index them to inflation. This leads to the printing of ever more money to cover the increase in expenditures and, as a result, to even higher rates of inflation. Pensions are at present indexed quarterly, but at the current rate of inflation they become worthless well before the end of each quarter. Thus, current policies serve to fuel inflation, which in turn brings hardship to those whom the increases/indexation are supposed to protect; namely, the poor living on fixed incomes.

It is interesting to consider whether the former communist countries are able to learn from one another's experiences. Poland attracted international attention by being the first of the former communist countries to adopt the "shock therapy" approach to reform. One of the arguments against this approach was the potentially serious adverse effects on large segments of the population, such as a sudden, steep rise in unemployment and a precipitous drop in the living standards of a large section of the population. Two years after the start of reform, one can begin to judge how drastic these effects have been. While Hungary adopted a more gradual approach to reform, it inherited from the communist regime a particularly extensive system of social security benefits, which it can no longer afford; the cost of maintaining this system has left the country without funds to introduce benefits for its new poor. Russia has ostensibly embraced "shock therapy" but is still reluctant to throw itself fully into reform, mainly because of residual fears about the social costs.[1] All these countries have inherited extensive social security benefits and indirect forms of social assistance, such as price subsidies, that were looked upon as rights that the state was obliged to guarantee its citizens. These "rights" constituted an important element in an unwritten social contract whereby the lack of freedoms and other deprivations were tolerated in return for the guarantee of certain fundamentals, such as jobs, housing, heating, and basic food items. Social security benefits and social assistance will not be withdrawn, but they will almost certainly be less universal in character. Trimming and targeting the existing social security system will remain politically sensitive as long as the economic benefits of reform remain intangible to large segments of the population.

---

[1] The cases of Poland, Hungary, and Russia are discussed in the articles that follow.

IN93178 RIR 13 April 1993

Light at the End of the Tunnel?

Keith Bush

The collapse of the planned economy, the lack of market mechanisms to take its place, and the disruption first of ties within the Council for Mutual Economic Assistance and then of relations between the former Soviet republics have resulted in a dramatic decline in respect of all Russia's major economic indicators. While privatization is proceeding apace, the massive issuing of credits, high inflation, and a large budget deficit mean that the Russian economy is still experiencing serious difficulties. One major factor has been the failure of the Russian government adequately to raise internal prices on energy carriers and to charge world prices for exports of these commodities to the former Soviet republics. Despite the severe drop in living standards, however, there has so far been little unrest, industrial or otherwise. A fundamental problem in implementing reform is that the country has become practically ungovernable.

The Russian economy is experiencing a severe depression that is expected to see a more than 40% decline in the gross national product (GNP) for the period 1990–1994. The depression followed some three decades of secular, gradual decline in average growth rates in the Russian Soviet Federative Socialist Republic and the Russian Federation economies.[1] Some of the preeminent factors were the unsustainability of the Stalinist growth model, whereby ever greater shares of GNP had to be devoted to new investment; a short-term approach, which led to the exploitation of the cheapest and most accessible resources at the expense of conservation, the environment, and rational development; demographic trends; the low growth of factor productivity resulting from disincentives to innovation, the lack of competition, and low foreign trade participation; and the monstrous defense burden, unequaled in any major peacetime economy.

Economic Indicators

The depression got under way in 1990 when the command economy started to disintegrate but had yet to be replaced by market mechanisms or institutions. It was compounded by the disruption of ties first within the Council for Mutual Economic Assistance and then between the former Soviet republics. The measurement of this decline has presented problems. Table 1 assembles the available official Soviet/Russian statistics for the period 1990–1992 on the annual percentage growth or decline in respect of some salient indicators. The process of gathering official data has suffered as a result of the overall economic disintegration, but in many instances they remain the best or only data available. Yet qualifications are in order, for a variety of reasons.

Whereas output under the traditional Soviet system was notoriously overreported to enhance bonuses, promotion, prestige, and the well-being of the producer, now production and sales totals are often underreported in order to allow a greater share to be retained for barter and for transactions through unofficial channels. The statistics do not fully reveal the burgeoning activity of the private and cooperative sectors—estimated to constitute about 20% of GNP and to employ more than 15% of the work force.[2] Corruption is rife but has always been present and is largely unmeasurable. It is difficult to keep track of magnitudes expressed in value terms when the annual rate of inflation reportedly exceeds 2,500%. Gradually, factories are switching to products that people want to buy. And the volume of military production is declining, albeit at a slower pace than foreign observers and most Russians had hoped.

For the year 1993, the Russian government and a well-respected Western institution project a leveling off of the overall decline in growth, with GNP falling in real terms by between 8% and 10% in GNP and between 7% and 10% in industrial output.[3] The preliminary results for the first quarter of 1993 do indeed indicate at least a temporary bottoming

---

[1] Keith Bush, "The Russian Economy at Mid-1992," *The Former Soviet Union in Transition* (Washington, D.C.: Joint Economic Committee, forthcoming).

[2] *Measuring Russia's Emerging Private Sector* (Washington, D.C.: Central Intelligence Agency, November 1992), p. vii.

[3] Andrei Nechaev, cited by ITAR-TASS, 11 March 1993; and *Annual Economic*

Table 1

The Russian Federation Economy, 1990–1992: Selected Indicators
(growth/decline in percentages)

INDICATOR	1990	1991	1992
Gross national product	—	—	–20.0
Gross domestic product	–1.6	–9.8	–19.0
National income, produced	–4.0	–11.0	–20.0
National income, utilized	–4.2	–10.2	—
Gross industrial product	–0.1	–8.0	–18.8
Gross agricultural product	–3.6	–4.5	–8.0
Capital investment from all sources	0.1	–15.5	–45.0
Housing space completed	–12.4	–20.0	–23.0
Transportation	–4.3	–8.1	–12.0
State and cooperative retail trade turnover including public catering	10.0	–7.2	–39.0
Consumer services	10.2	–20.8	–36.0
Retail prices (at end of year)	—	260	2,539

SOURCES: For 1990 and 1991, *Narodnoe khozyaistvo Rossiiskoi Federatsii. 1992* [The Economy of the Russian Federation. 1992] (Moscow: Russian State Committee for Statistics [Goskomstat], 1992), pp. 14, 15, and 205. For 1992 (preliminary), *Ekonomika i zhizn*, no. 4, 1993, p. 13; and *Kommersant-Daily*, 19 February 1993. Goskomstat put the increase in retail prices at 1,750%. The figure of 2,539% refers to December 1992 over December 1991 and was given in *Rossiiskaya gazeta*, 23 January 1993.

out of the fall in output. According to the Moscow think tank Macroecon-Link, national income was down by 20% and industrial output down by 19.5% compared with the first quarter of 1992, that is, roughly at the level of the last quarter of 1992.[4] No official projection appears to have been published for overall growth or decline in 1994, other than bland reassurances from politicians.

Even with the qualifications listed and a host of other caveats, the official Russian Federation data do not differ greatly from most Western estimates. They suggest that, during the period 1990–1994, Russian GNP will shrink by between 40% and 50%; that is, by a greater magnitude than the decline in US GNP during the Great Depression. The even sharper fall in investment from all sources of financing—the level of net investment in 1992 fell to less than one-third of its peak 1988 level[5]—implies that future economic growth will be limited for a considerable period even after any upturn. Consumption fell sharply. According to the minister of labor, during 1992 consumer prices rose by a factor of 26.1, while wages rose by a factor of 13.4 and money incomes by a factor of 10.0.[6]

In view of the importance of fuel and energy for the domestic economy and Russia's ability to earn convertible currency, it is worth looking at the output figures for fuel and energy during the period 1990–1993. Table 2 shows that the output of gas and coal has stabilized of late and that the key variable is oil production. Most projections see oil production continuing to decline in the near future, even with massive capital and technology inputs from Western firms. Moreover, since consumption has not been falling in line with overall economic activity (energy use rose by 38% per unit of industrial output during the period 1990–1992),[7] and since any conservation measures will take some time to yield results, the likely outcome is that the surplus of oil for export will fall further. How much of the dwindling supply will be sold to former Soviet republics and how much will be left for Western countries will depend to a large extent on whether and when Russia charges world prices for its fuel and energy exports to other former Soviet republics.

State of Affairs in April 1993

Privatization. The core of President Boris Yeltsin's economic reform

---

Review 1992 (London: European Bank for Reconstruction and Development, February 1993), p. 97.

[4] Interfax, 24 March 1993.

[5] *Russian Economic Monitor* (PlanEcon), 10 March 1993.

[6] *Izvestiya*, 9 February 1993.

[7] *Financial Times*, 21 April 1993.

program, as initially outlined in October 1991, is the rapid privatization of most of Russia's industrial capacity and service sector with the declared aim of making reform irreversible. The pace to date has been unprecedented. A large number of small enterprises and outlets were privatized during 1992, and at least half of them are scheduled to be privatized by the end of 1993. More important, it is planned to privatize a critical proportion of the nation's large enterprises before the end of 1993.

According to the State Property Committee, out of 205,000 state and municipal enterprises in Russia, 46,800 were privatized during 1992. The revenues from their sale came to 157 billion rubles. (It is thought that this latter figure was couched in current prices, which would mean that the total realized was, in real terms, well below the original target figure of 95 billion rubles in December 1991 prices.) Some 36% of retail trade outlets, 35% of wholesale businesses, 22% of catering outlets, and 40% of consumer service points were privatized. "Small privatization" fell short by between 30% and 50% of the admittedly ambitious goals in 1992.[8] By 12 March 1993 more than 300 large and medium-sized industrial enterprises had been privatized at voucher auctions in sixty oblasts.[9]

Nevertheless, the program faces stiff opposition from the parliament and from many people in the government. On 16 February the deputy prime minister in charge of privatization, Anatolii Chubais, warned of the "fourth variant" of privatization, which was being floated by many parliamentary deputies. This would, in effect, mean that in time collectives and their managements could purchase all the shares of their enterprise from earned profits, leaving none for workers and employees in other sectors and none for the public at large.[10] On 6 March,

Table 2

Fuel and Energy Production in the Russian Federation, 1990–1993

INDICATOR	1990	1991	1992*	1993'
Oil and gas condensate (millions of tons)	516	461	399	351
Natural gas (billions of m³)	641	643	640	647
Coal (millions of tons)	395	355	338	340
Electric power (billions of kWh)	—	1,068	1,011	1,010

* preliminary
' forecast

SOURCES: For 1990, *Narodnoe khozyaistvo Rossiiskoi Federatsii. 1992* [The Economy of the Russian Federation. 1992] (Moscow: Goskomstat, 1992), p. 373. For 1991–1993, *Kommersant-Daily*, 24 February 1993.

after some inconclusive parliamentary debate, the chairman of the Supreme Soviet, Ruslan Khasbulatov, took the privatization program as a whole off the agenda and sent it back for further study.[11] And on 28 April the assembly resumed the debate and passed a resolution condemning the program and ordering an audit of the State Property Committee. It voted to "consider the privatization of state and municipal enterprises in 1992 unsatisfactory" and demanded that the government repeal many of the decrees issued that year. The standoff continues. Speaking in St. Petersburg on 1 April, Prime Minister Viktor Chernomyrdin compared the current privatization program to Stalin's brutal collectivization of the 1930s.[12] This was rebuffed the following day by Chubais, who declared that "no honest man would dare to make such a comparison."[13] Although Chernomyrdin subsequently softened his stance and denied that he planned to make changes in the tiny privatization team, the exchange suggests that little love is lost between the two men.

Another challenge to the privatization program is presented by local authorities. On 8 April, for example, the Novosibirsk Oblast Soviet suspended privatization auctions until 1 July, following charges that outsiders, including foreigners, were buying up local industries.[14]

Budget Deficit. The scale of Russia's consolidated budget deficit is crucial in many respects. Until now it has largely been financed by printing money and thereby stoking inflation. Plans have been announced to auction treasury securities, but these have not been welcomed by Viktor Gerashchenko, the seemingly indestructible chairman of the Russian

[8] Russian Television, 9 March 1993.
[9] ITAR-TASS, 12 March 1993.
[10] Interfax, 16 February 1993.
[11] Russian Television, 6 March 1993.
[12] ITAR-TASS, 1 April 1993.
[13] Reuters, 2 April 1993.
[14] ITAR-TASS, 8 April 1993.

Central Bank. The budget deficit is also the key criterion for stability and rectitude applied by the International Monetary Fund (IMF), the Group of Seven leading industrial democracies, and other potential creditors. The trouble is that measurements of the deficit vary significantly; it is difficult to establish its true size.

In 1991, the last year of the USSR, the consolidated budget deficit (the sum of the Union and republican deficits) was 26% of the Union's gross domestic product (GDP), according to IMF measurements.[15]

At parliamentary hearings on 26 January 1993, the then Russian minister of finance, Vasilii Barchuk, revealed that the federal budget in 1992 had run a deficit of more than 1 trillion rubles, while local budgets had enjoyed a surplus of about 327 billion rubles.[16] Since GDP at the end of 1992 was put at 15 trillion rubles, this would suggest a consolidated budget deficit of less than 5% of GDP; in other words, within the target set by acting Prime Minister Egor Gaidar's administration and in accordance with the guidelines set by the IMF. However, this formulation appeared to overlook some major items of expenditure while counting foreign credits toward revenues. Some two weeks later, Gerashchenko put the deficit at twice that given by the government, which, he claimed, had deliberately doctored its budget figures to deceive foreign lending institutions such as the IMF.[17] According to Western accounting standards, the deficit was probably more than 20% of GDP.[18]

Clarity has also been lacking in the various presentations of the budget and budget deficit projected for 1993. What started off as a budget deficit equivalent to just over 5% of GDP[19] had grown to more than 8% by the end of February.[20] By the time the parliament gave the draft budget its final reading on 25 March, a quarter of the budget year was already over and the projected deficit had grown to 9.8 trillion rubles,[21] or 36% of a GDP estimated at 27 trillion rubles at the end of March. And this was before President Yeltsin decreed on 28 March the doubling of the minimum wage, additional subsidies for staples, increased financial assistance for students and invalids, and other benefits. It was also before the Congress of People's Deputies had voted to index savings deposits retroactively to January 1992. The price tag for such an indexation, given that retail prices have increased by a factor of more than fifty since January 1992, was estimated at 10–30 trillion rubles.[22] A few days later, the government agreed to pay the new higher interest rate on credits, thereby pushing the projected budget deficit even higher.[23] It is thought that Boris Fedorov, the finance minister and deputy prime minister responsible for financial and economic policy, omitted these last two proposals when he put the budget deficit at 17 trillion rubles.[24] With a GDP of around 27 trillion rubles (assuming that both magnitudes were couched in prices current at the end of March 1993), this would imply a deficit equivalent to 63% of GDP; that is, a runaway deficit.

Credits. In the absence of Western-type capital markets, Gerashchenko apparently believes it is his bank's prime duty to keep failing enterprises afloat—and to keep down open unemployment—by issuing credits on a massive scale, to the despair of the government, Western advisers, and potential Western creditors. (Gerashchenko has retorted that less than 10% of the credit issued by the central bank can be attributed to the initiative of the bank itself and that 90% has gone to accommodate decisions made by the government and the parliament.)

The scale of such credits has been variously reported and interpreted. The best estimate would seem to be a total of 6.3 trillion rubles in 1992: of this, about one-third was issued to the government; a quarter to central banks in the other former Soviet republics; and the remainder to Russian commercial banks. Credit emissions thus far in 1993 have grown faster than the overall rate of inflation, with a total of 11–13 trillion rubles of centralized credits issued during the first quarter.[25]

On 10 April Finance Minister Fedorov announced what appeared to be a "major breakthrough." He claimed that the three deputy governors of the Russian Central Bank, who sit on the Credit Policy Commission with representatives of the government, had signed an agreement to limit the growth of credits in the second quarter of 1993 to 30% more than the credit issued during the first quarter.[26] But, two days later, Gerashchenko appeared to overrule his three deputies. On 12 April he told the parliament that the bank planned to boost the money supply by 18% in each of the next three months in order to provide credits to industry.[27]

Inflation. The retail price index by the end of December 1992 was reported to have risen by a factor of about twenty-six over December 1991, while the industrial wholesale price index rose by a factor of 62.2.[28] Dur-

[15] *The Economy of the Former USSR in 1991* (Washington, D.C.: International Monetary Fund, April 1992), p. 13.
[16] ITAR-TASS, 26 January, 1993.
[17] *Ibid.*, 11 February 1993.
[18] See, for instance, *Financial Times*, 27 February 1993.
[19] Interfax, 18 December 1992.
[20] ITAR-TASS, 26 February 1993.
[21] *Izvestiya*, 25 March 1993; and *Rossiiskie vesti*, 3 April 1993.
[22] The estimate was given by a deputy chairman of the Russian Central Bank on Ostankino Television, 7 April 1993.
[23] See *Financial Times*, 2 April 1993.
[24] *Rossiiskaya gazeta*, 7 April 1993.
[25] *Izvestiya*, 14 April 1993.
[26] AFP, 10 April 1993.
[27] ITAR-TASS, 12 April 1993.
[28] *Russian Economic Monitor* (PlanEcon), 10 March 1993.

ing the first three months of 1993, retail prices reportedly rose by 27%, 25%, and 17% respectively.[29] However, some doubt existed about the March figure, as it was jubilantly quoted in the context of the Vancouver summit meeting between Presidents Yeltsin and Bill Clinton and the preparations for the 25 April referendum.

Fuel and Energy Prices. Oil, gas, coal, and electricity prices for domestic consumers and those for foreign importers are another key issue. For while domestic fuel and energy prices remain well below prime costs, the entire price structure is still distorted, rational costing is impossible, economic incentives to conserve energy are minimal, and either the fuel and energy sector is deprived of funds or the necessity for huge subsidies undermines fiscal stability. On the world market, oil and gas are Russia's primary source of convertible currency; yet much of Russia's export surplus of oil and gas is shipped to former Soviet republics at well below world prices. A Western study, published in early 1992, reckoned that Russia would generate a trade surplus of $20–30 billion in 1992 if world prices were used.[30] Most of this surplus would have been derived from higher prices for oil and gas exports. The chairman of the Russian Oil Industry Committee, Viktor Ott, has estimated that the value of Russian oil and gas supplied to other former Soviet republics in 1992 would have been $16 billion if world prices had been used. In return, according to Ott, Russia received fuel and energy equipment from Commonwealth of Independent States (CIS) nations worth only $800,000.[31]

In January 1992 some 90% of retail prices and 80% of wholesale prices were freed. Since then, further retail and wholesale prices have been liberalized, with the important exception of the prices of energy carriers. These have been adjusted from time to time, to compensate partially and retroactively for inflation; but they remain controlled and well below the world price level when their ruble price is converted to dollars at the official rate of exchange. Similarly, the export prices of oil and gas shipped to most of the other former Soviet republics have been kept well below world prices.

The precise levels of domestic and intra-CIS prices as well as their relationship to world prices have not been easy to determine. On 6 April 1993, for instance, four ballpark prices were given for crude oil: the state price of 15,000 rubles a ton; the commodity exchange price of 25,000 rubles a ton; the price of $60 a ton for crude exported to those CIS trading partners within the ruble zone; and the price of $120–130 a ton for crude exported outside the ruble zone.[32] On the Moscow Interbank Currency Exchange on 6 April, the exchange rate ended at 712 rubles to the dollar. This suggests that the state price was about 16%, the commodity exchange price roughly 27%, and the ruble zone price roughly 50% of the world price on that date. A very similar relationship existed between the commodity exchange prices and the world price on 24 March.[33]

The domestic and ruble zone prices of natural gas appear to be even lower in relation to world prices. In the Russian-Ukrainian dispute over quantities and prices of natural gas, according to a respected economic observer, Mikhail Berger, the world price in mid-March 1993 was said to be 45,000 rubles per 1,000 cubic meters; the ruble zone price was one-third of that; while the price paid by domestic consumers was reportedly one-tenth of the world price.[34]

Many in Moscow, including former acting Prime Minister Gaidar and Finance Minister Fedorov, tend to agree in retrospect that fuel and energy prices should have been liberalized along with most other wholesale prices in January 1992, or raised much higher while remaining controlled. But decontrolling these prices now would be politically suicidal, as hyperinflation would surely ensue. Indeed, rumors that the government was planning merely to increase controlled oil prices were recently criticized by the head of the presidential staff as a "provocation."[35] And President Yeltsin, in a prereferendum speech to Kuznetsk coal miners, ruled out any liberalization of the price of coal.[36]

The situation with regard to the price of Russian fuel sold to other former Soviet republics may, however, be about to change radically, with a potentially very positive impact on Russia's balance of payments. At a news conference on 14 April, President Yeltsin was asked about this very point. He replied: "We have quite a firm intention to go over to world prices for fuel in relations between the republics of the former Soviet Union," without saying when. But he implied that the IMF had prepared a program for assisting the other former Soviet republics when they are faced with greatly increased bills for oil and gas imports.[37]

Good News

Perhaps the greatest achievement since January 1992 has been a non-event. Social disorder has not occurred with the frequency or to the extent forecast by many external and

---

[29] First Deputy Prime Minister Vladimir Shumeiko, quoted by ITAR-TASS, 8 April 1993.

[30] *The Emerging Picture of Foreign Economic Relations of CIS Member Republics* (PlanEcon), 13 March 1992.

[31] ITAR-TASS, 30 March 1993.

[32] Private communication from the Institute for the Economy in Transition, Moscow, 6 April 1993.

[33] *Finansovye izvestiya*, 20–26 March 1993.

[34] *Izvestiya*, 18 March 1993; and *The Wall Street Journal*, 1 March 1993.

[35] ITAR-TASS, 1 April 1993.

[36] Russian Television, 13 April 1993.

[37] *Ibid.*, 14 April 1993.

internal observers. Indeed, the number of workdays lost to strike action in 1992 was said to be one-sixth that of 1991, despite a severe drop in living standards.[38]

No major political figure is seriously advocating a return to the command economy, even if Vice President Aleksandr Rutskoi, Chernomyrdin, Khasbulatov, and others may occasionally make statements that suggest nostalgia for a previous era. Instead, the focus tends to be on the pace of change. The rapid progress of privatization is nearing the point where reform may be said to be irreversible.

In the relatively short period of sixteen months, most prices have been liberalized, exchange rates have been unified, and currency and trade restrictions have been greatly reduced. The private sector has blossomed. Entrepreneurial activity has exploded, even if some visitors to Russia may prefer to use the term "rip-off" to characterize this activity. In the words of former Deputy Prime Minister Andrei Nechaev, the "market mentality" has taken root in the minds of ordinary people. Store shelves are full of goods, although these are prohibitively expensive for many citizens. Lines have largely vanished. Money has regained significance: *pokupat* [to buy] has replaced *dostavat* [to obtain]. Most transactions between enterprises are now based on freely determined contracts instead of state orders.

To these recent advances must be added the enduring attributes of Russia. It possesses some of the largest reserves in the world of oil, gas, coal, timber, precious and semiprecious metals, ores, and minerals. It has a highly educated, highly skilled and low-cost work force: the average monthly cost (with fringe benefits) in 1992 of a Russian industrial worker was calculated to be DM 95 at prevailing exchange rates, which was 1.6% of the DM 6,575 that his German counterpart cost.[39] And, as noted above, Russia appears to be moving toward charging world prices in convertible currency for its oil and gas exports to countries within the ruble zone, which should improve significantly its balance of payments, provided that there is a surplus for export.

Bad News

The litany of shortcomings is familiar and has been revived during the great Western debate on whether and how to aid Russia. Many of Russia's eighty-eight regions and republics may break away, emulating the disintegration of the former USSR. (A warning was manifest in the reaction of Bashkortostan, Karelia, Tuva, and other regions to President Yeltsin's proposed decree on special powers.[40]) As yet there is no viable legal code, nor are there stable institutions guaranteeing contracts. Property rights in the accepted sense of the term are missing. The "legal quality" of presidential decrees has been criticized by the country's own Constitutional Court. Millions of Russian citizens in accounting, banking, insurance, and other sectors must be completely retrained. The infrastructure is antiquated, in disrepair, or nonexistent. The system of health care is atrocious and the state of the environment is appalling.

The new prime minister remains a largely unknown quantity even after four months in office. It can be argued that Chernomyrdin is a more effective prime minister than his predecessor. He is an industrialist technocrat who knows how to deal with industry. He was elected by the parliament and can expect greater cooperation from the legislature than Gaidar received. Chernomyrdin continues to pay lip service to the market and to the need for radical reform, even when his actions contradict those concepts, as, for example, during his first major—and abortive—initiative to restrict price increases by controlling profit margins. Yet his true sentiments are becoming increasingly evident. During a recent visit to a farm in Krasnodar Oblast he opined that government support to agriculture should be based on a state contract system, with the state giving contracts to farms for their produce and providing them on a contractual basis with producer goods such as fuel, fertilizer, and seeds.[41] He has also been quoted as saying that destroying the USSR State Planning Committee and the USSR State Supply Committee had been a mistake and that they were still needed "in a slightly different form."[42] Under a different president, Chernomyrdin might revert to type.

Proponents of the market greeted the appointment of Fedorov in January as deputy prime minister responsible for financial and economy policy. But their enthusiasm must have been dampened when President Yeltsin appointed Oleg Lobov on 15 April to be first deputy prime minister with overall responsibility for the economy and Oleg Soskovets on 30 April to be first deputy prime minister in charge of industry. Both merit the labels "industrialist," "traditionalist," and "technocrat," and both will be Fedorov's superiors.

Prospects

On paper at least, there has been a succession of rescue plans, anticrisis programs, economic blueprints, and so forth. Those on the table at present appear to be the plan for priority economic measures in March–April 1993 submitted by Fedorov and approved by the Presidium of the Council of Ministers on 25 March;[43] the Economics Ministry's blueprint for the economy through the year 2000,

[38] Gaidar quoted by *The Chicago Tribune*, 3 December 1992.

[39] A study by the Deutsches Institut fuer Wirtschaftsforschung cited in *Handelsblatt*, 29 March 1993.

[40] Reuters, 22 March 1993.

[41] Interfax, 15 April 1993.

[42] Quoted in *The New York Times*, 9 April 1993.

[43] ITAR-TASS, 25 March 1993.

presented on 26 March;[44] and the president's bumper welfare package of 26 March.[45]

The short-term priority economic measures boiled down to yet another stabilization package. They included insurance for savings accounts, a rather vague provision that could mean the indexation of savings deposits retroactive to January 1992—a sure recipe for hyperinflation; the raising of minimum wages, modifications and refinements to the privatization process; curbs on credits to CIS trading partners; the raising of interest rates; measures to halt the "discrimination against the ruble in Russia's internal turnover"; and a plan unilaterally to announce a six-month postponement of all payments on foreign debts (which appears to have been rendered unnecessary by the largesse of—or the making of a virtue out of a necessity by the Paris Club on 2 April).

The long-term plan has two stages. The first, for the period 1993–1995, provides, among other things, for structural transformations by curbing or reorganizing inefficient production; support for key sectors; liberalization of economic relations; a gradual reduction in industrial output's share of GDP and a simultaneous increase in the proportion generated by construction and agriculture; and an increase in the savings ratio from 13% to between 18% and 20% of the national income. The second stage, for the period 1996–2000, envisages the revival of the financial market and an increase in capital mobility; the development of investment-dependent sectors; an increase in the influx of foreign capital; the development of competitive high-technology sectors; priority being given to housing and communications; and the conservation of fuel, energy, and raw materials.

As for the bumper welfare package, this was announced one day after the congress had passed a resolution on the indexation of savings deposits and thus seemed to be part of a populist duel to see who could promise the people more. For his part, Yeltsin promised to "protect" the population's savings, double the minimum wage, increase financial assistance for students and the disabled, empower regional governments to peg the retail prices of staple goods, and so on.

Currently, it is not certain whether the parliament will approve any of the programs or packages proposed by the government; nor is it certain that the parliament's own resolutions have any force. All of this points to the fundamental weakness of Russian reality—the absence of governance. The command economy has been abolished, but market mechanisms and institutions have not been put in place. Khasbulatov put it rather well in his *The Struggle for Russia*. The collapse of the old system, he wrote, meant that the executive had lost the capacity to govern. "The pyramid of power controlled by the state party was a terrible thing. But, one way or another, it managed to govern. Nothing has replaced the 100,000 or so links of this mechanism's chain from the Central Committee to the oblast committee, from the factory to the kolkhoz."[46]

More fundamentally—and this is the worst of the "bad news" litany—it might be asked if any economic reform or economic progress is possible in a country that has become ungovernable. In the words of a veteran observer of Russia, Michel Tatu, the long psychological drama played out between Yeltsin and the legislature serves to demonstrate "just how incapable the Russians are of governing themselves and how determined they are never to obey anyone again." Tatu goes on to ask: "How can reform mean anything when the president's decrees are annulled by parliament and disregarded as soon as they are signed, when even the most basic discipline is lacking at all levels, and when a large part of production and Western aid is diverted into alternate channels?"[47] Or, as the *Financial Times* put it: "A legally justified anarchy obtains in Russia."[48]

To give a nonanswer to the question posed in the title of this paper: Of course there is light at the end of the tunnel. But it is a very long and very dark tunnel, and at the moment no light can be seen. The track has many twists in it and maybe some breaks. And the tunnel roof may collapse.

---

[44] *Kommersant-Daily*, 27 March 1993.

[45] ITAR-TASS, 26 March 1993.

[46] Cited in *Financial Times*, 1 April 1993.

[47] *The Independent*, 5 April 1993.

[48] *Financial Times*, 6 April 1993.

RC93204 RIR 26 April 1993

SELECTED TOPICS

Twin Challenges Confront Economies in Transition in Eastern Europe

Several years after beginning their economic reforms, the previously centrally planned economies (PCPEs) of Eastern Europe are still trying to erase the legacy of decades of central planning. Initial sharp declines in output and real earnings and, in some countries, an increased volatility in financial aggregates have exacerbated uncertainty as to the structural changes they need to implement. *Financial Sector Reforms and Exchange Arrangements in Eastern Europe*, a recently published two-part IMF Occasional Paper, surveys the reform experiences of five Eastern European countries—Bulgaria, the former Czechoslovakia, Hungary, Poland, and Romania—through early 1992 and examines two of the key challenges facing them: how to develop efficient financial markets and what type of exchange arrangement to adopt.

Part I of the paper, "Financial Markets and Intermediation" by Guillermo Calvo and Manmohan Kumar of the IMF Research Department, links the success of the stabilization policies and structural reforms being implemented by the PCPEs with the development of efficient financial intermediaries and of credit and capital markets. These economies face the challenge not simply of liberalizing a repressed financial system but of reforming, or creating from scratch, the institutions needed to support a market-oriented system. How well they succeed will be determined, in part, the paper suggests, by how efficiently their financial markets are able to channel savings into the vital and massive restructuring of the productive sectors.

The Banking Sector

In examining recent economic developments in the Eastern European countries, the paper notes that the sharp declines in output and real earnings may have been due in part to problems in the financial sector. At the root of these problems are the weaknesses inherent in the banking sector. Although all five countries surveyed have abandoned the "monobank" system, under which the central bank dominated the financial sector, in favor of a "two-tier" system, under which central banking and commercial banking operations are separate, the bulk of financial intermediation is undertaken by state-owned commercial banks.

Despite the diverse structure of the financial sectors across the PCPEs, their banks have a number of features in common, the most important being the poor quality of their loan portfolios, which, the authors assert, threatens the entire reform process. Whereas, under central planning, the financial flows of the household and enterprise sectors were separate, when commercial banks were created, their asset portfolios consisted almost entirely of enterprise loans. Because of the administrative allocation of financial resources and soft budget constraints, enterprises had been allowed to service outstanding loans through additional borrowing. In Bulgaria, for instance, nonperforming loans at the end of 1991 exceeded 40 percent of total portfolio, while, in Czechoslovakia and Hungary, 15–20 percent of loans were regarded as unserviceable.

What are the consequences of the poor quality of loan portfolios? According to the authors,

- the willingness of banks to recognize loans as nonperforming will be limited thereby encouraging continued lending to weak enterprises;
- because of credit ceilings and high interest rates, the investment and output of profitable enterprises may decline—banks have tended to make loans to keep unprofitable enterprises afloat, rather than allowing others, which are potentially profitable at world prices, to expand operations; and
- privatization of banks is delayed because it is difficult to attract private, especially foreign, investors who are interested in purchasing the banks outright or in equity participation.

Of the possible approaches they list for restructuring loan portfolios, the authors single out cleaning bank balance sheets by replacing nonperforming loans with interest-bearing government debt, or some type of monetary reform, whereby both the nominal assets and liabilities of banks in relation to enterprises are written off. They point out, however, that both approaches share two related problems. First, the perception that banks are being bailed out could undermine confidence in the transition. Second, without a commitment to the hard budget constraint and without proper incentives, a "onetime cleaning of banks' loan portfolios would be, at best, a temporary measure."

The banking sector, the paper notes, cannot be reformed independently of the enterprise sector, which "will need to be restructured radically or privatized before banks can undertake market-oriented decisions and begin to channel credit to the most productive sectors." As well as lacking the experience to assess the creditworthiness of enterprises, banks lack the proper enterprise accounts on which to base their assessments. Enterprises, moreover, are cushioned from market forces by soft budget constraints. "It is therefore essential," Calvo and Kumar conclude, "to introduce private ownership to put the appropriate constraints, and the incentive structure, in place."

Furthermore, the authors suggest, developing transparent rules for supervising and monitoring banks and clear guidelines on the role of the central bank could reduce the barriers to entry and spur domestic and foreign competition.

Privatization and Capital Markets

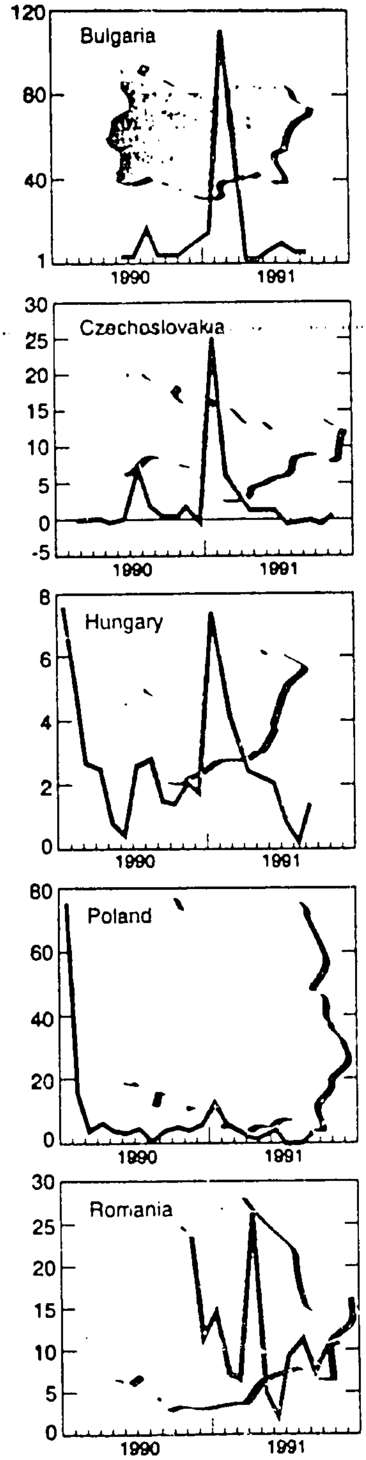
Beset as they are with serious systemic problems that have largely resisted early attempts at reform, the banks, the authors argue, have a limited role to play in privatization. Restructuring enterprises would require that many banks close down. Moreover, as both owners and creditors, banks could face a serious conflict of interest.

Capital markets, on the other hand, especially equity markets, would "yield substantial benefits by mobilizing and channeling risk capital while also reducing its cost." But how quickly can they be developed given time and resource constrains? The authors note that, in many developing countries, notably Korea and India, equity markets have grown extremely rapidly in recent years. Far from viewing the current volatile market environment of the PCPEs as a deterrent to the development of equity markets, Calvo and Kumar claim that, even in the industrial countries, equity markets have tended to play their most important role at the developmental phase. The most significant benefits for the PCPEs, in their view, are the provision of risk capital and the diversification of risks. "Equity markets can finance the risky yet productive borrowers that bankers avoid." They can also provide a mechanism for owners to supervise corporate operations.

Chart 1

Eastern Europe: Inflation Declined Sharply

(monthly percent change)



Data: IMF staff estimates

Financial Sector Reforms and Stabilization Policies

In examining the linkages between financial sector reform and recent monetary policy in the PCPEs, the paper notes that because several countries had intervened to guide banks in setting interest rates on loans and deposits or in limiting loan spreads, deposit and loan rates did not reflect the strength of loan demand, the supply of deposits, or the creditworthiness of the potential borrowers. The PCPEs, the paper concludes, should institute policies to deal with problem loans and parallel reforms of prudential regulations and supervision systems.

Financial reforms also affect monetary policy in that they can produce significant shifts, and hence instability, in the demand for money. Monetary policy needs to take into account the quantitative changes in the structural relationship between the demand for and the supply of money, the paper cautions. Similarly, it points to uncertainties about the monetary policy transmission mechanism, an important aspect of which is the availability of credit. Until the transmission mechanisms are fully developed, the paper cautions, restrictive monetary policies may aggravate output declines.

As regards fiscal policy, the authors single out the financing of deficits as the key issue in the context of financial sector reforms. Bank financing of the much-higher budget deficits that followed the move to market reforms has led to monetary expansion and increased inflation. At the same time, future nonbank financing of fiscal deficits will depend on domestic interest rates, which threaten to be high. However, the paper predicts that as the financial sector broadens and deepens, the financing of government deficits should become more efficient.

Credibility and Prudential Supervision

The destabilizing impact of the reform process is nowhere more apparent than in the banking system, and nowhere is stability more critical. To promote confidence in the system, the authors stress, the PCPEs must straightaway implement banking laws and regulations that establish the ground rules for bank operations and that constrain excessive risk taking. Adequate supervision is also critical in establishing confidence.

The authors eschew the adoption of explicit deposit protection schemes, which, they assert, "should be considered only after the first lines of defense against banking crises have been established." In the near term, they conclude, the restructuring and adequate capitalization of the banks should take priority.

The International Context

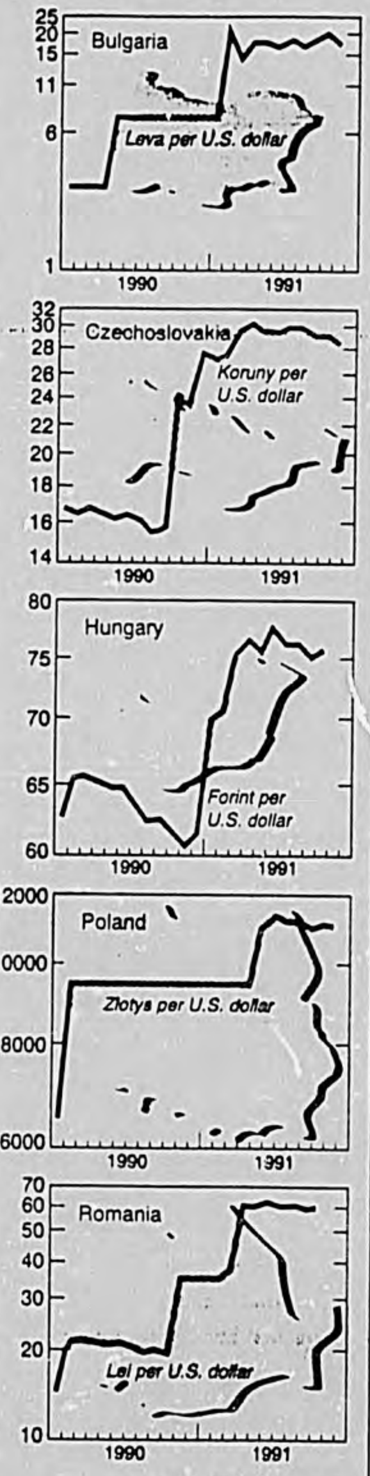
Part I of the Occasional Paper addresses the largely domestic issues related to the development of financial markets in the five PCPEs surveyed. Part II—"Exchange Arrangements of Previously Centrally Planned Economies," written by Eduardo Borensztein of the IMF Research Department and Paul R. Masson of European I Department—puts these economies into the larger context of their integration into the international monetary and trading system.

The PCPEs have inherited seriously distorted price systems and a monopolistic structure in domestic markets. Moreover, having traded very little internationally with market economies, they are hampered by low levels of foreign exchange reserves. It is, therefore, the authors contend, "especially important for them to liberalize their exchange rate systems and to open up their economies to foreign trade in order to import financial discipline, provide competition for domestic producers, and establish an anchor for domestic prices."

Chart 2

Eastern Europe: Exchange Rate Developments

(end of period: log scale)



Data: IMF staff estimates

Currency Convertibility

Current account convertibility—defined as "access to foreign currency for current account purposes"—is, the paper notes, crucial in helping the PCPEs move to world market prices. Moreover, convertibility is a prerequisite for determining the exchange rate in a free market. The paper examines general arguments for convertibility in the PCPEs and the desired speed of the transition before going on to consider the desirable degree of exchange rate flexibility.

One of the strongest arguments for the early introduction of current account convertibility is that it invokes a system of rational relative prices palpably lacking in economies with a legacy of administered prices. Import prices, the authors note, "provide an invaluable guide to rational pricing." However, trade restrictions can interfere with these forces. While convertibility does not demand complete trade liberalization, the authors argue that quantitative restrictions are particularly inimical to competition.

All five of the Eastern European countries surveyed have moved fairly rapidly—and successfully in the authors' view—to current account convertibility. All of them, however, maintain restrictions on capital account convertibility, mainly, the paper notes, because of concern that speculative capital movements might disrupt foreign exchange markets and international trade.

While Borensztein and Masson assert that it is "less imperative" to move to early and unrestricted capital account convertibility, they argue that "ideally current account convertibility should be declared immediately" along with an appropriate exchange rate, adequate foreign reserves, and sound macroeconomic policies.

Most PCPEs adopted current account convertibility with precariously low levels of foreign reserves and little margin to withstand negative balance of payments shocks. However, after convertibility, imports from non-CMEA [Council for Mutual Economic Assistance] countries either declined or more or less equaled the increase in exports to those countries. "It still remains to be seen," the authors observe, "whether, as income recovers and access to international financial markets strengthens, an excessive switch of spending toward imported goods will jeopardize current account convertibility."

Choice of Exchange Arrangement

Inextricably linked to the sustainability of current account convertibility is the choice of exchange arrangement. In examining the desirable degree of exchange rate flexibility, Borensztein and Masson point to the unique problems faced by the PCPEs, among them, the most urgent objective of controlling the price jump that occurs when prices are freed after decades of controls and distortions. They conclude that a fixed exchange rate may provide a useful anchor in the initial stages of liberalization to the extent that it contributes to stabilization and limits the inflationary effects of the price jump. Pegging the exchange rate to a major international currency or basket of currencies allows stable prices to be imported from world markets and therefore removes uncertainty as to the relative price structure and the absolute level of prices that will eventually prevail after controls have been removed. However, the authors point out, even if a country has adequate reserves, uncertainty about the equilibrium level of the real exchange rate makes its choice of the correct level at which to peg difficult; an overdepreciated rate may exacerbate inflationary pressures.

Czechoslovakia and Poland both pegged their exchange rates after substantial depreciations with a view to using the exchange rate as a nominal anchor for prices. In the authors' view, this policy seems to have generally supported domestic price stabilization in these countries. In May 1991, after nearly one and a half years of imposing a pegged rate, Poland depreciated the exchange rate parity in response to a deterioration in its balance of payments position. Just five months later, in October 1991, facing waning competitiveness and a less favorable economic outlook, it reverted to a preannounced crawling peg.

Czechoslovakia, on the other hand, remains committed to a fixed rate with the result that domestic inflation has subsided toward a level comparable with those countries to whose currencies its exchange rate is pegged. However, the authors suggest that it may be premature to contrast the experiences of the two countries since Czechoslovakia implemented current account convertibility at a fixed exchange rate exactly a year later than did Poland.

Bulgaria, Hungary, and Romania have successfully adopted more flexible exchange rate systems despite their rudimentary financial sectors, according to the authors. The adjustable peg system adopted by Hungary allows it to adjust the exchange rate unexpectedly—it has been devalued twice to defend the competitiveness of the forint—and reflects Hungary's greater concern for balance of payments considerations. Hungary, the paper notes, could afford to liberalize its market more gradually because, with about 50 percent of domestic prices already freed by 1988, it did not face the same degree of market disequilibria as did Poland or even Czechoslovakia. Under the adjustable peg system, its exports to the traditional convertible currency area grew by more than 40 percent during 1990 and 1991 (in current dollars), debt rescheduling has been avoided, and access to private international financial markets has been maintained. Inflation, however, remained slightly above an annual rate of 30 percent in 1990–91 (see Chart 1). The floating exchange rates adopted by Bulgaria, and Romania after it abandoned a dual exchange rate system in November 1991, the paper notes, have not generated excessive volatility (see Chart 2).

The experiences of Czechoslovakia and Poland suggest, according to the authors, that a pegged exchange rate regime "can be credible and can contribute to domestic price stabilization in the initial phase of price liberalization." However, they conclude, once stability is attained, other considerations that require exchange rate flexibility may become more important. Moreover, they argue, while reform of fiscal and monetary policy and restructuring of enterprises are indispensable to the functioning of the economy under any exchange rate system, "prolonged maintenance of a fixed peg does generally impose more stringent requirements on financial policies."

Margaret Casey
IMF, External Relations Department

Copies of *Financial Sector Reform and Exchange Arrangements in Eastern Europe*, which is No. 102 in the IMF's Occasional Paper series, are available for US$15.00 (US$12.00 for full-time college or university students and faculty members) from Publication Services, Box S-372, International Monetary Fund, Washington, D.C. 20431, U.S.A. Telephone (202) 623-7430; fax: (202) 623-7201

390

FINANCE & DEVELOPMENT

Intergovernmental Finance: *Critical to Russia's Transformation?*

JENNIE I. LITVACK AND CHRISTINE I. WALLICH

As RUSSIA and other transition economies move from centrally planned to market-based systems, fiscal decentralization emerges as an important dimension of public sector reforms. The design of intergovernmental fiscal systems will be critical to meeting key reform goals of stabilization, privatization, a robust safety net, and growth.

Intergovernmental finance is not a "local matter." How services and goods are provided by various levels of government and who pays for them have consequences that extend throughout the economy. In transition economies, the design of fiscal federalism is crucial because it affects almost all of the key goals of reform, including macroeconomic stabilization, the effectiveness of the social safety net, private sector development, and, in the case of Russia, nation building.

Russia, like other transition economies, is facing a difficult period of economic and political transition. It is attempting to simultaneously restructure its economic system, protect the well-being of its citizens, stabilize prices, achieve external balance, and establish a system of governance acceptable to 91 regions (oblasts) whose cultural identities, natural resource endowments, and degree of economic development differ widely.

Intergovernmental fiscal reform will play an important role in the success of Russia's reform effort. Russia's subnational governments account for almost half of total budgetary outlays, and sound intergovernmental fiscal policies are, therefore, crucial to a successful stabilization effort. Also, with centrifugal tendencies throughout the federation, how revenues are divided among oblasts is crucial for establishing a cohesive federation. The ownership role of subnational governments also makes them crucial as players or as impediments to privatization. Finally, expenditure reform has given subnational governments important new responsibilities for the social safety net. Failure to design an appropriate system of intergovernmental fiscal relations can jeopardize all these goals; conversely, a well designed system can facilitate greatly in achieving them.

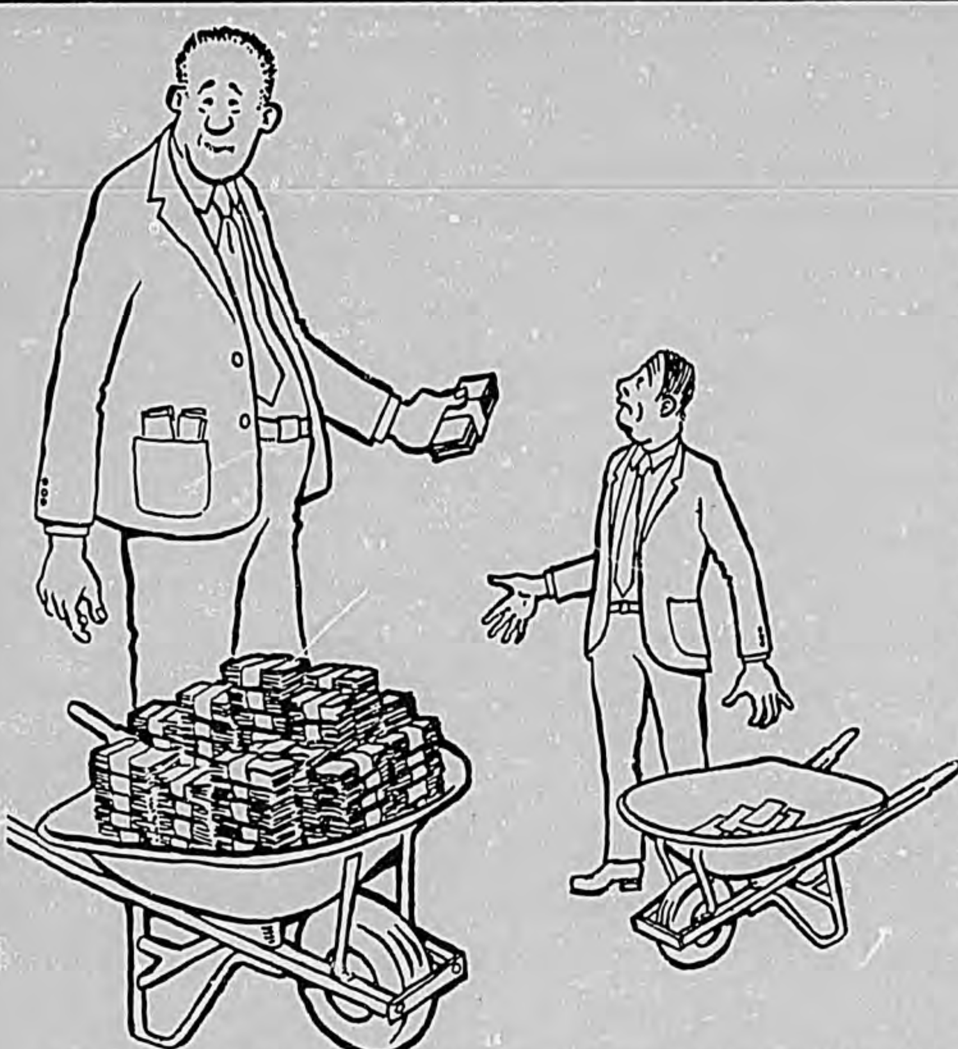
This article explores why intergovernmental fiscal relations are so critical to Russia's national goals. It looks at how traditional public finance theory is challenged by transition economies, and at the implications—for Russia and other transition economies—of systems that are not well designed.

The right design

An ideal system of intergovernment finances would:

- ensure correspondence between subnational expenditure responsibilities and overall subnational resources;
- incorporate incentives for subnational governments to mobilize revenues;
- ensure that the macroeconomic management policies of the central government are not compromised;
- give appropriate expenditure discretion to subnational governments, support public infrastructure development, and improve the accountability of government officials;
- be transparent, based on objective, stable, non-negotiated criteria, as well as administratively simple;
- be consistent with nationally agreed income distribution goals; and
- support the emergence of a governmental role consistent with market-oriented reform.

The challenge of transition economies. In transition economies, the first step in designing a good system of intergovernment finance is to delineate the roles of the public and private sectors. During the transition to a market economy, the pervasive role of government must be significantly reduced. In countries as diverse as China and Romania, budgetary outlays as a percent of GDP have



been halved over the course of reforms, as the role of government changes from owner, producer, and employer of first resort to provider of goods that cannot, because of externalities, be left to market forces.

Assigning expenditures. What are the respective roles of central and subnational governments? Traditional public finance theory suggests that an "efficient" expenditure assignment between levels of government is based on the geographic dimension of benefits. Ideally, each jurisdiction should provide and fund services whose benefits accrue within its boundaries. Responsibilities for stabilization policy are typically assigned to the central government, as is that of income redistribution (including the social safety net), since labor and capital mobility often interfere with serious attempts by local governments to affect income distribution. Until recently, Russia's system of intergovernmental finance broadly observed these principles.

Transition economies provide a special challenge, however, because the responsibilities and nature of enterprises and government are changing dramatically. Enterprises that played an important role in providing social assets (e.g., schools, hospitals, housing, urban infrastructure, water and sewerage) must spin off these expenditures because they are not directly related to production. Some divested social assets (e.g., guest houses) could be privatized; but many other expenditure functions (e.g., schools, hospitals, urban infrastructure) have benefit areas that dictate that they be assigned to the subnational level. Experience from transition economies indicates that as fiscal decentralization and privatization occur, the expenditures of subnational governments increase, relative to those of the center. The key challenge for governments is to determine the actual costs of providing these services and design a system of tax assignments, shared taxes, or transfers that provides for sufficient revenues to meet the assigned expenditures.

Revenue and transfer policies. There are many models of how to provide subnational governments with resources. Taxes can be assigned to different levels of government or shared between levels of government. Some countries allow concurrent tax powers (sharing the tax base) by allowing local surcharges on federal taxes, such as the personal income tax. In most countries, subnational revenues are supplemented by transfers, since typically the central government gets the bulk of the revenues, and subnational governments are assigned far more in expenditures than can be financed by their own revenue sources.

Designing the transfer system is complex, not least because there are usually a number of objectives, as noted above. The first step is to determine the aggregate volume of the transfer; the second is to determine its distribution across subnational governments. Transfers can be ad hoc and negotiated or, preferably, set according to a formula-based distribution and an ex-ante agreed volume for the subnational level that would provide budgetary certainty. Typically, a distribution formula will:

• estimate minimum or "normed" subnational expenditure needs (based on assigned expenditures and often related to population, per capita income, social indicators, or actual cost of delivering services); and

• assess the revenues (own, assigned, or shared) available to finance these needs (often looking at the localities' tax effort).

Depending on how much inter-regional equalization of expenditures is desired, transfers will fill all or part of the expenditure/revenue gap.

Mismatched revenues and expenditures. When subnational expenditure needs and revenue flows (including transfers) are not well matched, the subnational government is left with inadequate resources to provide needed services. In most countries, this leads to a fiscal squeeze on the local economy. In transition economies, because of the soft budget constraint, such an imbalance can lead to fundamentally different—and potentially more damaging—outcomes. Searching for ways to finance their services, subnational governments revert to "coping mechanisms" to permit services to be delivered where otherwise they could not. These include shifting public budgetary outlays to enterprises still owned by the subnational government; resisting privatization of enterprises that provide social services; and, in the peculiar soft budget environment that still prevails in the financial sector in many transition economies, encouraging government-owned enterprises to borrow (or accrue arrears) in order to be able to continue providing public services. Subnational governments may also establish ex-

390

trabudgetary funds that make the budget less transparent. As the example of Russia shows, if successful, these coping mechanisms can threaten macroeconomic stability and privatization; if unsuccessful, underfunding subnational governments can jeopardize the provision of the social safety net. In Russia, a three-tier federation with considerable diversity among regions, resource endowments, and ethnic groups, coping mechanisms may undermine national cohesion.

Fiscal federalism in Russia

Russia is at a crossroads. Since the breakup of the union, it has been seeking to define a new identity, introduce democracy, stabilize and privatize the economy, and accommodate clashing regional demands. Fiscal federalism is at the heart of this political and economic challenge and key to the tasks ahead.

Macroeconomic stabilization. The immediate objective of Russia's economic policy is stabilization, in which fiscal policy plays a crucial role. A striking reality of Russia's stabilization effort is the lack of revenue-expenditure correspondence at the oblast level. In the fiscal program for 1992, oblast budgetary expenditures increased as a result of the abrupt reassignment of many social expenditures and all investment outlays (including airports and military housing) to the subnational level. Oblast governments are also assuming the many public expenditures spun off by their enterprises. Social outlays should continue to rise significantly as growing unemployment and inflation lead to increasing numbers of vulnerable people. On the tax side, despite increased expenditures at the subnational level, the 1992 budget envisaged a marked increase in taxes, which accrue mostly to the federal level. The resulting revenue-expenditure mismatch may be severe, especially in some of Russia's poorer oblasts.

Russia's intergovernmental system has not addressed these expenditure re-assignments, nor the budgetary pressures they imply for subnational governments. The federal government's attempts to meet its budget deficit targets have pushed more and more expenditure responsibilities to the oblast level, while retaining ever increasing amounts of revenues at the central level. The basic strategy was to push the deficit downward by shifting unfunded expenditure responsibilities to subnational levels in the hope that they would do the cost cutting. Superficially, this has served to reduce the federal budget deficit, but the central government is merely pushing its headaches down to the subnational level.

> ***"The federal government's attempts to meet its budget deficit targets have pushed more and more expenditure responsibilities to the oblast level, while retaining ever increasing amounts of revenues at the central level."***

Caught without enough revenue to cover their newly assigned mandates, oblasts have accumulated expenditure arrears and, in some cases, delayed federal tax remittances; borrowed from banks and from "their" enterprises, which have easier access to credit than do the oblast governments themselves, thus adding to pressure for credit creation; and developed extrabudgetary resources. Ironically, focusing stabilization policy on the federal deficit is leading to actions that will further destabilize the economy, reduce the transparency of budgetary accounts, and, if oblasts are successful in their ability to obtain credit, subvert monetary objectives.

Privatization. Efforts to reduce the budget deficit by squeezing the subnational sector also harm privatization. An important aspect of fiscal decentralization in Russia has been the transfer of enterprise ownership from central to subnational governments. Oblasts derive significant funds from enterprises they own and benefit significantly from the expenditures they finance. Hard-pressed oblasts will therefore oppose privatization and seek to reinforce their revenue base by holding onto their enterprises, in an effort to ensure the continued provision of services increasingly unaffordable to oblast and rayon governments under current intergovernmental fiscal arrangements. At the same time, by encouraging enterprises to provide social services, these enterprises become harder still to privatize.

Economic growth. A fiscal squeeze on subnational governments can also worsen resource allocation and growth. Oblasts' vested interests in enterprise revenues and the provision of services by enterprises will, in an economy as regionalized and with as few antimonopoly policies as Russia, inevitably encourage domestic protectionism and interoblast trade barriers to protect local monopolies. This will ultimately reduce economic growth, just as impeding trade between states of the former USSR has done. Evidence from a number of oblasts suggests frequent use of export barriers to ensure that revenues from origin-based sales taxes stay inside the oblast. The behavior of oblast governments plays a crucial role in determining the efficiency with which the Russian economy performs.

Social safety net. In an apparent effort to balance the budget, in 1992 the central government in Russia transferred responsibility for social protection and price subsidies—previously financed by transfers from the federal government—to the oblasts. However, it did not estimate the cost of the social protection programs and whether it could be met with revenues available in each oblast. If an adequate social safety net is a national priority during the difficult transition ahead, then subnational governments must be adequately funded to administer the programs. Local administration of these benefit programs will facilitate targeting, but federal financing would be more appropriate.

Nation building. The ad hoc shifts in expenditures from the central to the subnational level—such as social outlays and capital investment—have led skeptical oblasts to wonder what expenditure functions the center performs that are sufficiently important to justify its existence. Already, the center is failing to provide macro stability. By not being concrete in assigning expenditure, and by jettisoning federal outlays onto subnational governments, the federal government could contribute to its worst fear—the disintegration of the Russian Federation.

The sense of injustice at the subnational level has risen as oblasts are left struggling with inadequate resources and frustrated by a revenue system that is not transparent. Wealthier oblasts complain that the present negotiated intergovernmental fiscal system is over-equalizing (i.e., they are subsidizing the poorer oblasts) and threaten to opt out.

(Regression analysis indicates that there is not a great deal of equalization in Russia's system, in reality.) This is not as impossible as it seems, since the system of tax administration, in which all tax revenues are collected at the oblast level and below and remitted to the federal government, makes the center very dependent on oblast compliance and, thus, vulnerable. Indeed, in early 1992, some twenty disgruntled oblasts unilaterally halted tax payments to the center. The proliferation of such behavior could lead to the fiscal dissolution of the Russian Federation, just as the failure of union republics to contribute to the union budget helped to foster its dissolution in 1991.

Dissatisfaction among oblasts is heightened by ethnic tensions and disagreements over natural resource revenues. Areas inhabited by non-Russian ethnic groups claim the right to greater fiscal autonomy. And some areas rich in natural resources feel entitled to special fiscal arrangements that allow them greater benefits from their natural resource revenue. For example, Yamal and Khanti-Mansisk, which together produce over 80 percent of Russia's oil and gas, have prevented the federal government from capturing all export and petroleum tax revenues. And Yakutia, which is home to an ethnic minority representing one percent of Russia's population and contains 99 percent of Russia's diamonds, is demanding greater fiscal autonomy and retention of natural wealth. It and others have threatened to break away from the rest of Russia if their demands are not met.

The role of the fiscal system

Given the tensions between the federal and oblast governments in Russia, the importance of developing a transparent, fair, consensus-based framework for intergovernmental finances with revenue-expenditure correspondence cannot be overstated. To establish such a system would require a number of specific steps. First, one must determine the aggregate revenues required by oblasts, based on their expenditure assignments. Some proportion of these revenues must then be distributed across oblasts on the basis of origin of collections—giving wealthier oblasts with greater tax capacity greater revenues; the rest should be distributed on the basis of a transparent and fixed formula. Local taxes or surcharges and limited borrowing might also be part of the picture. Such an approach is flexible and can be adjusted to accommodate changing expenditure assignments. The relative proportions of the revenues distributed on the basis of derivation and formula (i.e., the trade-off between regional equity and growth) can also be adjusted: choosing the degree of equalization is essentially a political judgement. In Russia today, this is arguably a key issue. If the intergovernmental fiscal system places too much emphasis on equalization, wealthier oblasts—including those rich in natural resources—will be less willing to participate in the federation. The need for political unity may thus be greater than the need for equality, suggesting that the intergovernmental system should allow the wealthier oblasts to develop more rapidly by reaping the benefits of their larger fiscal capacity.

A well-designed intergovernmental system that matches expenditures and revenues while incorporating the interest of diverse regional entities can contribute to the cohesion of the Russian Federation, and lies at the heart of any solution to demands for further autonomy.

Jennie I. Litvack
a Canadian citizen, is an Economist at the World Bank currently working on Vietnam country operations in the East Asia Department. She holds a PhD from the Fletcher School at Tufts University.

Christine I. Wallich
a US citizen, is the Lead Economist in the World Bank's Central Europe Department, Europe and Central Asia Region. She holds a PhD from Yale University.

Other transition economies

The critical linkages between intergovernmental fiscal relations and key reform objectives such as macroeconomic stability, privatization, social safety net, and nation building are not unique to Russia. Indeed, these issues are found in most transition European countries and aspects of these problems are found in countries throughout the world. Countries such as Canada, India, Malaysia, and the United Kingdom have tried, with varying degrees of success, to buy the cooperation of subnational governments through the design of the intergovernmental fiscal system. In transition economies such as Bulgaria, Hungary, and Romania, the fiscal squeeze on local governments seems to be making them impediments to, rather than partners in, privatization. And it is not only in Russia that the social safety net and other outlays have been shifted "downstairs," threatening both service provision and provoking the introduction of coping mechanisms—which contribute to further instability.

The major challenge for Russia as it develops an intergovernmental financing system is to create an integrated framework for change that will be compatible with short-term stabilization, will combine rules with discretion, and will be flexible enough to accommodate the major structural shifts in the economy while also providing stability to subnational governments. The present represents a critical window of opportunity to introduce such refinements, inasmuch as the overall design of the intergovernmental system is still in transition. New laws on fiscal decentralization introduced in 1992—the "Basic Principles of Taxation"—attempted to introduce greater transparency and to address some of these concerns. Nonetheless, the design of the program is incomplete and additional reforms are needed. The next step for Russia is to undertake a careful, concrete empirical study of expenditure assignments, revenue options, and transfers. Also needed is a process to establish consensus on the basic directions of the intergovernmental system—the degree of equalization, the allocation of expenditures, and the rights of natural resource producers.

Impediment or facilitator?

Is fiscal federalism an impeding or a facilitating factor in the transition toward a market economy? It certainly can be either. It is easy to view intergovernmental fiscal relations as yet another technical area to be addressed. However, intergovernmental finance will have a major impact on the efficiency with which Russia and other transition economies perform on the macroeconomic front, on the safety net, and on the success of privatization policies. In sum, local finance is not a "local matter." ■

For further information, see Christine Wallich, "Fiscal Decentralization: Intergovernmental Relations in Russia," Studies in Economies in Transition, No. 6, *World Bank, and Wallich, C. (ed.),* Whither Russia? Fiscal Decentralization in the Russian Federation, *forthcoming, 1993.*

312

PUBLICATIONS

Entrepreneurs Alive and Well in Poland

Forty years of socialism have not dulled the entrepreneurial spirit in Poland, says a new survey of Polish entrepreneurs carried out by the International Finance Corporation (IFC).

When Poland launched its "big bang" economic reforms in January 1990, thousands of risk-takers responded, says the IFC report, *Coping With Capitalism, The New Polish Entrepreneurs*. Private businesses sprouted up all over the country, selling everything from flowers to auto parts and computer services.

But the 75 Polish entrepreneurs interviewed for the study say that despite the growth of private companies, some obstacles remain. Poor access to credit is one of the main obstacles for new businesses.

"By all accounts, the private sector in Poland has responded with alacrity to the new business environment," says the study, written by Brian Pinto, lead economist in the IFC's Economics Department, and two consultants, Bohdan Wyznikiewicz and Maciej Grabowski. "The survey finds that there is no dearth of entrepreneurship, ability to exploit profit opportunities or to think big. The biggest constraint is financial."

The IFC, a World Bank affiliate, promotes the economic development of its member countries through investment in the private sector.

The entrepreneurs interviewed by the survey, typically between the ages of 36 and 45, run small- to medium-sized businesses, each employing anywhere from 20 to ...

Many of the entrepreneurs left jobs at state-owned enterprises where their salary reached $100 per month at best, before the economic reforms took place. The desire for more money, independence and a challenge drove them to launch operations making products ranging from cosmetics and plastics to toys and pharmaceuticals.

Benefits of Big Bang

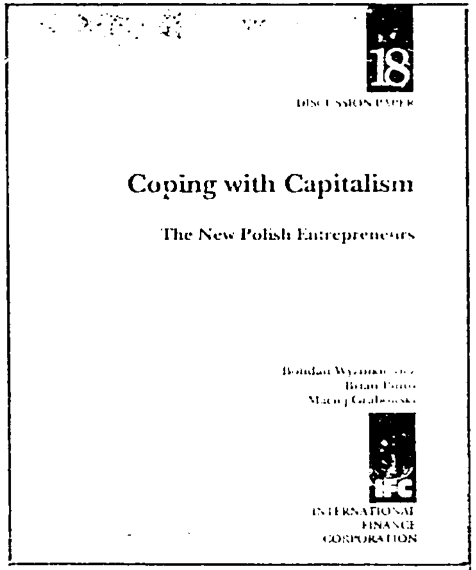
Many of the businessmen and businesswomen had already opened shop when Poland embarked on its economic reforms of 1990, thanks to relatively pro-business laws. The law on economic activity of December 1989, which removed state monopolies over economic activity, proved important in stimulating private response.

But almost everyone points to the big bang reforms of 1990 as a watershed for the growth of their businesses. Under the program, the government sharply devalued the currency and made it convertible for commercial transactions, largely freed prices and interest rates, and drastically cut subsidies to state-owned enterprises. Sales in the 75 operations now average $2 million annually with average yearly profits of $100,000.

The new economic reforms have cleared up the economic signals business people depend on in making smart business decisions, the study says. For example, many entrepreneurs are free to start or stop a venture quickly and switch into other businesses when they want to.

For many, that choice has meant abandoning import businesses that are no longer profitable and grabbing better opportunities in manufacturing. The manufacturing firms surveyed notched up their sales by 82 percent in 1992 compared to 61 percent in importing and trading companies.

Still, many of the entrepreneurs complain about the lack of capital available to finance their business ventures. Many local banks, used to lending to state companies with large assets as collateral, often refuse to lend to untried private clients with no security to offer. As a result, most of the entrepreneurs must use their personal savings and borrow from friends and family to get their companies off the ground.



Other complaints focus on the "usual gripes," of high taxes and burdensome regulations, the survey says. Bad telephone systems, incompetent bureaucrats and poor labor are also cited as problems.

Coping with Success

The study also says that although many entrepreneurs are catching on to the ways of private business, some are still reluctant to find outside help. Even though many admit to squandering large sums of money on misdirected marketing efforts, they still refuse to pay for professional expertise from marketing companies and consultants. Others have trouble simply dealing with their success.

"Some entrepreneurs admit they are not well-prepared to manage their firms," says the survey. "When a firm is small, they do not have problems, but as it grows and expands, they feel the lack of managerial experience and methods."

But overall, Polish entrepreneurs are adopting private business methods and are helping to transform Poland's centrally planned economy to a market-based system.

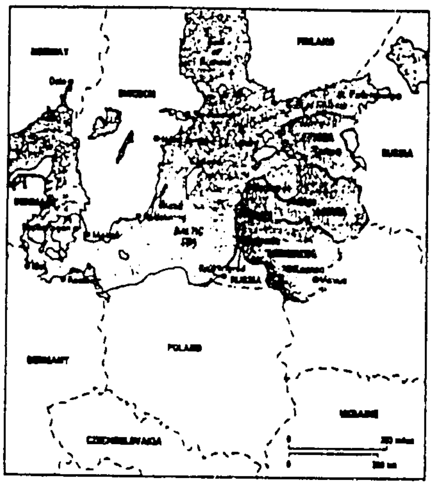
In 1992, private companies and businesses yielded half of Poland's economic output, marking a big departure from the past four decades of socialism.

"In any event, the response of private businessmen to the [economic reforms] was huge, especially evident in services, transportation and construction," the study says. "The experience of 1990 and after naturally led to expectations that the private sector would play a strong role in Poland's growth and transformation into a market economy. These experiences are being borne out by continuing private sector developments in Poland." □

Coping with Capitalism, The New Polish Entrepreneurs *is priced at $6.95.*

ECONOMIC REFORM TODAY

COUNTRY PROFILES



The Baltics: Economic Survival and Transformation

by Mats Karlsson

Estonia, Latvia and Lithuania now confront the challenge of building new democracies while they engage in a fundamental transformation of their economic systems. Their success in these tasks will determine whether they are able to integrate with Europe and the West or whether the great promise of independence becomes a greater disappointment.

In constructing the institutions that underpin a democratic, market-based society, the Baltics literally must start from scratch. The very essence of democratic society, such as creating a constitution, defining the powers of the legislative and executive branches, or even defining who is a citizen of these new republics, must be addressed. These are concepts and institutions that evolved in the West over hundreds of years.

As they establish both political and economic institutions, the Baltic states represent a virtual laboratory of reform, in that countries facing similar starting circumstances are adopting different approaches, although all three remain at an early stage in their transition. This difficult process is complicated by the dearth of past experience available to guide the present experiments.

The recent experience of the Baltic states demonstrates clearly the link between the process of constructing democratic institutions and the progress of their market-oriented economic reforms. A successful and sustainable reform must be based on a well-established political framework, one that creates a consensus in support of a democratic system, culture and principles.

Developing a democratic consensus is a top priority in light of the tarnished image of politics that characterizes the current Baltic political climate. After a period of national unity centered on civic norms, the political culture now features widespread public contempt for politics and politicians. If this mood prevails, democracy itself will be threatened and reform will fail.

Another important aspect of establishing a political framework for reform is external cooperation and integration. External support—through the transfer of knowledge, capital and emergency relief—is necessary for the Baltic states to progress. Unfortunately, the process of extending this support seems to be painfully slow and unimaginative.

Building Political Institutions

Since attaining independence, the Baltic states have displayed a significant divergence in their respective progress toward creating democratic societies. In Estonia, for example, a new constitution has been approved, and parliamentary and presidential elections have installed a reform-minded coalition government. The expression of popular support for reform through the electoral process has enabled the government to adopt bold measures, primarily the introduction of a new currency, the kroon. Thus, Estonia has been able to develop at least some forward momentum in its economic reforms.

Estonia is not without political problems, however, as its standards for citizenship have excluded most of its ethnic Russian population. Since non-citizens could not vote in the national elections, they have been excluded from political participation and are without a stake in the country's new political and economic systems. This situation may undermine political stability in Estonia as well as future progress in Estonian reforms. (The box on page 7 describes political developments in Estonia and Latvia.)

In Lithuania, recent developments point to movement away from continued reform. Although a new constitution has been put into place and parliamentary elections have been held, the results point to weakening public support for continued reforms, as the former Communist party won a majority (see box on page 8).

In Latvia, political paralysis has been the rule. There has been no agreement on a constitution, and parliamentary and presidential elections have yet to be held. A fractious political environment has yielded no consensus on how to implement reforms. The status of Latvia's large ethnic Russian population has yet to be resolved. The political uncertainty has undoubtedly dampened progress on the economic front, both in terms of a lack of consensus on where to take the country and a lack of political legitimacy of a government attempting to implement reforms without any

The Politics of Economic Reform in the Baltic States

On November 19-22, 1992, the Center for International Private Enterprise and the National Democratic Institute for International Affairs sponsored a conference on the Politics of Economic Reform in Riga, Latvia. The conference joined members of parliament, business leaders, journalists and others from Estonia, Latvia and Lithuania and brought in experts from the West as well as Central and Eastern Europe. After attending workshops on the various elements of economic reform programs, the parliamentarians were asked to design reform programs of their own with emphasis on the political communications strategies necessary to build and maintain support for reform among the general public.

Based on the economic reform workshops and the presentation of the model reform programs, and on insights gleaned from both the expert panelists and the parliamentarians, the following are highlights from the conference discussions.

- Although there is support for the transition to a market-based system, there remains considerable resistance to the actual workings of free enterprise. Fear and mistrust are widespread, and many people associate profit-making with criminal activity.
- As governments implement economic reform programs, they must communicate a sense of hope to their populations and a vision on where their countries are headed.
- Foreign governments and international organizations must provide technical and financial assistance to ease the hardships involved in the transition process; otherwise, support for reform may evaporate and the progress in economic reform attained thus far may not be sustainable.
- The transition process has a polarizing effect on the political climate, which places great pressure on the weak institutional frameworks of new democracies. The legitimacy of reform is enhanced by getting legislative approval for reform measures.
- The granting of property rights to the citizenry is vital to instilling a sense of initiative among the people and thereby overcoming the "learned helplessness" characteristic of the ex-socialist countries.
- Gateway enterprising, based on growing East-West links, may offer attractive future possibilities, but this potential will be hard to realize. The precarious state of the Russian and Baltic economies, the difficulties of the current transition period, and the decentralized nature of trade are obstacles. The good transportation infrastructure and growing links among the Baltics, their Nordic neighbors and Russia and the other former Soviet republics are pluses.
- The Baltic countries must diversify their export markets away from Russia, towards Europe and the West as much as possible. Given the competition in these markets, opportunities for exporting to the Third World should be explored.
- Efforts to manage reform on a technocratic basis have not been successful. The establishment of a political government in Estonia, based on popular support, has helped advance reform in that country. Reform in Latvia and Lithuania has been hampered by a lack of political consensus.
- Reforms cannot be implemented effectively without clear-cut political solutions, based on the assumption of political power by persons who did not have power under the old regimes. Such a political solution, embodying a clear break from the past, is the best guarantor of institutional stability and the eventual success of reform efforts.
- Prospects for regional cooperation are complicated by the different policies emerging in each Baltic country. After 50 years of Soviet subjugation, each country is eager to assert its independence and self-determination. This tendency, which is perhaps inevitable, must be tamed in favor of greater regional unity.
- Regional cooperation must be strengthened, particularly for improving transportation, communications and information links. Common customs and trade policies, for example, would enhance interest among foreign investors on a regional basis. Another possibility involves establishing a common market with a single currency. Regional institutions must be created and strengthened. Most participants felt that the conference provided a useful forum for exchanging ideas. Further meetings along these lines are planned to enhance regional cooperation.

formalized political support. Until there develops a vehicle for popular expression, it will be hard to muster confidence in the sustainability of Latvia's reforms.

Current Economic Situation

The transition process has created a very difficult economic environment in the Baltics. The three countries are torn between the demands for comprehensive economic reform on the one hand and the need to keep their economies going until the next day on the other. Of course, only fundamental economic and social reforms can ensure the countries' survival in the longer run. In the short-term, however, strategies appropriate for fundamental, long-term reforms may conflict with those necessary for immediate survival.

In the meantime, output has fallen drastically, and the balance of payments situation has deteriorated dramatically. Trade has meant more to the Baltic republics than most of the other former Soviet republics, yet the external position of these countries is still very tenuous. Trade with Russia and other former Soviet states has fallen severely, by as much as one-half or more.

A move to trade at world market prices will hit the Baltic states primarily through a significant rise in the cost of fuel imports. (The IMF estimates the terms of trade for Latvia to have fallen by 40% during 1992.) It is no wonder that the first big survival crisis has struck by way of an energy shortage.

Shortages in raw materials and inputs, such as fuel, cotton, metals and other key inputs, have disrupted basic industries. Many industries, in particular those formerly belonging to the military-industrial complex, also face the almost total loss of demand. Livestock production and agriculture have been hurt by decreasing imports of animal feed and fertilizer.

Highlights of Political Developments in Estonia and Latvia

Estonia

- Voters overwhelmingly approved a new constitution in June 1992, setting the stage for parliamentary and presidential elections in the fall.
- Elections in September 1992 installed a coalition government based on a platform of accelerating market-oriented reforms.
- Popularly elected President acts as Head of State and may serve for no more than two consecutive 5-year terms. The elected President is Lennart Meri, a former foreign minister. Executive power is concentrated in the Prime Minister, Mart Laar, who was appointed by the President and confirmed by Parliament. Laar made political cabinet choices, in sharp contrast to the technocratic predecessor government, which was unable to overcome opposition to reform by the state administration left over from the Soviet era.
- According to a member of the Estonian Parliament, the installation of a political government is better for reform, in that it will coordinate the policies of the various ministries more effectively and thereby assume responsibility for the overall course of reform. This government will also be more accountable to the public.
- Numerous parties covering the entire ideological spectrum are at work in Estonia. Many parties lack clear definition, but most take a nationalistic stance on ethnic issues. Citizenship rights are a dominant issue, as pre-russified Estonia was the most ethnically pure (95%) of the three Baltic states.
- Newly enacted laws limit Estonian citizenship to persons who were citizens of the republic during the interwar period and their descendants, regardless of ethnic origin. Naturalization requires a minimum of two years residence in Estonia (starting from March 1990), minimum competence in the Estonian language, and an oath of loyalty to the state and constitution. Non-Estonians (about 40% of the population), especially ethnic Russians, have complained of discrimination, particularly since only citizens were entitled to vote in the parliamentary and presidential elections.
- The threat of discrimination has been cited by hardliners in Russia as justification for maintaining a military presence. The number of troops stationed in Estonia has gradually declined, however, and negotiations are continuing.

Latvia

- Because there has been no agreement on a new constitution, parliamentary and presidential elections have not yet been held. It is anticipated that parliamentary elections will be conducted in the spring or summer of 1993.
- The current Supreme Council, headed by Prime Minister Ivars Godmanis, has been in place since before independence was declared. It is thus attempting to govern without any formal basis of popular support, which has slowed the implementation of reforms.
- The political environment is heavily polarized, with numerous parties and factions covering the entire political spectrum. A lack of consensus has hampered efforts to resolve issues like citizenship and the pace and scope of reform.
- Citizenship and naturalization laws have not yet been adopted. Guidelines issued by the Supreme Council stipulate that residents who were Latvian citizens in the prewar republic and their descendants will be granted citizenship automatically, regardless of ethnic origin. Other residents, almost one-half of the population, will have to apply for citizenship.
- This situation has prompted concerns of disenfranchisement and human rights violations among ethnic Russians in Latvia as well as the Russian government. As a result, tensions remain between the two countries, and Russian troop withdrawals have proceeded slowly.

Sources: Conference presentations, RFE/RL Research Report, Vol 2, No. 1, 1 Jan. 1993

Former Communists Assume Power in Lithuania

The Lithuanian political climate was rocked by almost constant turmoil during 1992, but perhaps no event was of more concern than the results of parliamentary elections held in October and November, which left the former Lithuanian Communist Party, now known as the Lithuanian Democratic Labor Party (LDLP), in power. Prior to the elections, the country had been paralyzed by a series of political disputes, primarily involving a debate on the powers of the presidency versus the parliament. The Chairman of the Lithuanian Supreme Council, Vytautas Landsbergis, who led the Sajudis movement that ultimately resulted in Lithuania's independence, alienated the parliament in attempting to institute a strong presidency.

Disputes also emerged over the economic reform program and over allegations that some members of parliament, including former Prime Minister Kazimiera Prunskiene, had collaborated with the KGB. Three main parliamentary factions emerged: those who supported Landsbergis; supporters of Algirdas Brazauskas, leader of the LDLP; and those who regarded neither of these leaders as acceptable.

With the victory of the LDLP, Brazauskas has assumed the acting presidency. Presidential elections are scheduled for February 1993, with the major candidates being Brazauskas and Stasys Lozoraitis, the Lithuanian Ambassador to the United States who is backed by Landsbergis and who is perceived as having the best chance to unify the country.

How will the parliamentary election results affect the country's economic reforms? Most observers interpret the results as a vote against the gridlock that hampered the parliament during most of 1992. However, it is also clear that there is strong public sentiment for slowing the pace of reform so as to cushion its harsh negative impact on the economy and on the daily lives of most Lithuanians. Indeed, the LDLP has imposed price controls, granted wage increases and temporarily suspended privatization. It has also promised to slow down land reform, support industry and limit unemployment, at the same professing its support for the transition to a market economy.

The party thus faces a delicate and unlikely balancing act, as any actions it takes to ease the transition in the short-term, such as extending credits to state enterprises to prevent bankruptcies, will make the transition more difficult over the long-term. Some observers feel that too much progress has been made in areas such as privatization to turn back to a Soviet-style system. However, given the recent election results, popular sentiment, and spotty progress of reform thus far, it is not at all clear that this optimistic outlook is warranted.

Sources: Conference presentations; RFE/RL Research Report, Vol 2., No. 1, 1 Jan. 1993

Unemployment, though still low, is rising rapidly and is likely to get significantly worse, since most firms have not yet been exposed to thorough restructuring. In addition, many benefits are tied to employment and wage levels. This means, of course, that the wage loss of an unemployed individual is compounded by the loss of access to day care centers, housing, vacation homes, and some hard-to-find goods.

The economic collapse is naturally very heavy for households to bear. Manifold price increases on basic amenities such as food and transport, electricity, gas and hot water take out large chunks of already very small household budgets. A sporadic supply of hot water and severe reductions in heating not only affect the quality of life, but are a direct threat to many households.

At the same time, the services that had been previously provided by the state have been reduced. The situation is particularly worrisome regarding health care. Average life expectancy is actually said to have fallen, and real poverty exists today in the Baltic states.

Development and Underdevelopment

The economic picture of recent years indicates problems typically associated with developing countries. In reality, the Baltic states display an often confounding combination of developed and underdeveloped characteristics. For this reason, generalizations on the state of development in the Baltic states often are misleading.

Although the impression is of very weak economies, the lifestyle is not altogether different from that of the West, despite the shortages, the run-down industries and infrastructure, and the shabby housing.

The duality of simultaneous development and underdevelopment is evident also when it comes to the level of education. The Baltic states take pride in their educated and skilled people, who are considered an important asset. At the same time, though, their training has not always prepared them well for the new challenges of the 1990s.

The level of technology also seems to exhibit this duality. On the one hand, there are pockets of quite advanced technology as well as a general understanding of Western technology. On the other hand, a large part of the capital stock is very old or based on a low level of technology. In industrial firms, the simultaneous use of high-tech and makeshift, low-tech solutions is quite striking.

Economic Prospects

Notwithstanding the uncertainty and difficulties of the transition process, the political independence of the Baltic states has fundamentally improved their prospects for building economic sovereignty as well. Improved economic prospects for the long-term stem from a variety of reasons.

First, prospects for negotiations and agreements with Moscow (plus Kiev and others) are now better on many urgent issues, including currency and finance, assets and debt, trade and property, and, especially, energy and infrastructure. While these negotiations will still not necessarily be easy, at least they can now proceed.

Prime Minister Ivars Godmanis of Latvia gives opening remarks at the Politics of Economic Reform conference held in Riga, Latvia on November 19–22, 1992.

Second, the almost total integration of the Baltic economies into the Soviet economy has given some Baltic firms significant bargaining power with respect to their customers. Under Soviet central planning, such firms were the major—or exclusive—producers of important industrial products as well as consumer goods, such as processed foods and textiles, for the entire former Soviet Union. For example, all of the tuners for television sets produced in the former Soviet Union are produced at the Banga factory in Lithuania. Thus, Baltic firms with market dominance can take advantage of the still-present demand for these products, as their customers in Russia and the other republics will need to make a deal for particular inputs, particular spare parts and so on.

Of course, given the scarcity of hard currency, many of these deals will be on a barter basis and directly between firms. Although barter trade is very cumbersome and costly, many deals are still being made because the Baltic economies produce some sought-after goods.

While Estonia, Latvia and Lithuania have quite diverse economies, even the medium-term does not hold obvious positive prospects. The Baltic states have developed agriculture, food processing, forestry and wood products, textiles, chemicals, manufacturing and electronics. Despite the diversity of outputs, it is not easy to see where the Baltic states will find their niche in the world market. They will face difficult competition from Central and Eastern Europe and the developing world.

Moreover, some of the current trade may have survived as a result of extreme price distortions or privileged access to certain inputs, and may therefore soon disappear. Other sectors of the economy may not be able to expand or replicate one-time opportunities and thus not provide any new jobs. Some areas, though, may develop into profitable growth industries. Such growth will depend on the creative capabilities of Baltic entrepreneurs.

Gateway Enterprises

One area in which the Baltic states have a unique advantage and which may thus hold considerable future potential is gateway enterprising vis-a-vis Russia and the other former Soviet republics. The Baltic economies have close links to these areas. Based on their extensive infrastructure—ice-free harbors, roads, railways—the Baltics have traditionally served as major trade routes for Russia. As contacts between the Baltic countries and their Nordic neighbors (primarily Finland and Sweden) expand, they may be able to serve as a bridge between East and West.

However, gateway enterprising involves more than transit trade; it means developing services and production that build on links to the vast Russian hinterland. Two Latvian joint ventures illustrate the economic potential of this approach. Laiks, founded in 1988, is based on the idea of joining Western computer hardware with locally produced software. The firm sells its services for hard currency throughout the former Soviet Union, while it also exports as much as 40% of its output to Western markets. Larossa, another Latvian joint venture, offers transport services for Western firms interested in trading in Russia, especially in Vladivostok and elsewhere in the Pacific region.

Of course, the future prospects for this type of activity will depend largely on how economic conditions evolve in Russia. Nonetheless, provided the Russian economy does not fall into complete disarray, Baltic firms should be well-positioned to capitalize on the need for foreign partnerships, capital and know-how among firms in the other former Soviet republics.

Economic Reform Programs

A successful outcome to the transition process will depend on the policy changes that are put into place. The dynamics of movement toward a more market-oriented economy generally involve both the results of conscious policy choices by the government and the decisions of the actors in the economy. The latter act partly in response to the new opportunities created by reform, and partly through spontaneous

Highlights of Economic Reform in the Baltic States

Estonia

- New currency, the kroon, introduced in June 1992 to break away from inflation of ruble zone. Value of kroon backed by a US$ 120 million stabilization fund and fixed at eight kroons per German DM. Value has remained stable, making currency experiment a success.
- Prices freed, except for energy, vodka and rent.
- Privatization based on direct sales by state holding company, Estonian Privatization Agency. Progress slow thus far. However, first round of privatization for 38 large enterprises announced in October 1992.
- Government committed to giving all land back to rightful pre-1940 titleholders or their descendants. Processing of land restitution claims began in January 1992, but many questions remain concerning rights accompanying land ownership. This may slow privatization of both large and small enterprises.
- Tax reform measures include progessive income tax structure, corporate taxation based on actual (not presumptive) profits, single value-added tax of 18%, and medical insurance and social security taxes to be paid by employers.
- Central government earmarks particular tax revenues so that, for example, local authorities receive all personal income tax revenue and one third of corporate taxes.
- Estonia enjoys most success among Baltic states in attracting foreign investment. 1,500 Finnish companies have invested in joint ventures, representing 24% of invested capital; 400 Swedish companies have joint ventures, representing 30%.
- Rapid growth in number of private companies. Small businesses now account for an estimated 20% of GDP.
- Reforms implemented at high economic cost. Production in 1992 fell by estimated 40% compared with 1991, while inflation rose some 400%.

Latvia

- Introduced temporary currency, Latvian ruble, to break away from Russian ruble. Temporary currency successful in maintaining fairly stable value. Permanent new currency, the lats, will be introduced.
- Privatization confined to retail sector and agriculture, based on state holding agency model. Most of retail sector was expected to be privatized by end of 1992.
- 1,500 joint-venture companies established with bulk of foreign investment from Russia, Germany, U.S., Finland and Sweden.
- 1992 was very difficult year for economy, as industrial and agricultural production dropped severely, unemployment increased and inflation jumped in response to freeing of prices. Sharp declines in living standards.
- Tax reform began in 1991, with Parliament determining maximum tax rates and establishing formulas for sharing revenues with local administrations.
- Profit taxes levied on all enterprises, with three different rates (15%, 25%, or 35%), depending on company's net profits.
- Personal income tax rates range from 15% to 35%. Self-employed may pay either personal income or profit taxes.
- Social security tax placed on any monetary reward for labor. Generally, rate is 38%, with employers paying all but 1%.
- Other taxes include excise taxes, turnover (value-added) tax, land tax, and natural resource tax, including tax on pollution and fines for excessive resource use.

Lithuania

- Most rapid approach to privatization among Baltic states, with voucher-based system for privatizing land, apartments and small businesses introduced almost two years ago. Auction system used for restaurants and other services. 60% of light industry now private, along with about 75% of agriculture. Almost 25% of all industry now private. Slow progress in divesting large state-owned enterprises in heavy industry.
- Rural areas hard-hit; collective farms disbanded.
- Industrial sector also hard-hit. In first ten months of 1992, volume of goods produced by Lithuanian enterprises was 41% of that during same period in 1990. With industrial production accounting for 42% of GDP, effects of decline are serious and widespread.
- Although new currency, the litas, is planned, progress in currency reform has been slow. As of October 1, a temporary currency, the Lithuanian coupon, has become only official legal tender.
- Inflation reached 2,200% from January 1991 to July 1992. Sharp declines in real wages and living standards.
- Official unemployment relatively low, but many redundant workers at state firms, and rate likely to go up when firms go bankrupt.
- Social safety net provided by 31% social security payroll tax, but may be in danger of collapse unless unemployment can be slowed or benefits (currently around 60% of laid-off worker's salary) scaled back.

Sources: Conference presentations, RFE/RL Research Report, Vol 2, No. 1, 1 Jan 1993.

reactions to the breakdown of the old system, such as the growth of the parallel market and barter deals. Even prior to independence, as the economic crisis deepened and the central planning system broke down, the actors in the economy—the households, firms and public authorities—increasingly pursued strategies at variance with official policies.

Given their circumstances, the Baltic governments have been promoting trade and barter deals, employing a survival strategy based on both perpetuating the old system and breaking it up. The approach seems to have worked not too badly for the time being, holding up output much more than might have been expected given the collapse of the Soviet economy. As an immediate survival strategy, it has some merit. However, its days are numbered, because it would likely conserve old structures that are not viable and thus block real transformation.

The reform programs that are now needed consist of three main elements:

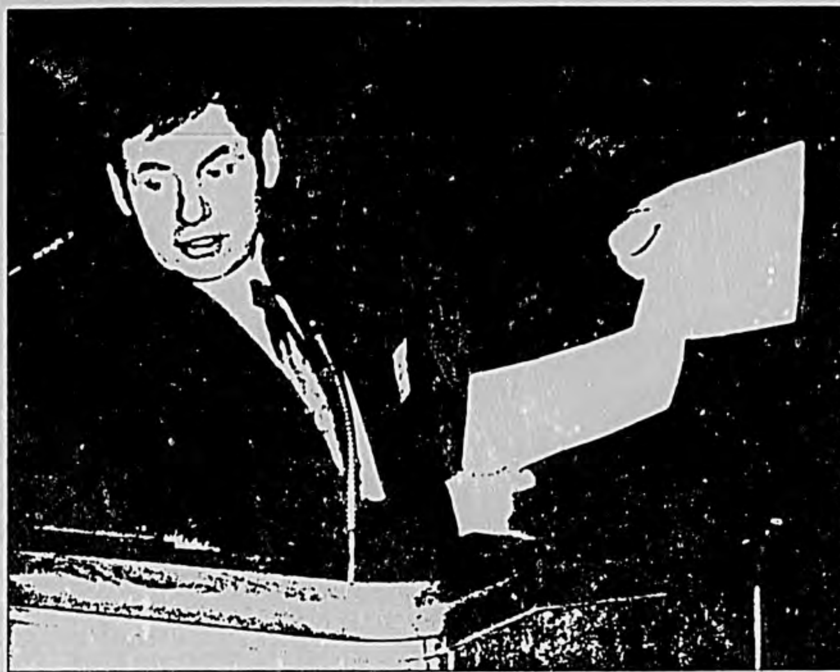
1) creating the fundamental macroeconomic institutions and instruments to stabilize the economies: new convertible currencies, functioning central banks, totally revised fiscal policies, tax and budgetary systems,

2) creating a market-economic framework: liberalization, free price formation, property and investment laws, an open trade regime, business and labor market organizations, etc.; and

3) the laborious work of implementing and promoting sectoral transformation, enterprise reform and privatization.

Progress thus far has been sporadic, with the Baltic states implementing reform at a differing pace. Highlights from the three countries' reform programs are presented in the box on page 10.

Without a doubt, many outsiders have been positively surprised by the progress achieved thus far. The new currencies have seemed to work, and it is to their credit that they have been introduced without major disturbances like confiscations from



Kazimieras Antanavicius, a Lithuanian Member of Parliament, describes the economic situation in Lithuania.

the public or conflicts with the ruble authorities.

Now, however, it is essential to underpin the new currencies with stronger fiscal and monetary policies, and policies to stimulate growth. Significant progress has been made in the difficult task of establishing working central banks, finance ministries and similar institutions. Nonetheless, much remains to be done, especially the development of a reliable banking system and a workable payments system.

So far, the budget deficits have been kept mostly under control, which is impressive since the initial situation was one of not even knowing what was part of the government budgets. New tax systems have been set up, and ever since the initial price liberalizations most subsidies have been cut.

This does not mean that the fiscal situation is under control. There are considerable difficulties in collecting taxes, since so much of the dynamic part of the economy is outside the old official structures. Also, it is not clear to what extent the governments have been successful in getting rid of the responsibility to cover for debt incurred by state-owned firms. The budget consequences of the present fall in output are not known, nor are the debt servicing requirements increased lending will bring.

Also, inflation is not yet under control. The high inflation rates that came as part of the price liberalizations had been brought down to what seemed to be manageable levels. The deepening of the economic crisis now seems to be pushing these levels up again.

On the whole, however, much has been done to build the fundamentals of macroeconomic stabilization and the market economic framework. Much of the legislation is being put into place. However, even when the necessary legislation is in place, a significant part of the new functions and institutions that are required will come into being only as competence and experience are built with consensus over time. While all three states have high aims, actual implementation is being held up by many difficulties, especially political uncertainties.

In the area of privatization, for example, there are the "objective" difficulties of privatizing without a developed credit market, choosing between a voucher system or sales, and finding the right sequencing

However, there are also the probably more difficult "subjective" problems, including the surprisingly widespread resentment of private enterprise and its consequences, which has hindered the establishment of the private property rights necessary to underpin privatization and other market reforms. Related issues involve the question of the economic rights of non-citizens and the problems of "nomenclature" privatization and organized crime.

It is no surprise that the private sectors are still very small, much smaller than in Central Europe, because of the closer integration of the Baltic economies with those of the other former Soviet republics. As noted earlier, the Soviet system of central planning featured large factories designed to meet the output requirements for the entire country.

Small-scale farming and small enterprises, especially in the service sector, are developing fast, but they still represent only a minor share of economic activity. Some major private firms still live off of state structures, and are not standing on their own legs. Large-scale private enterprise seems some way off. A significant part of the Baltics' economies will continue to be state-owned for some time.

Regional Differences and Reform

It is important to point out that vast differences exist between each of the Baltic republics. Subsuming Estonians, Latvians and Lithuanians under the common concept of Baltic nations often obscures how different they are—historically, culturally, linguistically and demographically.

Differences in industrial development, cultural ties and other areas will most likely play an important role in the transformation taking place in each country and the policies that will evolve within each. For example, Estonia pioneered economic reform in the Soviet Union even before *perestroika* was introduced in Moscow. As a result, Estonia established economic relations with foreign countries—primarily Finland and Sweden—earlier than the other former Soviet republics. Today, thanks to its early start, Estonia has more joint ventures than Lithuania and Latvia.

Different approaches to the economic transformation have already appeared in some important areas, such as currency reform and privatization (see box on page 10). In reality, it is not surprising that the Baltic countries would be aggressive in asserting independent approaches to their economic and political structures after 50 years of Soviet domination. Of course, they are fully within their rights to pursue policies as they see fit. However, if they should choose radically different or even only mildly different economic reform programs—and the record thus far in this regard is not encouraging—they may well be doing themselves a large disservice. They may benefit more from coordinating policy among themselves to attract investment on a regional basis and prepare for eventual European integration.

> *Those who simply preach the virtues of the market risk doing democracy a disservice.*

Overall, the outlook is uncertain, particularly in light of the daunting problems encountered in the transition to democratic political systems and market-based economies over the short-term. The citizens and political leaders of the three Baltic countries must display great courage in confronting these problems as well as an awareness of the unprecedented position in which they now find themselves.

The West faces the same challenges in attempting to support this crucial transition process. Those who simply preach the virtues of the market risk doing democracy a disservice. Democracy must not come to be associated with mass unemployment, intolerance and growing social divisions. The new democracies must be given a social content. At the same time, the Baltic economies must integrate themselves into the global economy based on access to industrialized country markets, foreign private investment, and technical and financial assistance from Western governments.

Mats Karlsson is a former chief economist at the Swedish Ministry for Foreign Affairs and currently serves as Foreign Policy Advisor for the Social Democratic Group in the Swedish Parliament. This article was adapted from his November 20, 1992 presentation at "The Politics of Economic Reform" conference in Riga, Latvia.

401

INTERNATIONAL
Economic Insights
Volume IV Number 3 May/June 1993

Take Two: The Czech Republic

by Josef C. Brada

The Czech Republic is well-placed to revitalize its industrial base: it has an educated population, a diversity of manufactures, particularly for export, foreign investment and a widespread privatization program.

When the Czechoslovak Republic was formed out of the collapsed Austro-Hungarian Empire after World War I, it inherited much of the Empire's modern industry. Using this legacy and a mix of orthodox fiscal and monetary policies and a relatively outward-oriented trade regime, the young Republic quickly expanded its foreign trade and achieved a level of prosperity that, at the beginning of the Great Depression, rivaled that of Austria and Belgium. Now, sixty years later, emerging from the Soviet empire, the Czech Republic is attempting to do this again to bring its living standards to West European levels through neo-liberal economic and trade policies.

Legacies of Communism. Forty years of Communist rule have not only left per capita incomes well below those of neighboring market economies, but also created a number of structural deformities. Industry, particularly heavy industry, was overdeveloped, technologically outdated, wasteful of energy and raw materials and overly dependent on the USSR for markets and inputs. Agriculture was heavily subsidized and employed an excessive share of the labor force, leaving services and infrastructure underdeveloped. Trade was directed primarily toward the USSR and other socialist countries; few manufactures were competitive on western markets. Economic growth declined throughout the 1980s and, by the end of the decade, ceased altogether.

The post-Communist government inherited some positive legacies as well. Unlike Poland and Hungary, the country's external debt was minimal. More importantly, neither open nor repressed inflation were serious problems. Czechoslovakia also had a skilled industrial labor force as well as a well-trained cadre of engineers and scientists. Although incomes had stagnated, they were among the highest in Eastern Europe.

Stabilization and Transition. The post-Communist government reduced many subsidies in mid-1990, and, like the Polish *big bang*, freed most prices on January 1, 1991. This equilibration of the market was largely successful. Although prices increased at an annual rate of 34 percent in the first quarter of 1991, since then the rate of inflation has fallen to 10 percent.

Foreign trade was liberalized and the exchange rate unified and devalued from 17 to 28 koruna to the US$. The koruna was also made internally convertible for current account transactions, affording Czechoslovak firms unrestricted access to foreign exchange. A system of tariffs, with an average *ad valorem* rate of 5 percent, was introduced.

The elimination of subsidies and higher tax revenues from inflation-induced increases in enterprise profits enabled the government to run a budget surplus in 1991, but in 1992, declining enterprise profits and growing expenditures on the social safety net eroded the surplus. Measures to remedy this situation were introduced by the Czech Republic in 1993. A value added tax was introduced which will both increase revenues and reduce the government's reliance on volatile enterprise profit taxes.

While these stabilization and reform measures succeeded in creating a market economy characterized by low inflation and a current account surplus, economic output and employment declined sharply, with real GDP falling by 15 percent in 1991 and 8 percent in 1992. This was in part due to domestic policy, as the elimination of subsidies, relative price changes, falling real wages and government austerity all served to reduce demand. A larger part was played by the collapse of exports to the former Soviet Union (FSU) beginning in 1991.

These domestic and foreign shocks had different effects on the Czech and Slovak Republics. Although industrial output fell by similar amounts in the two Republics, in the Czech Republic unemployment peaked at 4 percent while in Slovakia it exceeded 12 percent. This difference was symptomatic of other inter-Republic differences in their experience with, and attitude toward, the transition and stabilization policies implemented by the federal government.

The Separation of the Czechs and Slovaks. Ethnic and political tensions, exacerbated by differences in the two Republics' experiences with the return to capitalism, led to the dissolution of the Czechoslovak Republic on January 1, 1993. This separation has important long term economic and political advantages for the Czech Republic. On the political front, the legislative logjam of past years caused by Czech-Slovak conflicts has been eliminated. In the Czech Republic, Prime Minister Vaclav Klaus has a broad mandate to implement his neo-liberal policies and, in coalition with other parties, he has encountered few problems in obtaining the necessary legislation. The Czech Republic also emerges from the separation much stronger in economic terms. The federal budget was strained by subsidies to, and greater unemployment payments in, Slovakia. Moreover, the Czech Republic's foreign trade position was, and will continue to be, much stronger than that of Slovakia; in addition to its stronger export performance it also received the lion's share of foreign investment and tourism receipts. Finally, per capita GDP in the Czech Republic is almost 25 percent greater than in Slovakia. Thus the Czech Republic emerges politically united, with a budgetary surplus, 11 percent inflation, an unemployment rate under 3 percent and a strong currency and current account position. Tensions with Slovakia over trade, the distribution of federal assets and the distribution of privatized enterprises remain and, if not resolved, these could lead to short-term losses due to the disruption of trade between the two Republics.

Privatization. Until very recently, privatization in the Czech Republic, whether measured by the share of the private sector in total output or in terms of the number of state owned firms privatized, lagged behind the pace of Hungary and Poland. However, the recently-completed *voucher* *privatization* should put it ahead of the other East European countries. By the start of 1993 some 2,000 privatization projects had been approved, primarily using the voucher method. More privatizations, including a second round of voucher bidding, are to take place in 1993.

Exports to developed market economies grew by 21 percent despite lackluster economic conditions in the EC.

The consequences of privatization are uncertain. Investment funds, many organized by banks, garnered nearly 70 percent of the vouchers; they are in a position to play an important role in the management of the firms in which they have invested, and some have begun to do so, even before the shares are distributed. At the same time, some funds may face financial difficulties. It is expected that privatization will impose financial discipline on enterprises, leading to greater responsiveness to domestic and export markets, an upsurge in foreign investment and, in the short run, an increase in unemployment as firms become more efficient.

Trade Reorientation. The collapse of the Soviet economy, and subsequently of the USSR itself, forced a reorientation of trade toward the West, which, while desired by the Czechs, had to proceed more rapidly than had been anticipated. The FSU's share of trade fell from 23 percent in 1990 to 19 percent in 1992; because imports of fuel and raw materials from the FSU continued at high levels, the fall in the share of exports, from 25 percent to 10 percent was even more dramatic. At the same time, the share of market economies in the Czech republic's total trade rose from 56 percent in 1990 to 70 percent in 1992. The EC is the dominant and most dynamic trading partner, accounting for 32 percent of trade turnover in 1990 and 62 percent in 1992. The geographic distribution of Czech trade is quite similar to that of other European market economies, with the exception of its greater reliance on FSU exports of fuel and raw materials.

A key policy objective of the Czech Republic is to gain access to western markets and to become a full member of the EC. To this end Czechoslovakia, Hungary and Poland negotiated Association Agreements in 1992 that explicitly stated this goal and also provided for a mutual reduction of trade barriers. The EC has eliminated tariffs and quantitative restrictions on most industrial exports from the Czech Republic. Steel and textile products are subject to slower and less generous liberalization while agricultural exports will remain subject to a broad array of trade barriers. In this regard the Czech Republic, some 30 percent of whose exports fall into these three "sensitive" sectors, is more fortunate than its neighbors whose trade is more concentrated in these sectors. In return, the Czech Republic will begin to lower its tariffs against EC goods later in the decade. The Czech Republic has also signed a free trade agreement with the EFTA. Thus industrial exports to Western Europe are largely unencumbered by tariffs. The final measure for trade liberalization is the free trade agreement between the Czech Republic, Hungary, Poland and Slovakia signed on March 1, 1993. The agreement calls for the immediate elimination of tariffs on "noncontroversial" manufactures and a more gradual removal of barriers to trade in agriculture and other manufactures. Consequently, at least for purposes of trade, the Czech economy is open to world trade and will increasingly enjoy tariff-free access to the markets of its major trading partners.

Foreign Investment. In part due to the slow pace of privatization, foreign investment in the Czech Republic does not exceed $2 billion. By far the most important foreign investment to date is Volkswagen's purchase of the Škoda car company, a transaction whose final value could exceed $6 billion. The VW-Škoda deal is the type of foreign investment that the Czech Republic needs. VW will modernize Škoda's cars and production facility and provide a strong marketing network for Škoda in the West. Moreover, both Škoda and its Czech suppliers will increasingly be integrated into VW's worldwide supply system. Given the low labor costs in the Czech Republic, there are many traditional industries which could be successful in western markets if foreign investors updated their products and provided an effective marketing and service network in the West.

Is the Czech Republic a NIC? While the definition of a newly industrialized country (NIC) is somewhat nebulous, the Czech Republic shares many of the characteristics attributed to these countries and, indeed, it does so to an extent that suggests that it might become a particularly successful NIC. Consider, first, simple statistical measures. Its per capita GDP, measured at purchasing parity rates, is $6-7,000, which clearly puts it in the range of other NICs. Exports are equal to 15 percent of GDP and its trade, especially with the West, is growing rapidly. In 1992, exports to developed market economies grew by 21 percent despite lackluster economic conditions in the EC, the Czech Republic's main market. Moreover, export growth was concentrated in industrial goods. Thus while exports of raw materials to developed market economies grew by 17 percent in 1992, gains of 40 percent were recorded for exports semi-processed materials, 25 percent for machinery and transport equipment and 31 percent for miscellaneous manufactures. Trade is clearly the engine of industrialization in the Czech Republic.

Given the relative undervaluation of the koruna, with an official exchange rate of 28 ks/$ and an estimated purchasing power parity rate of 10 ks/$ and a low rate of inflation, Czech manufactures should continue to increase their competitiveness on world markets, particularly as Czech firms begin to learn how to distribute their wares abroad and as foreign investors begin to export from their Czech operations. The undervaluation of the koruna, of course, makes the Czech Republic an attractive investment due to low labor costs and the future appreciation of the koruna will provide a healthy boost to foreign investors' returns.

One difference between the popular conception of a NIC and the Czech Republic is economic growth, which tends to be high in the former, but has been negative in the latter. This difference, however, is likely to be temporary. The decline in GDP and industrial output appears to have been arrested in late 1992 and projections indicate that both should increase by 2-3 percent in 1993. Exports, foreign investment and modest government efforts to stimulate domestic demand should lead the way toward putting existing capacity to use. While an accelerated pace for restructuring may require investment in some sectors, in most there is sufficient excess capacity to provide easy increases in production. In the long term, additional labor can be freed up by both increased efficiency of labor utilization and shifting labor from agriculture to industry and services. Consequently the losses in output that occurred in 1991-92 can be made up relatively easily. The other difference between the Czech Republic and traditional NICs is that the Czech Republic has less of a need to industrialize and more of a need to restructure its industry. This will be a disadvantage in that restructuring will impose social and economic costs that are greater than when industrializing an agrarian economy, but it will be an advantage in that the country already has a well trained and educated labor force.

As with all efforts at economic prognostication, caveats are required. The country faces daunting challenges of establishing effective corporate governance and creating functioning credit and capital markets. While economic policy currently appears to be firmly set, a failure to raise living standards in the next few years would undermine the neo-liberal policies that seem to have worked so well to date. External events, such as a trade war with Slovakia or economic and political changes in Russia, could also limit future prosperity and integration into the world economy. All NICs, indeed, all countries, face similar challenges and it is to be hoped that the Czech Republic can make the transition to become a successful NIC and ultimately a developed market economy without further detours. ■

Professor Brada is professor of economics at Arizona State University.

IMF
SURVEY
A PUBLICATION OF THE INTERNATIONAL MONETARY FUND
July 12, 1993

IMF Board Approves Russian Loan

Following are excerpts from a press conference held by IMF Managing Director Michel Camdessus on July 1.

CAMDESSUS: I am happy to confirm the press release [reprinted on pages 220-21 of this issue] and delighted to tell you that yesterday afternoon the Executive Board acted to approve Russia's request for a loan under the systemic transformation facility [STF]. We had a similar meeting here two months ago (April 20, 1993) when we created this new instrument. This is a little bit of history, because Russia's case is the first one in which this facility is being used in a stand-alone fashion. Kyrgyzstan used it in mid-May in conjunction with a stand-by credit, which covers a comprehensive set of policies, including, in particular, the introduction of a new currency. It was clear when the facility was established, and it is even clearer now, that bringing the Russian economy to a point where first an STF program and then a stand-by program could be put in place would require imagination, determination, and perseverance to take and then implement persistently some very tough decisions.


Camdessus: Russia's program represents a milestone in its reform efforts.

In this context, let me pay tribute to the Russian authorities who, in support of their use of Fund resources under the STF, have submitted a program, which is a Russian program, that represents a milestone in their efforts to move the economy to a sustainable noninflationary growth path.

It is important to note that the Russian authorities have not come to the Fund with empty hands. The very high rates of inflation in the last several months have been reduced, and thus the very real danger of hyperinflation seems so far to have been averted. They are resisting with determination various pending populist initiatives. They have implemented various (Please turn to page 213)

The First Stand-Alone STF Loan

(Continued from front page) concrete measures to reduce subsidies to importers, the coal sector, and grain producers. They have tightened monetary policy and increased interest rates. The program for the rest of 1993 aims at achieving substantial progress toward financial stabilization. You remember, certainly, the recent declarations of President Yeltsin saying that stabilization was the key objective for 1993. Stabilization is no doubt a precondition for pushing ahead with the systemic transformation of the economy and the restructuring of the country's economic potential. But don't be misled by the word "precondition," because stabilization should not be an alibi for postponing structural transformation measures. They have to be taken simultaneously, and as rapidly as possible.

The key policy objective is to reduce the monthly rate of inflation to a low single-digit level by the end of the year. The program specifies detailed fiscal and monetary measures as well as institutional changes required to attain this objective. At the same time, considerable emphasis is given to the acceleration of reforms in the areas of foreign trade, privatization, and the whole legal framework. The measures of the program form an integrated whole.

Among its many elements, let me stress the importance of institutional changes in the conduct of monetary policy. You remember that I have stressed that the STF should concentrate on institutional changes, which would allow the stabilization efforts to be put in motion in a sustainable fashion. You will remember that in Russia the bulk of credit had been distributed as earmarked central bank credits at heavily subsidized interest rates to the so-called priority sectors of the economy. The central bank has now put strict limits on the amount of credit issued. The central bank refinancing rate has been adjusted and is to be set by reference to market rates. The Government has strictly limited the subsidies on interest rates and started auctions of treasury bills. I am not telling you there will no longer be subsidized credits, but the subsidy will come from the budget and under strict budget ceilings. It will no longer come from the central bank. This means that Russia's monetary policy will begin to resemble that of other market-oriented economies.

The end point of what the Russian authorities are trying to achieve and where we are trying to be helpful is a financially stable market economy that is fully integrated with the world market. This is, of course, not an end in itself, but rather it will establish conditions for a sustained, high-quality growth path that can create the basis for future prosperity for the Russian people. There are no illusions either here or in Moscow that this road will be an easy one. But it is equally clear there are no viable alternatives. It is in recognition of these facts that the world financial community has expressed its willingness to assist Russia on this difficult path, including through the STF.

The immediate first step for the Russian authorities is clear: successful implementation of the STF-supported program. This will pave the way for an upper credit tranche stand-by arrangement, which will allow the Fund to remain fully engaged in assisting the reform process in the Russian Federation. That can be a source of considerable pride for the governments of the member countries of the Fund—a new instrument that was created just two months ago is already proving its worth.

> ***". . . a sustained, high-quality growth path that can create the basis for future prosperity for the Russian people."***

At the time of our discussions leading to the STF, the emphasis was placed on the Fund's ability to be helpful to countries that undergo the difficult transition to a market economy. The traditional instrument through which the Fund has backed economic reforms in many countries is a stand-by arrangement, and the STF was designed to pave the way toward such an arrangement.

I would like to add one more point. Although the occasion of this meeting is to talk about Russia, I would like to inform you that the staff has been having intensive discussions with other countries about use of the STF and has recently reached agreements with the authorities of Belarus, Kazakhstan, and the Slovak republic about programs that will attract support under the STF. I hope that in due course I shall be able to recommend that the Executive Board approve such support, and I look forward to similar steps. We are working to this end, of course, in many other countries, Ukraine, for instance. Now, I would welcome your questions.

QUESTION: U.S. officials are telling us that the G-7 [Group of 7] summit next week in Tokyo is going to approve an establishment of a G-7 office in Moscow. It has been reported that the IMF was opposed to the establishment of this office.

40

The IMF panel at the press conference (from left): Ernesto Hernández-Catá, Deputy Director, European II Department; John Odling-Smee, Director, European II Department; Managing Director Camdessus; and Shailendra Anjaria, Director, External Relations Department.

Have arrangements been made that now make it acceptable to you to have a G-7 coordination office in Moscow?

CAMDESSUS: I would like to say that the account of IMF opposition to a G-7 office is misreporting. Not only are we not opposed, not only have we not expressed any opposition, but I must say in all modesty that we have not even been consulted! If I had been consulted, I would have said that if the G-7 countries say that such an office would help in their work in Russia, then I would warmly support this initiative. We know how important it is, indeed, to have people in Moscow assisting in implementing the strategy for cooperation with Russia. We know that G-7 countries are extending important and very diversified bilateral assistance to Russia, and if they see the need to coordinate the multifaceted forms of support to Russia, then I think it is good for them to set up an office.

As far as we are concerned, we have an office in Moscow which has played an extremely useful role, an invaluable role, as a matter of fact, in helping us to prepare particularly the first credit tranche and now the STF. It will continue its work there. But the existence of our office working in the limited domain of the IMF interventions is no reason for us to oppose a G-7 office if they agree to create one.

QUESTION: There is a perception, probably wrong, that the IMF's preoccupation with Russia and the former Soviet Union may divert attention from the needs of the developing countries. They may not be as unique as the Russian case, but they are as important. Would you care to comment on it?

CAMDESSUS: You are right to say that this perception is wrong. Indeed, the case of our cooperation with India is an extremely good illustration of the fact that even when working intensely in supporting transformation in Russia, we are able to support, I think efficiently and most successfully, a stabilization and reform program in India. As a matter of fact, I look forward to continuing to work as effectively as possible, not only in Russia and India, but in many other developing and transforming countries.

I must tell you in passing that we are now in this business with 75 countries in the world, and I do not intend to delay our work with 74 countries because we are interested in the historic transformation of an important seventy-fifth one.

As a matter of fact, I know those of you who have observed the work of the Fund for a long time know very well that there are two key determinants of IMF interventions. One is the quota of the country. There is a proportionality—a complex one, but very decisive one—between the quota of the country and the magnitude of IMF support. But there is perhaps an even more important determinant, which is the quality and the strength of a country's own effort in stabilizing and transforming its economy. You know my motto, the stronger the effort of the country, the stronger the contribution of the IMF and of the international community. I had the privilege two days ago to make this point very forcefully at the Economic and Social Council (ECOSOC) of the United Nations in Geneva. This is what matters: all countries in the world have to know that if they do everything that is possible to put their houses in order, the IMF will be there with its own support and with all its strength as a catalyst to make sure that international support comes in time.

QUESTION: Mr. Camdessus, a couple of questions relating to timing. When would you expect the IMF to approve a second $1.5 billion installment on the new type of lending to the Russians? I understand the Russians are looking for this maybe before the end of the year. And, secondly, in view of what you're saying now about what the Russians are doing, give us some sort of a timetable, if you can, on bringing into play the $6 billion ruble stabilization fund.

CAMDESSUS: Well, before the end of the year for a second tranche is a reasonable forecast or hope. This is what we have in the back of our minds, and on the back, I would say, of our envelopes when we make calculations of the financing for Russia for 1993. But we should be careful in speculating about calendars for disbursement of external support.

The essence here is, first, the implementation of all that is in this program. I don't think I am revealing any secret deliberations of the Executive Board in telling you that imple-

406

mentation was the motto of our Executive Board meeting yesterday when the STF program was approved.

Second, another key element for our subsequent support to Russia in the following months is the strength of policies adopted. Our subsequent disbursement will be, indeed, related to a new set of policies, and you know there is a lot to be done. This program is good. It is really what the systemic transformation facility is designed to support. But even at the end of such a good program, the Russian Federation will still have major problems to face. Even if they go to monthly low single-digit inflation, [there will be] high [annual] inflation. Then, certainly, a further effort at reducing inflation will be in order. Even if the budget deficit is cut as stated in this program, it will leave a high budget deficit in Russia, with all it entails about misallocation of resources. And so a major effort will continue to be needed in this domain, and we will discuss that with the Russian authorities.

Third, I mentioned discussions. We look forward to starting these discussions very soon. We are ready. But when you negotiate such comprehensive programs, normally it takes some time. You make calculations, you compare forecasts, you establish financial frameworks, and so forth. All of that takes time. It is naive to believe that this can be done in a few weeks.

In general, good programs take lengthy preparation. I am not telling you that because I want to protect the IMF against all forms of pressure, or because I want to protect these two gentlemen (Mr. Odling-Smee and Mr. Hernández-Catá, Director and Deputy Director, respectively, of the European II Department) from never spending a weekend at home. No, I am only stating facts.

So, implementation, strength of policies, and, indeed, due time for negotiations are needed.

You have a second question on the stabilization fund. As a matter of fact, all of our present initiatives are conducive to stabilization of the ruble. No wonder that for a few weeks now you have seen the first indications of ruble stabilization in the market. But, the stabilization fund is still part of the offer of the G-10 industrial countries to Russia. It can be helpful in a certain context. I have observed that, reasonably enough, the Russian authorities are not at this juncture putting a high priority on the implementation of the stabilization fund. They understand how market economies and exchange markets work. They are aiming for stabilization. They certainly will consider the activation of the stabilization fund at the appropriate time, but not for the next few months in my judgment.

QUESTION: Could you give us, sir, a breakdown of the \$43 billion in external financing that is due for Russia this year? And is that amount adequate?

CAMDESSUS: It is certainly adequate. It has been incorporated in our balance of payments scenario for Russia, which is behind the design of the present package. Very broadly speaking, you have, first, the \$3 billion of the IMF. Second, and most important, is \$29 billion of rescheduling and rearrangement of debt. You know, it is a very complex package. Finally, you have \$11 billion of grants and loans provided from bilateral and other sources. All of that, if my arithmetic is correct, should produce \$43 billion.

"The stronger the effort of the country, the stronger the contribution of the IMF and of the international community."

QUESTION: How direct was the U.S. pressure to approve this credit before the G-7 meeting? Were you contacted by Secretary Bentsen or other people of the administration?

CAMDESSUS. Well, I will tell you several things. I suspected the word "pressure" would be pronounced this morning. But, please, don't allow what is anecdotal to blur what is essential. What is essential is the excellent cooperation we have with the most important members of the international community in support of a historic development in Russia.

Now, "pressures." The old Fund watchers here, and I see several of them, have heard me say that pressure is the most natural thing, the most ordinary thing in Fund life. It is like atmospheric pressure for human beings. So we have developed, I would say, a kind of very simple, good-sense philosophy about pressures in the IMF. I will give you the three basic tenets, even if there are more.

First, never yield to pressures.

Second, equally important, never be deterred from doing reasonable things, even if you are pressured to do them.

And third, possibly even more important, be sure that your sense of humor grows in proportion to the pressure.

One more thing—the date of the Executive Board meeting before the G-7 summit: I can tell you that the Executive Board set it for June 30th. Technically speaking, by Fund calendar rules, it should have been the 29th, namely 10 working days after circulation of the report of Mr. Hernández-Catá. It was the 11th working day, because on the 10th day I was in Geneva delivering a speech at the UN ECOSOC meeting. My speech is being distributed, and it is worth reading, particularly the final section! Thank you.

WORLD BANK NEWS

Slow Pace of Reform Hinders Bulgaria's Economic Recovery

In 1989, the collapse of Eastern bloc trade sent Bulgaria's economy into a tailspin that would eventually claim one-third of the country's economic output. To revive the ailing economy, Bulgaria launched an ambitious reform program in early 1991, targeting the financial system, state-owned enterprises, trade, prices, the agricultural sector and social services.

Kyle Peters

The reforms paid off and helped slow down the country's economic losses. But just as the economy began to show signs of turning around, the reforms lost their momentum.

Because of the slowdown, Bulgaria's economic recovery may come a year later than expected, says Kyle Peters, Senior Economist in the World Bank's Europe and Central Asia Region. Peters recently spoke to World Bank News *about Bulgaria's future and the need for quicker reforms. Excerpts follow:*

WBN: When will Bulgaria's economy pick up again?

Mr. Peters: We thought the trade turnaround was a good sign that the drop in the country's gross domestic product (GDP) would stop. Now, because of the slowing of economic reforms, GDP will probably decline by another 4 percent or 5 percent in 1993 before it resumes growing in 1994. If the reforms had kept pace, Bulgaria might have started growing earlier and faster.

Until the fall of 1992, Bulgaria was making good progress. But as in many Eastern European countries, the government began to experience political difficulties that led to a slowing of stabilization and structural reforms. consensus around particular reforms. Because of that, the stabilization and structural reform program has slowed substantially.

WBN: Have Bulgaria's reforms helped spur economic growth?

Mr. Peters: The program has suffered from some starts and stops and has not fully arrested the decline in GDP. In 1992, for example, output fell by about 8 percent.

The reforms have had some positive impacts. In late 1990 and 1991, there were food shortages. Those have been eliminated because agricultural production has increased. Small business and private sector activity has increased in both retail and wholesale trade, although it started from a small base. Before the reforms, there used to be hardly any shops. Now, all of the major metropolitan areas are full of shops where goods are freely available.

The first signs of the turnaround came in 1992 when both exports and imports increased. Also, Bulgaria has seen a very healthy orientation of trade toward Western European markets which is a steadier and more reliable base for export growth than the Eastern European nations they were dependent upon.

WBN: What does Bulgaria need to do to get its economy growing again?

Mr. Peters: There is a very clear agenda for Bulgaria to get its economy moving. Basically, the Bulgarians need to move rapidly on enterprise restructuring, including privatization, financial sector reform and agriculture. That's when out-

So far, they've done a very good job of putting in place the legal and institutional framework for privatization and financial sector reform. But now they have to implement that. Now, they have to start privatizations, both through widescale auctions of small firms and privatization of large firms. They have to move these assets into the private sector where they can be more efficiently used.

The same goes for banking. The government needs to clean up the portfolios of the country's banks by assuming their inherited bad debts, craft financial restructuring plans for the enterprises and consolidate the banks.

Also, Bulgaria needs to reform its agricultural sector which has a lot of potential for being a big exporter. Assets must be quickly returned to private hands so people can help production recover.

WBN: In 1990, Bulgaria declared a moratorium on its debt, now totaling $12 billion. Does that debt pose a major obstacle to the country's development?

Mr. Peters: The debt is an extremely big obstacle that creates an air of macroeconomic uncertainty constraining private capital flows, especially direct foreign investment in Bulgaria.

There's a lot of macroeconomic risk in that debt overhang. The moratorium has virtually eliminated any access the country has to private credit flows, trade credits and medium and long-term finance from the private sector.

Reducing the debt is a key step to normalizing the country's external situation and regularizing capital flows. There is hope there because progress is being made between Bulgaria and its commercial debt creditors on seeing some consensus on negotiating a debt-reduction agreement for Bulgaria.

WBN: Overall, how does Bulgaria's economic situation compare to other Eastern European countries?

Mr. Peters: Bulgaria had a much worse starting point than the other Eastern European countries.

Bulgaria faced a tough time in the transition. First, it was more heavily dependent on trade with Eastern Europe and the former Soviet Union than any other country in the region. Up to 80 percent of all its external trade took place there, with half of that alone being with the former Soviet Union. The official unemployment rate at end of 1992 was 15 percent, one of the highest unemployment rates in the region. Second, Bulgaria was disadvantaged because its private sector was underdeveloped compared to most other Eastern European countries. At most, 2 percent of economic activity in Bulgaria was in private sector hands when the communist system collapsed.

WBN: What are Bulgaria's prospects?

Mr. Peters: The key to Bulgaria's economic future lies in reviving external trade, diversifying its markets and implementing reforms. Bulgaria should have an agriculture and service-led export-oriented recovery. But there are factors that constrain it. Bulgaria needs to have access to markets where their products can be competitive. Its recent agreements with both the European Community and the European Free Trade Association hold some promise. But many of Bulgaria's commodities, like agricultural products, iron and steel, lie outside of these agreements or are subject to protective clauses.

Bulgaria can also take advantage of its unique position between the East and West. It also has great tourism potential in the beach areas on the Black Sea and in the mountains. □

VOLUME XXIII • NUMBER 2 • SPRING 1993

PRESIDENTIAL STUDIES QUARTERLY

CENTER FOR THE STUDY OF THE PRESIDENCY

PRESIDENTIAL PERCEPTION AND PERSUASION

Ukraine: Challenges for a Former Soviet Republic*

ROMAN POPADIUK
United States Ambassador to Ukraine

It is my great pleasure to be here with you tonight. This evening brings back many fond memories of my college days when I was a member of the Center and participated in its various programs. For me, the Center is Gordon Hoxie, an individual whom I admire for his steadfast dedication to the youth of our country. I would like to commend him for all his efforts in inspiring countless students over the years with the fundamentals of public service, patriotism, and professionalism.

Five hundred years ago, Columbus embarked on a journey that not only resulted in the discovery of a New World, but can be viewed as the beginning of the interdependency of the world community. It is only fitting, therefore, that we study the progress of these past centuries and their impact, as you have done over the past few days.

Much as Columbus, we are embarked on a new era. Today, however, we live in a world very much different than that of Columbus or even of twenty years ago. The threat of nuclear war has diminished, nuclear arms are being dismantled, and the cold war is over. But the end of the cold war has given rise to a new challenge. Over the past decade it has been increasingly fashionable to speak about global interdependence. And there is no doubt that the world has increasingly moved in this direction. We see this on a daily basis, whether in terms of communication, technology or trade. The freeing of Eastern Europe and the demise of the Soviet Union add a new dimension and challenge to this term. These states not only have to become integrated into this world structure which itself has not yet become solidified, but at the same time are experiencing the breakdown of a previously self contained and highly interdependent world.

Over the past two years, therefore, what we have been witnessing in Eastern Europe and the former Soviet Union, is both a building and destruction process. Interdependence ranged from the previously shared economy to the legacy of Chernobyl across the expanse of three states. The challenge is to manage the breakup of interdependence so that the best parts remain to maintain and support the desire of sovereignty, rather than be seen as a threat to that sovereignty. This presents a rich field for research by social scientists, but more immediately presents a challenge not only to these countries but the entire world. Some countries have already managed these transitional steps and are fast becoming members of the international community. Poland and Hungary are examples of this.

We are, therefore, tasked with managing the integration of a new frontier into a global structure that itself is not certain of what direction it is taking. What I would like to do for the next few minutes is outline the problems the newly independent states face, with a particular focus on Ukraine, and the challenges they pose. Broadly speaking, the challenges they encounter are ethnic conflict, economic and political security, defining their regional and international roles, and military security.

We are witnessing the thawing out of Eastern Europe and the former Soviet Union. For over 70 years this area of the world has been frozen in time under the control of totalitarian rule which gave an artificial peace and cooperation. We now have a 19th century world with 20th century technology. The ethnic conflicts and suspicions that ravaged Europe in the last century have come back with a vengeance in this part of the world.

Thus, we are witnessing the ravages of war in the former Yugoslavia, the division of Czechoslovakia, the conflict in Moldova as well as in many states of the former Soviet Union.

The outbreak of ethnic conflict is a serious concern for the leadership of the newly independent states. In this environment we have witnessed a tendency to favor some form of authoritarian control or at a minimum a slowing down of the democratic reform process. Here we and these states face the challenge of maintaining a delicate balance between political stability and democratic reform. In no case can the needs for the former be utilized as an excuse for lagging on democratic reform. This is where active western involvement politically and economically can play a crucial role.

A second feature is the growing global economic crisis, highlighted by the economic difficulties in our own nation and other economic powers such as Britain and Germany. Unfortunately, these are not individual failures of leadership or planning but rather the result of the changing world political structure—the demise of communism, the entrance into the world economy of Eastern Europe and the states of the former Soviet Union. The false perception for the base of this problem is leading many leaders to turn inward, to promise and seek domestic solutions for problems that are global in nature. Retrenchment now will make us pay a greater price in the future. Witness our isolationism in the wake of World War I.

With the decline of great power conflict and the simultaneous decline of the economic strength of the leading industrial states, we can expect international institutions to take a leading role or be the focus for security guarantees and economic stabilization. Thus, for Ukraine, we see the importance of cooperation in the NACC and CSCE processes as instrumental in identifying Ukraine's international role and helping preserve its security. Likewise the IMF and World Bank will be important for economic development. The challenge is to strengthen these institutions so they can serve as viable alternatives to unilateral actions or new bloc alliances, and as a security measure for maintaining the viability of the new states and preventing the return to empire in the former Soviet Union. And, as the economic powers of the West wrestle with their difficulties, the newly independent countries need to realize the importance of private versus public capital in the development of their economies. To make use of this, however, these countries need to attract investment by implementing favorable investment environments.

A third feature is that we are no longer living under a global threat. Communism is dead, the Soviet Union no longer exists. The fact that the world is no longer under

a global threat is giving rise to shifting balances as all states, particularly, the newly independent states, seek to establish their roles regionally and vis-a-vis the West. In this context we will find states undertaking actions that do not parallel our views or desires. We should not seek to support old structures only because we are familiar with and used to them. Thus Black Sea litoral cooperation or cooperation among the former Soviet Asian republics should be viewed as regional attempts to deal with regional problems and the problems of national survival. These are new states groping for identities and roles. Our challenge in the West is to work with these states and harness them in positive directions so that we can be partners and not adversaries. We in the West have been responsive to the security concerns of these states with the creation of the NACC process which gives these states a close relationship with NATO countries and thus a forum for discussion of mutual concerns. What has to be prevented is any one state from imposing its power over the others. History has shown that empire does not produce democracy. While all of the new states will not become democracies overnight, they have a greater chance for doing so if they are allowed to develop on their own, without external influence.

And, finally, we are witnessing a concerted effort to limit and reduce both nuclear and conventional forces throughout the world. CFE and START Treaties are major steps forward. But these actions are continuing with the Middle East Arms Control talks and the movement towards a Global Protection System. The challenge is in working with the newly independent states so that they realize that cooperation on this front is not a sacrifice of security. After all, the former Soviet Union had an enormous nuclear and conventional force, but fell apart. Ukraine has been cooperating on this issue. In May, it got rid of its last tactical nuclear weapons.

We also have to guard against the temptation of these states seeking short-term economic gains from arms sales. Such a move can have a de-stabilizing effect in many regions of the world. We are very cognizant of this and have moved towards assisting Ukraine with defense conversion, including the goal of a multi-million dollar Enterprise Fund.

As you can see, Ukraine is an integral part of the new world. United States interests in Ukraine are clear and simple. They involve security, investment, and partnership. As regards security, how Ukraine handles its relationship with Russia is of interest to the U.S. and the world. Furthermore, how it develops internally is also of interest. Problems in either sphere can have regional as well as international repercussions. A stable, viable and secure Ukraine is, therefore, a major aim of United States foreign policy.

In terms of investment, Ukraine's natural and human resources destine it to become a major economic nation. Ukraine possesses a broad industrial base, an advanced space industry and has important energy and mineral resources. The United States fully realizes that an economically strong Ukraine is a secure Ukraine and a viable trading partner.

Ukraine is also a new partner on the international level. Whether in the UN, NACC or the CSCE, the U.S.-Ukrainian partnership is aimed at furthering peace, democratic values and cooperation. This partnership was inaugurated during President Kravchuk's May visit to Washington and reaffirmed in the July Helsinki meeting between President Bush and President Kravchuk.

And, Ukraine's geographic position gives it the opportunity to be a bridge between Europe and Asia and a new international center. In this regard, the United States and other western states are actively engaged with Ukraine concerning the creation of a Science and Technology Center and a Nuclear Safety Center in Ukraine. Ukraine must seize these opportunities to be a regional leader.

However, this is not a totally one-way street. There are a number of positive steps the West can take in approaching the challenges of the newly independent states. We need to realize that we in the West had decades for building our political and economic bases. We cannot expect dramatic change overnight. But we can insist on no deviations from the road of democratic and economic reform.

We need to understand the abiding fear of these states at losing their independence to a resurgent empire. Their perceptions are a reality with which we have to deal. For example, we need to appreciate Ukraine's historical fears of its Russian neighbor.

As a consequence of this, we need to appreciate these states' desire to be treated as equals on the international scene not only because of the signal it sends their neighbors, but also because of their domestic political processes. Public opinion, exemplified by the mass media and opposition parties, constantly search for evidence of the smallest slight against the newly found sovereignty.

We must also admit that we have a learning process. While previously it was convenient to view everything from Moscow, now we have 15 capitals. Our bureaucracy has been adjusting to this change. We need greater efforts to learn the languages and cultures of these new countries. This is true for government, private, as well as media officials.

In its one year history, Ukraine has had numerous successes. Unfortunately, its success is measured mostly by what has not happened. As we look back over the past year, we see a world that was skeptical about the chance of Ukrainian independence being achieved. Once achieved, attention turned towards skepticism that Ukraine could survive as a nation. The fear was that ethnic strife would quickly bring an end to the great experiment. And even as this skepticism was prevalent, there were doubts being expressed that Ukraine could behave in a responsible fashion on the international arena, particularly as regards its nuclear weapons. Yet we have witnessed the removal of tactical weapons from Ukraine and Ukraine's commitment to ratify the START Treaty and the Nuclear Non-Proliferation Treaty. Ukraine has very expertly handled its relations with Moscow. In addition, Ukraine has ratified CFE and has been cooperating with the inspection regime and has despatched over 400 peacekeeping forces to the former Yugoslavia. Ukraine, therefore, has become a responsible and active partner in the international area. Last year's forecasts have proven false. But Ukraine cannot take comfort in this. It has to look toward the future.

Ukraine has to be careful, in particular, that the goal of independence does not overshadow and undermine the objective of democratic and economic reform.

Movement on these two fronts is Ukraine's greatest guarantee of internal and external security. On the economic front Ukraine must take the hard steps towards privatization, freer prices and the acceptance of investment. These steps will ensure all Ukrainians the hope of a better future. The government must learn the distinction between controlling and managing an economy. Economic control did not work for 70 years and those in the government that believe it may do so now are mistaken. On the political front, Ukraine must continue its movement towards political diversity. This warrants acceptance of various ideas and organizations. A free exchange of ideas and values is the foundation of democracy, tolerance and unity for a strong domestic and political base. Ukraine must also take its military industry and make it into an engine for civilian production.

We will continue to work with Ukraine. We will be supportive when we can and critical and questioning when we believe it is necessary. Such an approach should not be viewed by Ukraine as a lack of support or neglect, but rather the development of a strong bilateral relationship in which a free give and take is a normal course of events. This is how we deal with the rest of our Western allies. If Ukraine wants to be accepted as a major country, it must accept that this type of dialogue comes with that responsibility. Indeed, Ukraine has already shown its willingness to accept international responsibility.

It is indeed remarkable how Ukraine, only a year old, has come on the international stage with the multiple challenges of nation building, establishing its security, and integrating into the world community and has done all of these quite smoothly. Ukraine's mission is to maintain this course. Our government's mission is to support it and work with Ukraine.

* *This essay is based upon an address by Ambassador Popadiuk on October 24, 1992, at the 23rd Annual Leadership Conference of the Center for the Study of the Presidency in New York City.*

CONGRESSIONAL QUARTERLY

BOSNIA

Voices of Restraint Grow Louder Amid Cries for Military Action

Groping for ways to crack down on Serbia, President Clinton took literally Congress' customary plea to be consulted before U.S. forces are committed abroad. But in return, he heard a cacophony of impassioned but conflicting advice.

The approaching possibility of military action sharpened differences over the war in Bosnia-Herzegovina during the week of April 26. Many lawmakers went public in opposition to possible airstrikes against Serbian artillery positions, warning that the United States could be stepping into a Balkan quagmire.

The calls for restraint provided a counterpoint to the previous week's debate. It had been dominated by members who favor urgent military action as a moral imperative to curb the brutal Serbian practice of "ethnic cleansing" that they compare to the Holocaust. *(Weekly Report, p. 1031)*

"People now are trying to figure out whether this is Germany, 1942, or Vietnam, 1975," said Henry J. Hyde, R-Ill., a member of the House Foreign Affairs Committee.

A Muslim woman and child watch from their doorway April 27 as the village of Kazagici burns.

Clinton and his senior aides consulted in hours of meetings with members of Congress on several options: limited airstrikes by the United States and its allies on Bosnian Serb artillery emplacements; airstrikes on other economic or military targets in Bosnia or in Serbia; and pressing the United Nations to lift the embargo that prevents Bosnia's outgunned Muslim-led government from obtaining weapons.

By week's end, Clinton had not announced a new Bosnian policy. Aides said a decision was likely May 1, although a scheduled new round of U.N.-sponsored peace talks among Bosnia's warring factions added yet another element of uncertainty.

Lawmakers, lacking a foreign policy compass for the post-Cold War era, appeared to go off in every direction. Old alliances had disappeared with the Soviet threat, and the new array of opinion defied easy categorization.

The Pentagon's closest congressional allies tended to be among the strongest opponents of military intervention. Yet no one in Congress supports the military services more ardently or consistently than Sen. Strom Thurmond, S.C., who evoked images of the Holocaust in making an emotional plea for action in Bosnia.

"What's taking place there is worse than what Hitler did. Can we do nothing?" Thurmond, the ranking Republican on the Senate Armed Services Committee asked at a panel hearing April 28.

Democrats who had opposed wars from Vietnam to the Persian Gulf this time have formed the backbone of support for airstrikes and other tough measures. Yet some such leading Democrats, including House Foreign Affairs Chairman Lee H. Hamilton, Ind., have emerged as voices of caution.

After an exhaustive 2½-hour White House meeting with a group of about 20 senior lawmakers April 27, Republicans and Democrats said they were equally impressed with the president's willingness to hear them out.

But if Clinton, a new president lacking in foreign policy experience, was hoping for a consensus from Congress, he was to be disappointed. After quickly ruling out any deployment of ground forces — an option the president also has vetoed — the lawmakers disagreed on most other points.

House Misgivings

In a development that could spell trouble for the administration, House leaders on both sides of the aisle have expressed misgivings about airstrikes. That has led some Democrats to predict that the House could reject a resolution authorizing such a course.

"I think that is a loser," said Robert G. Torricelli, N.J., a member of the House Foreign Affairs Committee who opposes any U.S. military involvement in the former Yugoslavia. He warned that the administration "should know that there are limits to partisan loyalty."

But other lawmakers believe that if Clinton were to throw the full weight of his office behind U.S.-led airstrikes, he would build support in Congress and among a skeptical public. They emphasized the traditional instinct to rally around the president when U.S. forces are at risk.

"I can remember only a very few times when a president of the United States, going to the Congress on a national security issue, has been defeated," Hamilton said April 28 on the

By Carroll J. Doherty

412

Debating Bosnia

Feinstein

"We have watched while the annihilation of a people goes on and on and on. And we have done little to stop it. ... It is time to end the shelling by taking aim at the gun and mortar emplacements."

Sen. Dianne Feinstein, D-Calif., April 22

"There's an old saying in the artillery: No matter how well the gun is aimed, if the recoil's going to kill the gun crew, don't fire. Watch that over there because you've got a lot of people around here who haven't figured any recoil at all."

Sen. Ernest F. Hollings, D-S.C., April 27

"Even if the administration thinks it best to proceed with airstrikes, it is by definition the wrong policy because of the lack of unity. If anybody should understand the importance of maintaining the public support for a policy, it should be the first president of the Vietnam generation."

Rep. Robert G. Torricelli, D-N.J., April 28

Hamilton

"The Serbs ... are a very proud people, who for hundreds of years have taken great pride in resisting the Germans and the Russians and the Austrians and many, many other people. I doubt very much if a few airstrikes are going to make them suddenly capitulate and turn around. My guess is their reaction to airstrikes will be to be even more aggressive, and that will raise the level of killing."

Rep. Lee H. Hamilton, D-Ind., April 28, on PBS

Thurmond

"I've been in the Senate 39 years. During my entire lifetime, I have never seen a situation — anywhere, anytime — that is like what is going on in former Yugoslavia. ... They are raping women, raping little girls under 10 years old, robbing and killing without any justification. Is the civilized world going to stand by and do nothing?"

Sen. Strom Thurmond, R-S.C., April 28

"I'm not ready to risk another Vietnam situation."

Sen. John McCain, R-Ariz., April 28 on NBC

"My heart is with Strom, but my head is with McCain."

Sen. Phil Gramm, R-Texas, April 28

"I will decide what I think the right thing to do is and then see if I can persuade the Congress and the allies to go along."

President Clinton, April 28

"MacNeil/Lehrer NewsHour."

Some supporters of airstrikes argue that the president will face little significant opposition if he carefully limits the scope of the mission to calm fears of an open-ended intervention. Clinton's "strong pitch should be that it's limited," said Rep. Barney Frank, D-Mass.

The chairman of the Senate Intelligence Committee, Dennis DeConcini, D-Ariz., introduced a resolution calling on the administration to take immediate steps with U.S. allies to neutralize Serb artillery, "including through the use of military air force."

The resolution also urges that the U.N. arms embargo be lifted, a step that appears to have broad support in Congress.

A diverse group of lawmakers — including Rep. Richard J. Durbin, D-Ill., and Sen. John W. Warner, R-Va. — have urged the president to seek congressional authorization for any military action in Bosnia. Durbin rounded up signatures from 91 House members for a letter making that case. But lawmakers appeared uncertain as to whether Clinton needed to obtain authorization before beginning any intervention.

In advance of a decision by Clinton, the rising congressional opposition to airstrikes stemmed partly from pessimistic assessments in the Pentagon. A panel of senior military officers told the Senate Armed Services Committee on April 28 that multilateral attacks — without the deployment of large-scale ground forces — could not halt the Serb advance.

"My gut instinct is that in the larger sense there is no military solution to this," said Lt. Gen. Barry McCaffrey. The officers also warned that Serbian gunners would respond to air attacks by moving artillery pieces to populated areas, raising the possibility that U.S. bombing could cause civilian casualties.

Like Congress, however, the Pentagon appeared divided. Gen. Merrill A. McPeak, the Air Force chief of staff, insisted that Serb positions could be effectively attacked with very little risk to U.S. pilots.

With little else to go on, even lawmakers not closely allied with the Pentagon said the military's judgment could prove crucial. "I'm looking for the military stamp of approval for whatever policy we come up with," Durbin said.

Scattered Views

It is not merely that some Cold War hawks have become doves, and vice versa. Rather, the foreign policy alignments that endured largely intact from the Vietnam War through the Persian Gulf War have been shattered:

- **Born-Again Hawks.** Much has been made of the evolution of traditional foreign policy liberals, such as Sen. Joseph R. Biden Jr., D-Del., into determined advocates for military action in Bosnia.

John McCain, R-Ariz., who has led Senate opposition to military intervention, recently seized on Biden's past opposition to using force to undercut his arguments in favor of airstrikes. "I hope Sen. Biden isn't listening to the same people he listened to when he opposed the action in the

413

Persian Gulf," McCain said in a mini-debate with the Democrat on the "CBS Evening News."

But liberal senators such as Carl Levin, D-Mich., and Paul Wellstone, D-Minn, were joined by Thurmond and other conservatives in signing a letter urging airstrikes.

• **Cautious Veterans.** Opposition to airstrikes and other military action has come largely from pro-Pentagon lawmakers, many of whom fought in the Vietnam War. McCain — one of the nation's most-famous prisoners of war from the Vietnam era — has said he is unwilling to "risk another Vietnam" in the Balkans.

"The hangover from Vietnam is still there," Hyde said. "It'll be 10 more years before it's not a force in people's thinking."

Yet veterans from Vietnam, such as Charles S. Robb, D-Va., and from earlier wars, such as Senate Minority Leader Bob Dole, R-Kan., have supported airstrikes.

• **Desert Storm Opponents.** Senate Majority Leader George J. Mitchell of Maine, Biden and other Democrats had urged former President George Bush to hold off on attacking Iraq to allow stiff international economic sanctions more time to work.

Now, many of those same Democrats believe that it is too late for sanctions to be effective in pressuring Serbs to agree to peace terms.

The cautious Hamilton, who backed a sanctions strategy against Iraq, has been consistent in urging a similar reliance on economic sanctions against Serbia. That has put him at odds with Biden, with whom he has clashed publicly.

• **Foreign Policy Pragmatists.** Some of the most influential voices on foreign policy for the past generation — including former secretaries of State Henry A. Kissinger and Lawrence S. Eagleburger — have issued dire warnings against becoming mired in the Balkans.

But Sen. Richard G. Lugar, R-Ind., who generally shares Eagleburger's pragmatic view of foreign policy, has been one of the few lawmakers to urge the deployment of ground forces to Bosnia. Lugar argues that if Belgrade's drive to create a "greater Serbia" is not stopped in Bosnia, the entire region will become engulfed in war.

"Without stopping the music at this point," Lugar said, "the United States and its allies are fated in my judgment to face difficulties that are very severe down the trail." ■

LATIN AMERICA

Remarks of Treasury Secretary Lloyd Bentsen, Council of the Americas, Washington, DC, May 3, 1993, Treasury News, U.S. Department of the Treasury, May 3, 1993.

"Forging a True Partnership of the Americas," Address of Deputy Secretary of State Wharton before the Council of the Americas on behalf of Secretary Christopher, Washington, DC, May 3, 1993, U.S. Department of State Dispatch, U.S. Department of State, May 3, 1993.

"Prosperity, Democracy, and Security: Pillars of U.S. Foreign Policy," Excerpts from the confirmation hearing statement of Alexander F. Watson for Assistant Secretary of State for Inter-American Affairs, before the Committee on Foreign Relations, U.S. Senate, Washington, DC, May 5, 1993, Washington Report, Council of the Americas, Summer 1993.

"U.S. Commitment to Democracy in Guatemala," Statement of Department Spokesman Richard Boucher, Washington, DC, May 27, 1993, U.S. Department of State Dispatch, U.S. Department of State, June 7, 1993.

"Guatemala," Statement by Secretary of State Warren Christopher before the Organization of American States (OAS) Foreign Ministers' Meeting on Guatemala, Washington, DC, June 3, 1993, U.S. Department of State Dispatch, U.S. Department of State, June 7, 1993.

"Guatemala," Address by Deputy Secretary Wharton to the OAS Foreign Ministers' Meeting on Guatemala, Managua, Nicaragua, June 6, 1993, U.S. Department of State Dispatch, U.S. Department of State, June 7, 1993.

"U.S. Investors Discover that Chile Has a lot to Offer," LA/C Business Bulletin, U.S. Department of Commerce and the U.S. Agency for International Development (USAID), February/March 1993.

A Budgetary and Economic Analysis of the North American Free Trade Agreement (Summary), Congressional Budget Office, 1993.

"Window of Opportunity," NACLA: Report on the Americas, North American Congress on Latin America, May 1993.

Burbach, Roger. "Clinton's Latin America Policy: A Look at Things to Come," NACLA: Report on the Americas, North American Congress on Latin America, May 1993.

"IDB President Calls Completion of Economic Reform Region's Major Priority," Inter-American Development Bank (IDB), March 31, 1993.

"Latin American Integration: Experiences of the 1980s and Outlook for the 1990s," The Latin American Integration Process in 1988/1989/1990, Inter-American Development Bank (IDB) and the Institute for Latin American Integration (INTAL), 1992.

Eberlei, Walter. "Latin America's Debt Burden: A Never-Ending Crisis?" Ways Out of the Debt Crisis, A Study by the Foundation Development and Peace and the Institute for Development and Peace, 1993.

Fiszbein, Ariel, Haeduck Lee, Samuel Morley, George Psacharopoulos, and Bill Wood. "Poverty and Income Distribution in Latin America: The Story of the 1980s" (Executive Summary), Latin America and the Caribbean Technical Department, The World Bank, December 1992.

"Agencies Develop Platform on Advocacy for Haiti," Monday Developments, InterAction, May 31, 1993.

TREASURY NEWS
Department of the Treasury Washington, D.C. Telephone 202-622-2960

Text as Prepared for Delivery
Adv. for 1 p.m. EDT
May 3, 1993

REMARKS OF TREASURY SECRETARY LLOYD BENTSEN
COUNCIL OF THE AMERICAS
WASHINGTON, D.C.

I recall talking with the Council up on Capitol Hill about this time two years ago. At the time we were discussing fast track authority, the Enterprise for the Americas program, and the GATT and NAFTA negotiations.

I've changed jobs since then, but those are still my concerns. And so is the pace of domestic and international growth.

I'd like to talk about my new concerns, but first I'd like emphasize our commitment to a solid partnership with our neighbors in the hemisphere. The Enterprise for the Americas Initiative is a bipartisan effort to focus on trade, investment, debt and the environment.

If you followed my testimony on Capital Hill, you know that the Clinton Administration has asked Congress for additional money for debt relief and the Multilateral Investment Fund. We intend to continue and build on these efforts to improve the quality of life for all our people through hemispheric growth.

All our nations are now so closely tied together economically, that nothing any one nation does truly happens in a vacuum. That's particularly true for an economy as large as ours. For example, our interest rate decline will shave $2 billion a year off debt service for Latin America. And when we grow, it affects the growth of the rest of the world, particularly that of our closest neighbors.

In dealing with growth in a global sense, we must look at more than just our own economy. We just concluded an important series of meetings of the G-7 finance ministers, and the committees of the World Bank and the IMF. We talked extensively about how we can encourage international economic growth. Some encouraging steps have been taken toward getting all economies to grow and prosper.

LB-153

For instance, the United States and Canada are working to get our deficits down and increase investment and savings. Interest rates are coming down in Europe. And Japan has announced a stimulus aimed at improving domestic demand and reducing external imbalances.

We're seeing some progress in our efforts. But we cannot rest. We must do more to create growth and jobs.

I'm sure you saw the World Bank forecast that said our economy -- the U.S. economy -- is going to help lead world growth this year and next. That report said world growth itself is going to be lackluster, about 2.2 percent.

The fact that our economy is likely to grow faster than the global economy underscores the importance of our aggressive effort in this country to break free of recession. Let me just remind you that we calculate that a decline in first quarter exports shaved almost a full point off our first quarter GDP figure. That sort of figure only magnifies the argument that we have a large stake in faster economic growth elsewhere.

These growth figures also remind us that NAFTA -- and the jobs and stronger growth it can bring -- is important, particularly for the long term outlook for our region.

Now, grant you, it'd be a challange to get it passed now before we get the supplemental agreements finished. I wrote an article last August about NAFTA. I said then that we had concerns about labor and environmental issues. These are issues of interest to all Americans. Now those concerns are being met. We're improving NAFTA. We are working for meaningful and effective supplements to the agreement on those issues.

In addition, we're getting our message to the Hill on the benefits of NAFTA. We're explaining how it fits in our strategy of improving our competitiveness. We're explaining how it will create more net jobs.

True, some jobs will be lost, but it's a small number in relation to our workforce. I won't minimize the personal suffering involved. But these jobs are at risk not because of NAFTA, but because of the global challenge to our competitiveness. You don't stay competitive by turning your back on competition and new markets. We're responding to a changing world, and we're going to train our workers to meet that challenge.

I think once Congress understands how we're making NAFTA better, they'll agree it should be approved. This is an important agreement. It's important to our national interests. It is important to Canada, and to Mexico. It's important over the long run to every nation in the hemisphere because of the growth it can help generate.

I stongly support NAFTA, and we're working hard to have it adopted this year.

I also want to see NAFTA approved because of the importance of trade to our entire region. Let's examine some of those numbers, because there's so much focus on our trade with Japan that the business we do with one another in this hemisphere tends to be obscured.

If you look at just Latin America and the Caribbean, our exports to these areas went up from $43 billion in 1987 to more than $75 billion last year. That's real growth, and it means jobs for Americans. And last year we exported about 1.5 times more to Latin America than we did to Japan.

Look at the trade relationship we have with Canada. The Canadians are our largest trading partner. Last year, we exported over $100 billion in goods and services to Canada. In turn, we bought $100 billion of Canadian goods. Canadian exports to the United States account for nearly one quarter of Canada's GDP. Free trade, obviously, is a good deal for everyone.

I also want to see NAFTA up and running by the first of the year because we have in President Salinas a man who has done some remarkable things. He has shown political courage in opening the Mexican economy to foreign trade and investment. He's lowered tariffs -- substantially -- but there is no guarantee that whoever succeeds him will have the same idea.

You know, we once had a trade deficit with Mexico, but now we have a substantial surplus, a $5 billion surplus. We sold them over $40 billion dollars of goods last year. That's up from $15 billion in 1987. Many people lose sight of the fact that Mexico is our third-largest trading partner. They buy more from us on a per capita basis than the more affluent Europeans.

The importance of NAFTA as a vehicle for growth is also reinforced by the fact that we've just come out of the decade of debt in the region, and we're putting it behind us. We can already see substantial progress.

Let me give you an example. Many of the largest debtors in the region have moved beyond that problem and now face the challenge of properly managing a new influx of capital. The dramatic inflow of capital we see now has been in response to the very encouraging steps many nations have taken -- countries like Mexico, Chile, Argentina and others. This capital can support projects that will create jobs, improve productivity, and assist regional growth.

Obviously, I think NAFTA's a good idea. We have an excellent opportunity to make a contribution to our region and to its growth with this agreement.

If you look around the Americas, free trade agreements are breaking out all over. Nations are adopting free trade agreements, or expanding on them. One of the problems we have seen in Latin America has been too little trade amongst one another. Free trade agreements help with that, and contribute to the growth we all want.

Let me give you an example. One Latin finance minister told me the other day that before his nation and another reached a trade agreement, there were 7 flights a week between the two capitals. Today, a year later, there are five or six times as many flights. The lesson there is obvious.

Now, I also want to discuss growth on a larger scale. Just as we in the Americas are linked economically, the United States is similarly linked to the rest of the world's economies. What we do to improve our economy can affect others.

That World Bank report suggesting rather unimpressive growth overall pegged our growth in the United States at about 3.2 percent. Our internal forecast is about the same, 3.1 percent. A rate like that will let us start chipping away at unemployment by creating new jobs faster than our labor force grows.

Our last quarterly growth figure was poor, but my feeling is our economy is stronger than what the 1.8 percent figure suggests. I believe our March storm had something to do with it. The number that came out last Thursday is a winter pothole in our road to recovery, but it's not going to give us a flat.

Our economic plan is an aggressive effort to deal with our deficit, and at the same time make the kinds of investments in our infrastructure and citizens that will pay us dividends for years to come. Simultaneously, we will also be encouraging the kind of investments by the private sector that produce growth for our economy, and a more competitive, profitable economy.

The reason we're doing this is because we want to change the status quo. Twice before we've seen our economy coming out of recession. The previous administration in all sincerity decided to stick with the status quo. They believed the recession was over. But they went 0 for 2. We drafted our plan to make certain we don't go 0 for 3.

I think the economic signs we've been seeing these past few months just reinforce our decision to start taking these long term steps to make major changes in our economic direction. It's not something that's going to happen overnight. You can't turn the U.S. economy on a dime. I think most Americans understand that it will take time to have a lasting impact on our economy. The important point here is that we're taking action to change the status quo.

We've convinced Congress to pass the Budget Resolution in record time up on Capitol Hill. It has put us on the path toward nearly $500 billion dollars in deficit reduction. That's the largest deficit reduction package ever advanced. We sent a full budget to Congress this year, something that's unheard of for a new administration.

We have proposed 200 specific budget cuts for Congress. They affect every department and every area of government. We've even proposed making cuts in entitlement programs, what I like to call the third rail in American politics.

We have a very fair revenue package. It includes provisions to ensure that we collect what is due from foreign-owned enterprises doing business in the United States. It is only fair that if we ask our citizens and corporations to pay additional taxes, that we make absolutely certain we have international compliance reforms.

It's an ambitious plan, but one we think will bring long term change to the American economy.

Change is a topic that has been getting a lot of comment these past few days. People ask what change the Clinton Administration has managed to effect in its first 100 days in office?

We have some major accompishments.

Long-term interest rates are down substantially. Rates came down by about a full percentage point by mid-April. They're back up a bit now, but fluctuations are normal, and the bottom line is rates are down and saving all of us money. Consumers are saving. Businesses are saving. And our government is saving billions.

Our deficit reduction plan has cleared its first hurdle, and our budget proposals are on the table on Capitol Hill. This is the earliest in my memory that Congress has passed a budget resolution. It used to be that budgets were dead on arrival when they got to the hill, or that a majority of Republicans voted against a Republican president's budget. That's not the case now.

We've taken steps to eliminate the credit crunch. That will lead to increased access to credit for the small and medium-sized businesses that are going to be creating the jobs in our economy.

Our willingness to advance a realistic economic program has strengthened our leadership in the international economic arena. We now talk about balance sheets, not the balance of power, at our international meetings.

And the other thing we've accomplished is we've changed attitudes in Washington. There is now an acceptance that change will come, that the status quo will not continue. People accept that there will be health care reform, and they see Democrats cutting the deficit, and cutting, and cutting. Now that's a change.

This is a new administration, with an agenda for change, and we're making it happen.

Thank you very much.

* * *

Forging a True Partnership Of the Americas

Deputy Secretary Wharton

Address before the Council of the Americas on behalf of Secretary Christopher, Washington, DC, May 3, 1993

It is a pleasure to have the opportunity to speak to you today. First, allow me to express Secretary Christopher's disappointment that he could not be here. He had wanted to speak to you personally and assure you that the US partnership with Latin America and the Caribbean is among this Administration's highest foreign policy priorities. I am delivering the Secretary's speech, and he asked me to be sure you understand that these are his words.

But before I read the Secretary's speech, let me first make a personal comment. Upon graduation from SAIS in 1948, I joined the late Nelson A. Rockefeller, David's brother, in Nelson's Latin American activities. This led to a 22-year career in foreign economic development with the Rockefeller family's philanthropic interests. Therefore, I am especially pleased to be here to compliment my good friend David Rockefeller.

David, I want to pay a personal tribute to you for your lifelong leadership and dedication to improving relations among the nations of the Americas. No one exemplifies our country's commitment to the region better than you.

On behalf of the Secretary, I would like to begin by expressing appreciation to you and to John Avery, George Landau, and all the members of the council for the very important work you have done over the years.

The council has rendered an invaluable service to our country. You have promoted greater communication and understanding among leaders throughout the Americas. And you have educated our citizens about what all of us have at stake in inter-American cooperation.

Members of the council have contributed significantly to the new growth spurred by open markets and free trade. You have long understood the link between political and economic freedom and the importance to both of the rule of law.

Those are the values which must guide US policy toward Latin America and the Caribbean. Let me state in unmistakable terms: Our marching orders from the President are to engage with Latin America and the Caribbean to strengthen democracy and expand prosperity for all our citizens to share.

Too often in our history, we have turned our attention to Latin America in times of crisis, and we have turned our back when the crisis passes. That is short-sighted and self-defeating. This Administration will not make that mistake.

President Clinton is committed to forging a true partnership of the Americas—a Western Hemisphere community of democracies—to strengthen democratic institutions, to defend human rights, to fight for social justice, to support economic reform and free markets, and to protect the environment. And let there be no doubt: We will build a hemisphere of free trade.

Our interests in the hemisphere are mutual, and the benefits flow both ways. When our neighbors prosper, they buy our exports and our job base grows. When democracy is strong in the Americas, together we are able to address the problems we face and seize the opportunities we share.

Change in Latin America today often comes from inspired leaders: from men like Presidents Salinas and Menem, who have led the most dramatic economic reforms their societies have ever seen, and President Aylwin, who is promoting economic growth and fighting poverty. Change also comes from the work of the Salvadorans and Nicaraguans in all walks of life who are working to reconcile their people and rebuild their countries. It comes from voters, political activists, and election workers who have placed their faith in electoral processes and made them work. And it comes from entrepreneurs, whether street vendors or major investors, who are taking risks, creating new jobs, and lifting people's lives.

This is the generation in Latin America which established democracy as the only form of government acceptable to the people. Now, this generation must show that democracy will attack the daunting problems which remain: that it will stop political violence and safeguard human rights; that it will assure efficient and accountable forms of government; that it will reduce poverty and glaring inequalities of income; that it will address population growth and protect the environment. Indeed, our common challenge in every part of the hemisphere is achieving economic prosperity while advancing social equity.

President Clinton and Vice President Gore are leaders of this new generation. Under their leadership, the United States is committed to working with our neighbors in the Americas to achieve these vital goals. Our task throughout the Americas is to make democracy work for ordinary citizens every day, not just on election day. And that job begins with economic policies that put people first here at home and throughout the hemisphere.

There is no longer a distinction between sound domestic and sound international economic policies. President Clinton's budget proposals are a more serious and comprehensive program to cut the deficit than anything Washington has seen in a long time, and they deserve your support. Already, the reduction in long-term interest rates that has taken place in response to those proposals has saved billions for American businesses, consumers, and homeowners. And that same reduction will save Latin America

$2 billion in debt service in the course of a year. The more the President's program works, the more it will benefit our economy and those of our trading partners to the south.

Our international economic policy is designed to expand global trade and prosperity, enlarge export opportunities for our businesses, and create jobs for our workers, as the President said in his American University address in February. We will work to eliminate trade barriers, ensure fair competition for our businesses, and spur growth and prosperity abroad. The jobs of over 7 million of our workers—and 1 acre in 3 planted by our farmers—depend on exports abroad. For their sake, as the President has said, "we must compete, not retreat" in this hemisphere and around the world.

Today, the Americas are vital to our international economic strategy. No region in the world is doing more to liberalize trade with us, and no region is better suited to join us in economic partnership than Latin America. The hemisphere is growing again. In nearly every country, hyperinflation has been tamed. New private capital is pouring into the region, modernizing former state enterprises and trading in some of the world's newest and most dynamic stock markets. Seventy-five percent of the new investment capital flowing into the developing world today is going to Latin America. In country after country, the emergence of a new middle class, with growing purchasing power, is creating new markets for exporters of US goods and services.

In fact, with Mexico modernizing, with Chile growing at 9%, with Argentina enjoying a sound currency and high levels of investment, with Colombia preparing to develop the world's largest new oil field, it is time to start talking about Latin American tigers.

Last year, our worldwide exports grew by 6%. In Latin America and the Caribbean, our exports grew by 17%—and there we had a surplus. Our market share is five times greater than that of Japan and growing every year. US exports to this hemisphere have more than doubled in the past 5 years. This has created nearly 800,000 American jobs at higher than average wages. And each additional percentage point of growth in Latin America generates $5 billion in new US exports and over 100,000 new American jobs. Clearly, what is good for the economies of this hemisphere is good for the United States.

Moreover, Latin America is opening its markets to US exports. This is a region where we face relatively little entrenched resistance to open markets or lower tariffs. Instead, for the most part, we are blessed with good, open, and fair trading partners in Latin America. And as we move forward, we want to make sure that the smaller countries of the region, especially in the Caribbean and Central America, benefit as well.

In the last decade, economic reformers in Latin America cut their tariffs dramatically and unilaterally. Maximum tariffs ran well above 200% in the 1970s and 1980s. Today, most countries are committed to lowering maximum rates to 20%. Our Latin trading partners lowered their barriers because they recognize that this is the way to raise their economies to competitive, prosperous positions in the global economy.

The countries that have gone farthest in trade liberalization, like Chile, have seen the largest growth, the greatest increase in real wages for their citizens, and the biggest reduction in poverty. We are committed to build on that progress and expand trading opportunities throughout the Americas.

This is what we envision: a community of Western Hemisphere countries linked by open markets and democratic values. A North American Free Trade Agreement is central to that vision. For over half a century, every American President—Democratic and Republican alike—has stood for closer economic cooperation and for more open trade through the hemisphere, beginning with Mexico. Now the leaders and people of Mexico are embracing historic reform—economic and political—to open their country to the global economy.

Through a North American Free Trade Agreement, the United States and Canada have a once-in-a-generation chance to open up a new frontier of trade with our neighbor to the south. And we have a chance to make North American free trade—and cooperation on labor and environmental standards—a model for the rest of the hemisphere and the world.

Mexico is our nation's fastest-growing export market. The economic growth of Mexico—the nation with which we share the longest land border in the world between a developed and a developing nation—is good for our nation's prosperity and good for our security.

Let me state clearly: A North American Free Trade Agreement is in the overriding economic and foreign policy interest of the United States of America. On behalf of the President, I also want to assure you that once parallel agreements to strengthen protections for the environment and workers are completed, we will seek—and I am confident that we will win—congressional approval of NAFTA so that it can take effect next year.

President Clinton also intends to build upon NAFTA to expand free trade further south. As the President recently reaffirmed, after NAFTA we are committed to enter negotiations with Chile. Ambassador Kantor will also seek to negotiate with other democratic countries in this hemisphere committed to free market policies.

Our global trading partners should know that we see free trade in the Americas as a building block for a freer world trading system. This hemisphere is united in the desire to achieve a successful Uruguay Round agreement by the end of this year. And I would note that the United States stands today with the entire region, through the OAS, in calling for greater access for our agricultural products to markets in Europe and Japan.

We will continue to urge countries to bring their investment laws and intellectual property protections up to world standards so that these protections apply to domestic and international investors alike. This is not just a North American agenda. Strong patent protections and sound investment regimes are the magnets

421

that will lure new investment and growth to this hemisphere. This Administration will support and co ribute to the Multilateral Investment Fund at the Inter-American Development Bank. We will also continue to reduce our neighbors' official debt to the United States through an initiative that dedicates those savings to environmental and child health programs.

This region's free-market reforms—like those elsewhere around the world—are creating more than jobs and growth. They are also creating new middle classes and, in that way, unleashing new political forces and invigorating democracy. For our part, we seek to promote prosperity, equity, and liberty in the Americas in every aspect of our foreign policy.

Throughout the hemisphere, as we are witnessing this week in Paraguay, democratic elections have become the only legitimate means for transferring political power. And the Organization of American States, like no other international body, has taken on a formal collective responsibility to defend the right of all Americans to be governed by the representatives they freely elect. The OAS remains the premier forum in the Americas for dialogue and inter-American cooperation. Under this Administration, the United States will be a full and true partner—and one that pays its dues.

In Central America, we applaud and support the courage and vision of Salvadorans and Nicaraguans struggling to bind up the wounds of war through national reconciliation, establish civilian authority over police and military institutions, defend human rights, and promote economic development. I am encouraged by signs of progress in the peace talks in Guatemala. The United States urges all sides in those negotiations to seize what we believe is a historic opportunity to forge a permanent, just, and lasting peace.

Human rights is the core of our foreign policy. The United States will direct its aid and influence in every way possible to enable the nations of this hemisphere to advance human rights and strengthen the democratic institutions which promote the rule of law.

First, we will support, through our foreign assistance, the development of civil society. In the past 2 decades, this hemisphere has seen an explosive growth in the number of private organizations such as labor unions, political parties, community and charity organizations, legal aid and civil liberties groups. These non-governmental groups are vital to genuine democracy because they represent and enfranchise citizens at the grass roots. And they are vigilant defenders of democracy and human rights.

We want to work with governments to strengthen key public institutions and the administration of justice. We want to share our experience to help democratic governments to fight corruption and other abuses of power. Corruption is a cancer that will destroy democracy—and investment opportunities—if it is not eradicated.

We will work in partnership with the governments of this region to fight narco-traffickers, whose corruption and violence threaten the survival of democratic institutions. We will work with the OAS to create a common legal framework for action. Let no one doubt our resolve to reduce drug consumption, to enforce our laws, and to help our democratic neighbors defeat the drug-traffickers.

The end of the Cold War and the disappearance of traditional adversaries is recasting the role of the military around the world. We will encourage countries to reduce the level of armaments and prevent costly competition in conventional weaponry. We support the efforts of Latin nations to establish firm civilian authority over the armed forces. And we will cooperate with civilian leaders in this hemisphere to help them enlist their armed forces in international peace-keeping efforts, as they are doing from Croatia to Cambodia, from El Salvador to Mozambique.

Great strides have been made, especially in the countries of the Southern Cone, to control the proliferation of weapons of mass destruction. I believe the day is near when this hemisphere will ban the spread of nuclear, chemical, and biological weapons for all time. And we strongly support that goal.

In our Western Hemisphere community of democracies, there is also an important place for the democracies of the Caribbean Basin. There is no better model of democratic institutions and fierce commitment to human rights and the rule of law than in these nations. We applaud CARICOM's continued positive role in defense of democracy in Haiti.

The people of Haiti have had their electoral mandate thwarted by an illegal regime. President Clinton has made clear that the current situation is unacceptable to us and to the international community. Let no one doubt our position or our resolve. President Clinton is committed to the prompt return of constitutional government and President Aristide. The forces resisting democracy should understand that they cannot—and will not—prevail against the will of the international community. The winds of democracy cannot be resisted.

We are working very closely with Dante Caputo, the special envoy of the United Nations and the OAS, in his effort to negotiate a political settlement. Mr. Caputo's efforts for democracy and peace have been tireless. We are all in his debt. We call on all Haitians to work constructively with Mr. Caputo to speed the day when democracy can be restored. Then the international community will work as never before to develop Haiti's economy, protect human rights, and bolster the institutions vital to a democratic society.

As for Cuba, despite what the people of that nation have been told, the United States poses no military threat to their island. The people of Cuba believe in the revolutionary idea that they have the right to live in freedom. This free hemisphere and the free world support them in their aspirations.

We hope the Cuban people will win their freedom through the kind of peaceful transition which has brought so many other nations into the democratic community. We oppose attempts to bring change through violence. But our policy—through the Cuban Democracy Act—is to refuse support for the Castro dictatorship while opening a door to a democratic Cuba to rejoin the inter-American community. Soon the time will come when the Cuban

Government can no longer defy political gravity and deny basic guarantees of liberty for the Cuban people.

In conclusion, let me thank you again for all the work you are doing to contribute to the shared prosperity of this hemisphere. Never before in our lifetimes has there been such a convergence of values and goals among all the people of the Americas—North, Central, and South—and the Caribbean Basin. Never has the potential for cooperation and progress been so great.

At the dawn of the 21st century, only 7 years from now, I believe we will be a hemisphere of solidly democratic nations—from the Arctic Circle to Argentina, two continents where liberty is inscribed into law; where human rights are rigorously defended and the dignity of all citizens is respected; where free trade and the free flow of ideas enrich the people of every nation.

Together we are putting the foundations in place. This President and this Secretary of State will work with you to realize that vision. ■

PROSPERITY, DEMOCRACY AND SECURITY: PILLARS OF U.S. FOREIGN POLICY

Alexander F. Watson

Assistant Secretary for Inter-American Affairs
Department of State

There follow excerpts from the confirmation hearing statement before the Committee on Foreign Relations, United States Senate, Washington, D.C., May 5, 1993

I am honored to be nominated by President Clinton to serve as Assistant Secretary of State for Inter-American Affairs.

I am particularly fortunate to be nominated for this post at this historical juncture when, as Secretary Christopher has said, there is an unprecedented convergence of goals and values among all the people of the Americas. We have an opportunity to work together with our neighbors in this hemisphere, inspired by common values, to strengthen relations and achieve a wide range of benefits for all our peoples.

Fortunately, representative democracy is now the norm in this region. But elections alone do not guarantee that all citizens are fully enfranchised, have recourse to fair and effective systems of justice, or have a government capable of meeting needs and guaranteeing basic rights.

By the same token, the countries of the region are recognizing the enormous potential of liberal, market economics to generate economic growth, investment and employment. But sound macroeconomic polices alone do not guarantee that a society will work effectively to lift people out of poverty, or to create equal opportunity for all citizens. I believe the United States should cooperate in efforts to extend the benefits of democracy and sustainable economic growth as broadly and as deeply as possible in this hemisphere, as President Clinton intends to do at home.

President Clinton and Secretary Christopher have made a clear decision to engage actively on the full range of issues confronting the Americas.

I would like to discuss these issues briefly, making reference to the three pillars of President Clinton's foreign policy: building American prosperity, promoting democracy and defending American security.

Building North American Prosperity

First, economics. This is the area where a strong relationship with Latin America and the Caribbean offers the clearest, most tangible mutual benefits.

Latin and Caribbean reformers are adopting market-oriented economic policies, and their economies are growing as a result. In 1991 and 1992, for the first time in a decade, the region's economic growth outpaced population growth.

These governments' unilateral moves to drop trade barriers and cut tariffs has led to a boom in regional trade. This hemisphere has become our fastest growing export market.

President Clinton is committed to working with the Congress to achieve approval of the North American Free Trade Agreement (NAFTA), and to seeing it enter into force on January 1, 1994.

The President has also made special mention of this hemisphere as a region where we will work, after the NAFTA is completed, to reach further agreements with democratic countries which are succeeding at economic reform.

The Enterprise for the Americas Initiative, launched in 1990 with bipartisan support, provides a solid policy foundation to expand trade and investment, and to alleviate debt burdens in the hemisphere. Its essential elements are continuing in this Administration.

Strengthening Democracy

President Clinton's second foreign policy pillar — strengthening democracy — is of vital importance.

Strengthening democracy means first and foremost bolstering the public and private institutions which defend human rights, engage citizens in the political process, and promote justice and social equity. If confirmed, I would use our foreign assistance, working with public and private organizations throughout this hemisphere, to strengthen these vital institutions.

I know first-hand from my experience in the Andean region that one of the most dangerous threats to democracy and free societies is narcotics trafficking. I have seen the courage and the sacrifice with which many of our neighbors are confronting this threat, despite resources that are even scarcer than ours. Their losses have been great. Their victories have benefitted us as well as themselves. I look forward to examining with our partners in the hemisphere the ways we can cooperate which will most likely lead to further success in this terrible struggle.

I would also work with our neighbors to promote good governance. Misapplication of funds or simple corruption is corrosive to public trust, undermines democratic institutions, subverts governments' efforts to serve their citizens, and is a cruel tax paid most often by society's weakest members.

Central America remains an important focus of U.S. foreign policy. The people of El Salvador and Nicaragua have ended their civil wars and are making extraordinary efforts to heal their societies, rebuild their economies and strengthen their democratic systems. In Guatemala, good progress is being made in negotiations to end the last military conflict in Central America. I believe we have a strong interest in exercising leadership and providing assistance to help Central Americans consolidate a democratic peace and pursue a brighter future.

Enhancing American Security

Modernizing our armed forces and enhancing American security is a third pillar of President Clinton's foreign policy.

In this hemisphere, with the Cold War ended, with the spread of democracy and the waning of guerrilla movements once sponsored by Cuba, the issue of regional security has been transformed.

One of the most hopeful developments of recent years has been the action taken by Brazil, Argentina and Chile to control the spread of weapons of mass destruction.

I would also search for opportunities to contribute to the solution of lingering border disputes, and to foster understandings to restrain the buildup of conventional weapons.

In my 31 years in the Foreign Service, I have served 16 years in Latin America and five more working on Latin American affairs in the State Department.

Prior Experience

Yet I have also had opportunities to step back from Latin America and the Caribbean — in the Bureau of Economic and Business Affairs and at our mission to the United Nations — where I could view inter-American affairs in a broader policy perspective.

I value my economic experience, given the high priority of economic issues in the affairs of this region. If confirmed, I would make economic and business affairs a key priority of our personnel in Washington and in the field. I want the American business community to see the State Department and each of our Embassies as working partners in the search for new export opportunities.

In my service as the U.S. Deputy Representative to the United Nations the last three years, I gained an appreciation of the opportunities offered by strong multilateral organizations. In our hemisphere, the Organization of American States (OAS) is today working constructively in a wide range of areas beneficial to our interests. I would welcome the chance to work closely with Ambassador Babbitt to strengthen the OAS for the benefit of all its members.

I would also place a high priority on consulting frequently with the Congress and on achieving the highest possible degree of bipartisan support for our policies.

Finally, I would work to maintain a tone of partnership and mutual respect in our relations with the nations of the Americas.

I believe President Clinton has set forth a policy for this hemisphere which is worthy of American values and which will serve our economic and security interests. If confirmed, I look forward to working with you and with the nations of this region to make that vision a reality.

U.S. Commitment to Democracy in Guatemala

Department Statement, Secretary Christopher, Deputy Secretary Wharton

Department Statement

Statement by Department Spokesman Richard Boucher, Washington, DC, May 27, 1993.

In response to President Serrano's suspension of Guatemala's Congress and judiciary on Tuesday and his actions yesterday against press freedom and other civil liberties, the United States is suspending assistance to Guatemala.

We condemn the suppression of press freedom in Guatemala and continuing censorship. These actions are a sign that Guatemala is on a dangerous course leading to further repression and further threats to democracy.

We urge an immediate return to constitutional government in Guatemala. We urge that this be done through legal, constitutional, and peaceful means. Guatemala only stands to lose by continuing on its present course.

Today, we are suspending the following aid programs:

- Economic support funds (cash transfers to the government);
- Military education and training programs, deployments for training, and joint military exercises;
- Police training;
- Economic development project assistance and PL 480 food aid, which is channeled through the government.

Aid for humanitarian, environmental, and other projects provided to private organizations in Guatemala will continue.

We reject President Serrano's assertion that his actions will contribute to the fight against narco-trafficking. They will only make cooperation more difficult. As a result, we are reviewing our counter-narcotics cooperation with the Government of Guatemala.

We note that trade benefits under the Generalized System of Preferences (GSP) cannot be maintained in a country where labor rights are not respected. Unless democracy is restored in Guatemala, GSP benefits are likely to be withdrawn.

We will monitor closely Guatemala's commitment to democracy and take that into account as the U.S. casts its vote on loans to Guatemala from the World Bank, the International Monetary Fund, and the Inter-American Development Bank.

Secretary Christopher

Statement before the Organization of American States (OAS) Foreign Ministers' Meeting on Guatemala, Washington, DC, June 3, 1993.

Mr. Chairman, Mr. Secretary, fellow Foreign Ministers, and friends: First, Mr. President, I want to congratulate you on your election as President of this meeting. I also want to give great credit to our Secretary General and the other distinguished members of the mission who traveled to Guatemala. They expressed our unswerving commitment, the commitment of this organization to the restoration of democracy, and I know that we are all grateful to them for doing so.

The events of this past week teach an important lesson for our hemisphere. When democracy is at risk, we must rush to its defense immediately and strongly. When we do, and when the people of the nation affected rush to its defense as well, the defenders of democracy prevail. The prompt, unequivocal, and effective condemnation by the nations of the Western Hemisphere is a strong warning signal for the future to those in the region who might seek to derail democracy.

President Serrano's actions of May 25 did not stand. They met a firm response from the people of Guatemala and from the entire inter-American community. The United States and other nations suspended bilateral assistance and placed trade relations under review; the OAS quickly called for the meeting of Foreign Ministers that we are holding today; the Presidents of Central America convened an emergency meeting in San Salvador. The people and the institutions of Guatemala spanning the political spectrum rallied to the defense of their hard-won democracy.

Now President Serrano himself has left office. Many questions remain, but we hope that Guatemala is on the path to restoring constitutional democracy.

These events would not have been possible if the inter-American community, through the OAS, had not taken an historic, unanimous decision in Santiago in June of 1991 to come collectively to democracy's defense—whenever and wherever it is threatened in our hemisphere.

Still, Mr. President, it is premature to claim victory. Events continue to unfold in Guatemala. Let there be no doubt about the resolve of the United States and the inter-American community. There must be a full and immediate restoration of constitutional democracy and basic human rights. Unless and until democracy is fully restored, Guatemala will find itself isolated.

Hence, we must remain vigilant an engaged. For the United States, there is nothing we wish to see more than th immediate restoration of constitutiona democracy through legal, peaceful, an constitutional processes. Until that occurs, Mr. President, our aid will remain suspended—and we will weigh suspension of trade preferences under the GSP system as well as the Caribbean Basin Initiative.

Our organization must remain vigilant and engaged. We urge the Inter-American Commission on Huma Rights to ask the new Guatemalan authorities for authority to travel to

426

Guatemala immediately to monitor and review the progress made in protecting human rights and restoring constitutional guarantees. The Unit for the Promotion of Democracy should also offer its cooperation.

We urge, Mr. Chairman, that the Secretary General continue to monitor Guatemala's rapid return to democracy, to return there himself, as has been proposed by Mexican Foreign Secretary Solana, and to inform the General Assembly on progress to date when it convenes next week in Nicaragua.

We urge as well that once constitutional democracy has been restored, the new Guatemalan Government should make its first priority the renewal and revitalization of the peace process. There is no step that will strengthen democracy more than negotiating an end to Guatemala's 33 years of conflict. The time has come in Guatemala not just for a return of constitutional rule, but also for the establishment of peace.

We urge the Secretary General, in consultation with the Presidents of Central America and Friends of the Peace Process, to offer their good offices to the Guatemalan parties. Their objective should be to assist and promote a rapid and successful conclusion of the peace process. There was a chance for progress in the last round that unfortunately was not seized upon by the URNG. The parties to the process will bear a heavy responsibility before the Guatemalan people and before history if they squander this new opportunity for peace.

If peace comes to Guatemala, then all of Central America can unite in working to fulfill the possibilities for expanding development and trade, strengthening democratic institutions, regional arms reduction, the return of refugees, and attention to the problems of poverty.

The OAS must renew our debate about how to strengthen the instruments available to defend democracy. We must recognize that after elections are held and power is transferred peacefully in this hemisphere, the struggle to consolidate and institutionalize democracy has only just begun. Basic institutions, like the judiciary, legislatures, law enforcement, and human rights, must be strengthened and professionalized. The armed forces must function under strict and unchallenged civilian authority. New threats to democracy, from corruption to narco-trafficking, must be met and overcome.

Mr. President, we are reminded that an extensive and complex agenda is before us. Let us seize from the developments which have prompted this meeting an opportunity to redouble hemispheric efforts to confront the broad range of problems. Let us use this opportunity to consolidate democracy.

Thank you very much, Mr. President.

Deputy Secretary Wharton

Address to the OAS Foreign Ministers' Meeting on Guatemala, Managua, Nicaragua, June 6, 1993.

Mr. Secretary General, Mr. Chairman, Ministers, friends: This is an historic moment for Guatemala, for Central America, and for the Organization of American States. The news from Guatemala could not be more heartening: The Guatemalan Congress, acting on instructions from the Court of Constitutionality, has selected a new president to serve out the term of former President Serrano. The hopes of the Guatemalan people, of this Assembly, and of the entire hemisphere are being realized—the restoration of democratic government through peaceful, legal, and constitutional means.

Let us give credit where credit is due. This is a victory first and foremost for Guatemala's democratic civic society. Civilian leaders from all sectors of Guatemala's society—political parties, labor unions, and the private sector—took a strong stand in support of constitutional governance. And they have prevailed. We congratulate as well the Guatemalan Congress which, in a display of national unity and consensus, has selected one of Guatemala's most respected public figures—a man whose name is synonymous with the protection of human rights and democracy—as Guatemala's new president. We congratulate President De Leon Carpio, and we look forward to working in friendship and respect with his new government.

This is also a defining moment for Central America. We congratulate the Presidents of Central America who, recognizing the region's stake in a peaceful and democratic outcome, acted quickly and decisively to encourage and bring about that result. In doing so, they have responded to the highest aspirations for peace and democracy enunciated at Esquipulas nearly 6 years ago.

Mr. Secretary General, my government applauds the strong and vigorous leadership you and the members of your mission have shown in this successful collective defense of democracy. Your mission to Guatemala enabled us all to work from a common understanding of what had happened and of what was at risk. Your presence in Guatemala—acting with the guidance of all the Foreign Ministers of the OAS—gave strong, visible support to the democratic forces and the institutions of Guatemala.

We congratulate you, Mr. President, for your effective leadership in chairing the important emergency meeting of Foreign Ministers last week, which acted quickly and in unity to express this hemisphere's unequivocal support for the Guatemalan people's effort to defend their democracy.

Let us be clear about what we have learned. As Secretary Christopher said last week:

> When democracy is at risk, we must rush to its defense immediately and strongly... the prompt, unequivocal, and effective condemnation by the nations of the Western Hemisphere is a strong warning signal... to those... who might seek to derail democracy.

This was the intent of the Santiago Resolution. The wisdom of that resolution is demonstrated today, but we must continue to find new tools to strengthen and guarantee that collective commitment. I hope that, as one step in that direction, every member state will move quickly to ratify the recently enacted Washington protocol.

As we look ahead let us all find ways, individually and collectively, to give the new Guatemalan Government our strong support. My own government has announced today that it is resuming the full range of our assistance and trade programs that were suspended May 25. Tomorrow, at President De Leon Carpio's invitation, I will be visiting Guatemala to reaffirm our support for democracy in that nation. We also look forward to the arrival in Guatemala of our new ambassador at a very early date. We will do all we can to help strengthen democratic institutions in Guatemala. We urge all member states, observer nations and the international financial institutions to do likewise. The OAS should offer its resources through the Unit for the Promotion of Democracy.

The restoration of constitutional government is also an opportunity. We urge the Secretary General together with the presidents of Central America and Mexico and other Friends of the Peace Process to explore with the new Guatemalan Government how they might jointly renew and reinvigorate the Guatemalan peace process. Ending the 33 years of conflict is fundamental to strengthening democracy, protecting human rights, and providing all Guatemalans with a new, more hopeful vision for their collective future.

Thank you.

Deputy Secretary Wharton

Opening statement following meeting with President De Leon, Guatemala City, Guatemala, June 8, 1993.

I have come on behalf of the Secretary of State to underscore the support of the United States for the constitutionally elected Government of Guatemala. The fact that the Guatemalan people peacefully confronted the extra-constitutional steps taken by their former leaders and successfully restored democratic government through a peaceful, legal, and constitutional process is a momentous historical achievement.

I had a warm and positive meeting with President De Leon. We reviewed the steps which he has taken to restore constitutional government, his hopes for the future of democracy in Guatemala, and the challenges ahead for all Guatemalans.

The United States strongly supports the government of President De Leon. The United States has resumed the full range of assistance programs interrupted May 25. We are urging the international community and international organizations to provide substantial support for his government.

I have just come from the General Assembly of the Organization of American States, where the Foreign Ministers met again on Guatemala. We consider it particularly important that the OAS, under the energetic leadership of Secretary General Baena Soares, has committed itself to remaining engaged in support of democracy in Guatemala.

The success of the Guatemalan people in resolving the crisis which arose May 25 represents an enormous opportunity for making progress on the large problems Guatemala faces. We welcome President De Leon's commitment to seek an early end to the 33-year-old conflict which has plagued this country. We will work with the Group of Friends of the Peace Process to support the peace process. Peace is vital to stable democratic institutions and greater respect for human rights objectives our nations share. We will cooperate with the Guatemalan Government to fight the scourge of narcotics trafficking.

Upon my return to Washington, I will report to the Secretary on the very positive democratic developments which Guatemalans have taken and on the excellent prospects for future strengthening of our bilateral relationship. ■

LA/C Business Bulletin

A Publication of the Latin America/Caribbean Business Development Center
In cooperation with the U.S. Agency for International Development

VOLUME III NO. 2 FEBRUARY/MARCH 1993

USAID

U.S. Investors Discover that Chile Has a lot to Offer

Chile's remarkable economic growth and political stability make it one of the most promising markets in Latin America. The accompanying surge in trade and enhanced attractiveness for foreign investors suggest Chile is an economic model for most developing countries. In the last two years, foreign investment inflows constituted 4 percent of Chile's gross domestic product, a rate matched by few countries in the world.

Chile's Minister of Finance, Alejandro Foxley, recently noted that the country is open to any type of initiative, including investment, that liberalizes its marketplace. Since the beginning of President Aylwin's administration in 1989, approved investment has risen to $13.9 billion, of which $5.3 billion is from the United States. Actual foreign investment put in place during 1992 exceeded $1.4 billion, a record.

In December 1992, Standard and Poor issued a "Double A" credit rating for Chilean internal debt instruments. Four months earlier, it had issued a "BBB" credit rating to Chile, making it the first in Latin America to achieve an investment grade rating in the wake of the Latin American debt crisis.

The United States and Canada currently hold 40.5 percent of all foreign investment already in place in Chile. The European Community has approximately 28 percent. In 1992, the United States, Canada, and Finland were authorized the highest amount of direct investment in Chile. The United States accounted for $320 million, Canada $1.2 billion, and Finland $600 million.

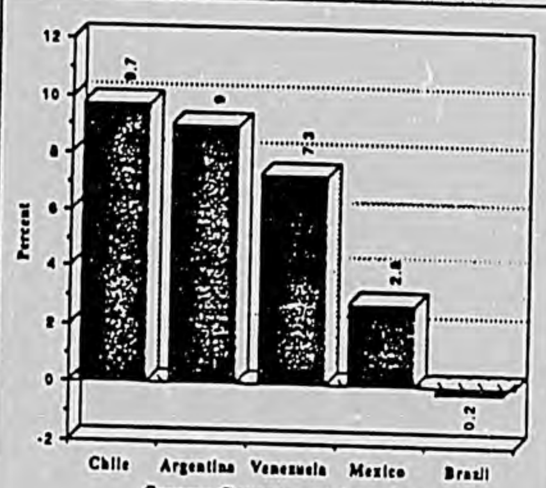
Since 1982, about 45 percent of foreign investment in Chile has been in mining, but Chile has recently begun to diversify. New sectors include manufacturing, services, and agriculture. Total approved investment to date in mining is $8.1 billion, services $3.4 billion, and agriculture $130 million.

U.S. firms are major investors in Chile's mining sector. A $1.5 billion Phelps Dodge/Sumitomo joint venture in the "La Candelaria" copper mining project was recently approved. Bell South's $40 million investment project to further upgrade Chile's telecommunications company (CIDCOM) is yet another example.

Japan and Australia have been given approval for a joint venture involving ENDESA (Chile's national electrical company), COMALCO Aluminum (Australia), and the Marubeni Corporation (Japan). Total investment in the project should reach $1.5 billion.

Chile Leads the Pack

Estimated percentage change in GDP during 1992 for some Latin American economies



Source: Government Agencies

Chile encourages foreign investment under its Decree Law 600. This provides national treatment for all foreign investors. Further, there is free access to capital markets and economic sectors in Chile, and minimal government intervention in investor activities. The policy also provides for liberal profit and capital repatriation regulations. The free exchange system sets no time limit on remittance of profits and dividends. Investors should note that there is a noninterest bearing cash reserve requirement or deposit (ENCAJE) of 30 percent, for a period of one year. The ENCAJE is a monetary tool used to control excess liquidity and is not designed to discourage foreign investment.

Individuals and businesses established in Chile, except foreign subsidiaries, are subject to a tax on income received from Chilean as well as non-Chilean sources. It is likely that tax agreements will be negotiated with some countries in 1993 to avoid this double taxation burden.

Foreign investors have two income tax options—either the general regime applicable to all Chilean-owned businesses or the special regime solely for foreign investors. The general regime has a corporate tax rate of 15 percent on accrued income. If repatriation occurs, however, there is an additional tax of 35 percent, but accompanied by a 15 percent credit on corporate taxes paid.

The special regime currently features two alternate methods of taxation—an overall income tax rate of

Continued on next page

429

Key Contacts for Information on Chile

Roger Turner
Chile Desk Officer
Office of Latin America
Room H-3021
International Trade Admin.
U.S. Department of Commerce
Washington, DC 20230
Tel: (202) 482-1495
Fax: (202) 482-4726

Latin America/Caribbean
Business Development Center
Room H-3203
International Trade Admin.
U.S. Department of Commerce
Washington, DC 20230
Tel: (202) 482-0703
Fax: (202) 482-2218

Rick Villalobos
Commercial Counselor
U.S. Embassy-Santiago
Unit 4111
APO AA 34033
Tel: (011-56) 2-671-0133
Fax: (011-56) 2-697-2051

Chilean Embassy
1732 Massachusetts Avenue, NW
Washington, DC 20036
Tel: (202) 785-1746

Prochile Commercial Offices

One World Trade Center
Suite 5151,
New York, NY 10048
Tel: (212) 938-1943
Fax: (212)321-1943

510 West 6th Street, Suite 1206
Miami, FL 33131
Tel: (305) 374-0697
Fax: (305) 374-4270

1360 Post Oak Blvd., Suite 2330
Houston, TX 77056
Tel: (713) 961-3682
Fax: (713) 961-3910

Chile...

Continued from Page 3

approximately 44.3 percent and a 40.0 percent rate with variable surtax. Pending legislation, expected to pass in 1993, will likely reduce the 44.3 percent to 42.0 percent, and eliminate the 40 percent option entirely. The same investment legislation should also include a reduction in the waiting period for capital repatriation from the current three years to one.

The Capital Goods Corporation of Chile predicts that between 1992 and 1997 there will be $26 billion invested in Chilean projects. Sectors with the most projects should be private sector mining with $3.5 billion, state mining with $1.3 billion, and industry and services with $4 billion. Some additional projects involve forestry, energy and fuels, parts, tourism and travel, real estate, and public works.

A May 1992 law enables the government-owned CODELCO, the world' s largest copper producer, to establish joint ventures with private firms to develop mining projects to improve CODELCO'S profitability.

The telecommunications sector expects to continue its explosive growth of the last five years. Proposed legislation designed to speed up development in the telecommunications sector will be presented to the Chilean congress in May.

Chile' s government is expected to continue encouraging foreign direct investment, including joint ventures of small- and medium-sized firms, to foster economic expansion and generate increased foreign trade.
By Julie P. Doherty, Chile Desk, Office of Latin America

412

A BUDGETARY AND ECONOMIC ANALYSIS OF THE NORTH AMERICAN FREE TRADE AGREEMENT

The Congress of the United States
Congressional Budget Office

Summary

Legislation to carry out the North American Free Trade Agreement (NAFTA), which would eliminate most barriers to trade and investment among the United States, Canada, and Mexico, provides the Clinton Administration and the 103rd Congress with one of their most important challenges in the area of international trade. This study analyzes the major effects of the proposed agreement and, where possible, measures its likely impact on the U.S. economy and the federal budget. The study is not a cost or revenue estimate of the legislation that the Congress will be asked to vote on to implement NAFTA, although it provides a basis on which the Congressional Budget Office (CBO) can make those estimates. The information and analysis provided in this study will also assist others who wish to understand the economic and budgetary effects of NAFTA.

Each of the countries participating in NAFTA should realize net economic gains. It carries Mexico further along in its strategy of promoting economic development by opening markets and encouraging foreign investment. This strategy has already led to a higher rate of economic growth and an improving standard of living. A rising standard of living in Mexico, based on greater economic efficiency and open trade, can also help raise the standard of living in the United States as Mexico imports additional U.S. agricultural products, manufactured goods, and services.

The United States would also benefit from the improvement in economic efficiency that accompanies freer trade. U.S. consumers would benefit from lower prices; U.S. workers, from a net increase in jobs and income; and U.S. investors, from new investment opportunities in both Mexico and the United States. The United States would also be helped by changes in Mexico that, over the long run, would reduce pressure for illegal immigration and increase political stability.

A thorough review of the myriad changes brought about by NAFTA, and of their interactions, leads to the single resounding conclusion that the net effect on the U.S. economy would be positive and very small. The biggest changes introduced by NAFTA would be those related to Mexico, and the Mexican economy is small (less than 5 percent of U.S. gross domestic product) and its impact on the United States is even smaller. That the net effects for the United States are positive, of course, should not obscure the painful adjustments and losses that some U.S. workers, firms, and communities will undoubtedly experience. But the gains cannot be achieved unless such adjustments are made, by shifting labor and capital resources from less profitable uses to more profitable ones.

Contrary to some commonly expressed concerns, the reallocation of resources would not be massive. Americans should not fear that NAFTA would cause a wholesale relocation of U.S. manufacturing plants and jobs to Mexico to take advantage of the lower average wage. Labor costs are only one of a number of factors that influence where firms locate their plants. The United States will still retain the economic advantages it now has, and Mexico will

still hold some drawbacks for firms that produce there.

With or without NAFTA, low-skilled workers in the United States will continue to face competition from low-skilled workers in other countries. The failure of Mexico to continue with its economic reform strategy, or of the United States to approve NAFTA, would not amount to much of a reprieve for these workers, nor would the success of NAFTA greatly affect their fortunes one way or the other. Without NAFTA, a few of those workers might be granted a temporary reprieve, but technological change and the competitive forces that drive the U.S. economy (and larger flows of cross-border migrants) would continue to apply pressure. And more important, workers and firms that now depend on trade with Mexico could find themselves in jeopardy if NAFTA were not carried out.

What Is NAFTA?

The North American Free Trade Agreement provides rules and guidelines for dismantling trade barriers and creating a trilateral free-trade area encompassing the United States, Mexico, and Canada. The free-trade area eliminates barriers to trade, but does not create full economic integration or a common external policy like the European Community's "common market." NAFTA does, however, provide for the substantially free flow of capital among the three parties to the agreement, and for some mobility of labor in the form of rules governing the temporary entry of businesspeople. Because the most significant aspect of the agreement is the addition of Mexico to the existing free-trade area with Canada, most analyses, including this study, focus on interactions between the U.S. and Mexican economies.

Each of the participants to the agreement is seeking to achieve greater economic efficiency and a higher standard of living by opening its markets. According to its major stated objectives, NAFTA would

- o "eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
- o promote conditions of fair competition in the free trade area; and
- o increase substantially investment opportunities in the territories of the Parties."

Each of the parties is also pursuing objectives that are unique to its particular situation, some of which are unstated in the agreement. The United States, for example, entered the agreement as a means of promoting the successful completion of the ongoing multilateral trade negotiations under the auspices of the General Agreement on Tariffs and Trade (GATT), or as an alternative to the GATT if those negotiations were to fail. In addition, the United States has viewed the agreement as the possible basis for an even larger free-trade area throughout the Western Hemisphere. Equally as important to the United States, the agreement could, over time, relieve the pressure of illegal immigration into the United States by supporting the growth of jobs and income in Mexico.

Budgetary Effects of NAFTA

As the Congress considers legislation to implement NAFTA, one element to be reviewed will be its impact on the federal budget. Overall, this impact would be very small and insignificant compared with NAFTA's broader economic effects. NAFTA could affect the federal budget in four ways: by reducing revenues from tariffs, increasing expenditures for displaced workers, changing outlays for agricultural programs, and increasing pressure for spending on infrastructure and environmental cleanup along the border.

Reduced tariffs on imports from Mexico could result in revenue losses on the order of $2 billion to $3 billion over five years. In 1991, tariffs on imports from Mexico amounted to nearly $0.6 billion. About 50 percent of the total value of imports from Mexico was duty free, of which one-quarter entered the country under the Generalized System of Preferences (GSP) program. The estimated revenue loss from NAFTA depends in part on the status of the GSP program when the Congress votes on the NAFTA legislation. If the GSP program expires as scheduled on July 4, 1993, and is not extended before the vote on NAFTA, the higher revenue loss would apply.

An additional budgetary cost related to NAFTA could result from increased expenditures for workers who may lose their jobs as a result of the agreement. The Administration has indicated its intention to submit legislation that would address the needs of all displaced workers regardless of whether their displacement was caused by NAFTA, defense cuts, or any other reason. Meanwhile, the Administration proposes to triple the funding for the main existing retraining program, from about $600 million in 1993 to more than $1.9 billion in 1994. No estimate is available of the portion of the increased funding that would be attributable to NAFTA.

The agreement would probably have a small net effect on the cost of U.S. commodity programs and programs to promote exports of U.S. farm products. If exports of grains, oilseeds, and related products rise, the cost of U.S. programs for those commodities could fall (depending on whether the Secretary of Agriculture uses discretionary policy mechanisms that offset the budgetary effects of the increase in demand for exports). If Mexico uses credit backed by U.S. programs that provide credit guarantees to finance those exports, the cost of those programs could increase.

Pressing environmental problems and the lack of adequate infrastructure along the U.S.-Mexican border create another potential set of budgetary expenditures related to NAFTA, although these problems predate the agreement and would continue to create pressure for spending even without it. In 1992, the United States and Mexico issued an integrated plan for the border area (known as the Border Plan) to deal with common resource and environmental problems. Federal funding for projects included in the Border Plan is subject to annual appropriations. The Bush Administration requested $241 million in fiscal year 1993 to fund projects under that plan. Although the Congress denied some of the request, the Environmental Protection Agency and other agencies with jurisdiction are believed to have sufficient funds to fulfill the commitment for 1993. Requests for additional funding are likely, but the amounts are not known.

Growth in Mexico and Its Benefit to the U.S. Economy

In the mid-1980s, Mexico embarked on a market-oriented policy agenda that broke with the past by emphasizing reduced restrictions on trade and foreign investment. In many ways, NAFTA is a logical next step in this development strategy. The key to this strategy is for Mexico to attract and productively absorb foreign capital. In addition to making Mexico more attractive for U.S. investors (because of the investment provisions of the agreement), NAFTA reduces doubts that other foreign investors may have about the permanency of Mexico's economic reforms--that is, it helps lock in those reforms and so reduces the risk involved in investment.

The success of NAFTA largely depends on whether Mexico pursues policies that enable it to achieve a sustainable increase in economic growth. NAFTA would support this pursuit, but it is not sufficient. Mexico must continue on its current path of market liberalization and macroeconomic stability, although this path will cause dislocations and require painful adjustments for a large segment of its population. Political reform may also be a necessary ingredient. Most, if not all, of the reforms that Mexico needs to make are ones it could carry out on its own.

Mexico's more liberal investment policies will encourage additional investment in its physical capital, which over time should greatly improve its standard of living. Much of this physical capital will be exported to Mexico from the United States--90 percent of the $11 billion in capital goods imported by Mexico in 1991 came from the United States. Illustrative simulations, based on the experiences of other countries that have successfully liberalized their trade, suggest that after 20 years NAFTA could raise real output in Mexico by as much as 6 percent to 12 percent.

To achieve this rate of growth, Mexico will need to attract foreign financial capital on the order of $15 billion per year for 10 years or more. The potential capital flows from the United States to Mexico will probably not represent a significant net draw on the pool of resources available for investment in the United States. The yearly amounts that might come from the United States are very small relative to U.S. capital markets, and the United States would also be in an enhanced position to attract capital from the rest of the world. Thus, the extra demand for investment in Mexico would amount to only a small draw on U.S. capital markets. And over time, this investment would generate interest and dividend income for U.S. investors.

Since the announcement in 1990 that Mexico would seek a free-trade agreement with the United States, substantial capital inflows have already occurred, leading to an increase in the Mexican trade deficit and an appreciation of the peso of about 43 percent in real terms from its low point in 1987. CBO's macroeconomic simulations confirm that a reduced risk premium on foreign investment resulting from NAFTA and Mexico's continuing policy liberalizations would increase capital inflows, appreciate the Mexican peso, and push Mexico's trade balance into deficit for some time. This scenario should benefit Mexico by providing capital for its economic growth and the United States by increasing exports to Mexico.

Effects on Industry and Employment in the United States

Estimates of the overall net benefits of NAFTA mask its effects on individual industries. NAFTA would boost the expansion of some firms (and job opportunities) because of increased efficiency or access to a larger market. Other firms (and jobs) would contract in favor of less costly imports. Although these effects will be fairly small when viewed against aggregate figures, they may appear large to those who gain from the agreement and especially to those who are hurt by it.

A key reason that freer trade with Mexico would create winners and losers is that the Mexican and U.S. economies have different strengths and weaknesses. Mexico's competitive strength comes from having a large, low-wage work force. As a result, firms in Mexico can produce at lower cost than firms in the United States those goods and services that rely heavily on low-wage labor. Similarly, the United States has relatively more capital and skilled labor than does Mexico, so U.S. firms can produce at lower cost than Mexican firms the goods and services that rely on those factors of production. By trading the types of goods and services that each country can produce more cheaply, both countries gain overall. The benefits of lower prices spread to all consumers; workers and firms in expanding industries also gain; but the costs are visibly concentrated on workers and firms displaced by foreign competition.

Modeling studies reviewed by CBO consistently indicate net gains from this type of resource reallocation. The gains for the United

States, however, are small, ranging only as high as about one-quarter of one percent of gross domestic product. Although these studies fail to provide a consistent list of industries that will gain or lose from the realignments of these resources, economic theory suggests that industries in the United States that make intensive use of low-wage labor and are now protected by trade barriers are likely to be disadvantaged by NAFTA.

CBO's review of a selected group of traded goods and services confirms these intuitive observations. In the automobile industry, for example, most of the barriers to be removed by NAFTA are imposed by Mexico against imports. Hence, NAFTA would be more likely to help than to hurt U.S. automobile firms and workers, as a group. The textile and apparel industries employ a relatively large number of low-wage workers and therefore would come under competitive pressure because of NAFTA. Certain aspects of NAFTA may actually help the textile industry slightly, but some apparel workers would probably lose their jobs in the face of increased competition from Mexico. In the energy sector, NAFTA would provide an opportunity to boost the very low level of U.S. energy and energy-related exports to Mexico, but would change U.S. access to Mexican oil very little. In services, the overall effect of the agreement would be positive and, because of the low level of cross-border trade in services, very small. Nevertheless, the agreement has important implications for trade in services because it is likely to become a model for future negotiations with other countries, which ultimately could add substantially to the net export of U.S. services.

Some firms that depend on low-wage labor may migrate south of the border to take advantage of Mexico's low-wage labor and liberalized investment climate. Owners of these firms would benefit from NAFTA, but their workers would not. Most workers who lost their jobs as a result of such displacement would try to find other jobs in the United States that are at least as good as the ones they leave. NAFTA creates some opportunities for such employment by lowering tariffs and other restrictions on U.S. goods entering Mexico and by creating new opportunities for exports of services. But the jobs created may not match the skills or geographic location of the displaced workers, and no provision in NAFTA can guarantee that the workers who are displaced will be the ones who will find the new jobs. Moreover, even for those who do find new employment, the transitional costs of retraining or relocating can be high.

Many workers who are potentially affected by NAFTA are worried about losing their jobs. Permanent loss of one's job--referred to as displacement or dislocation--can be quite costly. It may take many months to find another job, and the new job might not be as good as the one lost. One way of reducing workers' costs, and thereby mitigating their concerns, is to provide them with temporary income support and reemployment assistance. A key issue is whether existing programs--unemployment insurance, Economic Dislocation and Worker Adjustment Assistance, and Trade Adjustment Assistance--are sufficient and appropriate to handle the needs of workers displaced by NAFTA.

A review of information available about the potential effects of NAFTA on worker displacement, the experiences of workers who lost their jobs during the 1980s, and the programs available to them indicates the following:

- o Even though NAFTA would increase total employment in the United States, some U.S. workers would lose their jobs. The total number of jobs lost would probably be well under half a million, spread over at least a decade. Viewed as part of a larger, dynamic labor market in which nearly 20 million workers were displaced during the 1980s, the effects of NAFTA appear relatively small.

- o Judging by the experience of workers who lost their jobs over the past decade, the consequences for some of those who do lose their jobs could be quite large. Half of the workers displaced in the 1980s were either not working or were making less than 80 percent of their previous earnings one to three years later.

- o Workers displaced because of NAFTA could have a more difficult time than others finding new jobs to the extent that they were less skilled than the average displaced worker. The differences in outcomes, however, are likely to be small.

- o Existing programs--particularly unemployment insurance--would provide a basic safety net, but many of the displaced workers would run out of benefits before they found a new job.

Agricultural Issues in NAFTA

The agreement recognizes the importance and complexity of agricultural markets by devoting an entire chapter to them. NAFTA includes two bilateral agreements for opening markets to agricultural trade--one between Mexico and the United States and another between Mexico and Canada. For the most part, the Canada-U.S. Free Trade Agreement would continue to govern U.S.-Canadian agricultural trade.

Mexico is one of the U.S. farm sector's most important trading partners. In 1991, Mexico ranked fourth as an export market for U.S. farm goods, with U.S. exports to Mexico reaching almost $3 billion. NAFTA would expand that relationship by reducing tariff and nontariff barriers to trade between the two countries. In Mexico, agriculture employs about 26 percent of the active work force. Any policy reforms that reduce farm supports in Mexico--including movements toward freer trade--would probably have a large impact on the sector, resulting in substantial adjustment costs.

The overall effect on agriculture in the United States would be modest and positive, but agriculture in Mexico could suffer sizable losses as a result of NAFTA and ongoing domestic reforms. For specific commodities, the results would vary. U.S. producers of grains, oilseeds, and some animal products would benefit from the agreement, and U.S. producers of some horticultural products would face additional competition. In Mexico, losses for producers of corn could be substantial and might have important effects on employment. Mexican consumers, however, would benefit from lower food prices.

The agreement could promote rural-to-urban migration in Mexico and, for a time, increase migration from Mexico to the United States. These patterns would depend largely on changes in Mexico's domestic policies for agriculture. Mexico has recently initiated an extensive process of market-oriented reform in its agricultural sector. These reforms could encourage investment and efficiency in Mexico's farm sector but could also lead the sector into a difficult period of transition. If Mexico continues to remove supports for agriculture, unemployment and a growing urban population could become important issues. NAFTA could ease the strain of the transition by promoting growth and employment in other sectors, but it could compound the problem if it removed barriers to trade in agriculture before gains in other sectors were realized. Ultimately, the agreement should lead to economic growth in Mexico, thus reducing migratory pressure on the U.S. border, but substantial adjustment costs could arise during the transition.

Environmental Regulation and Other Health and Safety Rules

Environmental issues have had a unique and unprecedented influence on NAFTA. Most of the public debates about the agreement have focused on two issues related to Mexico:

- o Will firms in the United States be at a competitive disadvantage because firms in Mexico face lower costs for controlling pollution? If so, will U.S. firms move to Mexico as a result?

- o Will rapid economic development in Mexico cause long-lasting harm to Mexico's environment and natural resources? And will it increase pollution along the U.S.-Mexican border?

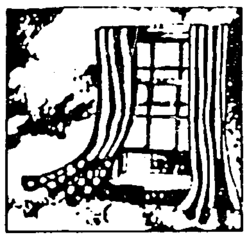
The answers to both sets of questions are not unequivocal, but they are reassuring. Most analysts conclude that differences in pollution control costs should not cause widespread movement of U.S. manufacturing facilities to Mexico, mainly because such costs are a small portion of most firms' total costs. And over the longer run, the quality of the environment in Mexico should benefit from economic growth and a rising standard of living. In the shorter term, however, the environment in Mexico and along its border with the United States could suffer unless appropriate steps are taken, such as building additional sewage and water treatment facilities and enforcing more strictly Mexico's environmental laws.

Two related questions have generated concern. Will NAFTA undermine food safety and other product standards in the United States? And, specifically, how can existing environmental conditions along the border be remedied? As with the other issues, the answers to these questions are unclear. NAFTA creates new protections for U.S. health and safety standards, but their enforcement is not guaranteed; and some people believe that NAFTA would put pressure on the United States to lower its environmental, health, and safety standards. Although the United States and Mexico have agreed to a separate and ambitious border plan on a parallel track to NAFTA, many people believe that the lack of dedicated funding and specific goals for the plan will undercut its chances of success.

NACLA
REPORT ON THE AMERICAS
VOLUME XXVI NO5 MAY 1993 $4.00

Window of Opportunity

Will a Post-Cold War Democratic Administration in the United States Make a Difference in Latin America?



Somewhere in the confluence of ambition, inertia, perceived interests and ideology, the Clinton Administration will spend the next few years crafting—and maintaining—a relationship with Latin America and the Caribbean. And as that relationship is crafted, new opportunities may emerge for progressive forces in the hemisphere. The following pages examine some of Clinton's key appointments, the ways in which specific policies might mesh with overall objectives, the pressures on policymakers, and the consequences of all this for Latin America.

The new Administration comes to power in a reconstructed world order, with a political agenda somewhat at odds with that of the previous two administrations. But administrations don't make policy precisely as they please. Despite the replacement of the Reagan-Bush team with a Democratic administration, and despite the end of Cold-War politics, the United States continues to have powerful long-term interests in the region. Any change in policy will be severely constrained by these continuing interests, by the bureaucratic legacy of past U.S. policies, and by the dynamics set in motion by past events and the policies of previous U.S. administrations.

The new Administration, for example, inherits government bureaucracies with agendas of their own. As Kate Doyle explains, whatever the Clinton people finally decide to do about the hemispheric drug trade, they will have to deal with the plethora of federal agencies with a stake in continuing the "drug war." And, as Cecilia Muñoz argues, an inherited dynamic exists that prevents the Administration from devising its own immigration policy without dealing with the expectations and contradictions created by former refugee and asylum policies, and by recently passed immigration restrictions and employer sanctions.

And above all, the structures of the U.S. economy and social order often dictate policies of their own. Doug Henwood argues that the globalization of U.S.-based capital is doing just that in the case of U.S. economic policy. As the political leader of the home country of a great deal of the world's transnational capital, Clinton is not likely to do anything to upset either the solidarity among the leading economic powers, or the country's position of dominance in the hemisphere. Some forces, says Henwood, are larger than personnel and political party.

U.S. dominance in the hemisphere, established and reestablished many times over in two centuries of declaration and practice, has given rise to a long series of interventions—both overt and covert—from Santo Domingo to Santiago de Chile. Today, as Burbach and Henwood both argue, "free trade" is becoming the new tool of U.S. domination. Yet, the Administration must also stake out positions on other facets of hemispheric policy: development, drugs, immigration, and that thorn in the side of nine U.S. presidents: Cuba. By focusing on these areas of concern in this Report, we hope to develop some insight into the constrained transformation of U.S. hemispheric policy that may be in the offing. ■

NACLA Report on the Americas, Vol. 26, No. 5, May 1993,
475 Riverside Drive, Suite 454, New York, NY 10115.

Clinton's Latin America Policy: A Look at Things to Come

BY ROGER BURBACH

As the Clinton Administration settles into office, the changeover from the Reagan-Bush years seems to mark a turning point in U.S. foreign policy. New figures are in charge of Washington's diplomacy—figures who, over the past 12 years, have staked out major ideological and political disagreements with their foreign-policy predecessors. The differences are striking when one contrasts Alexander Haig, the aggressive cold warrior who served as Reagan's first Secretary of State, with Clinton's appointee, Warren Christopher, an early advocate of a strong U.S. human-rights policy and an able practitioner of negotiation and cautious diplomacy. In the area of Latin American policy, there is a clear distinction between Reagan's appointees to the Latin American position on the National Security Council, Roger Fontaine and Constantine Menges, both rabid anti-Communists, and Clinton's appointment to that post, Richard Feinberg, who has written extensively over the years on the need to avoid seeing Latin America and the Caribbean exclusively through the prism of superpower rivalry.[1]

Clinton meets in Washington with Aristide, during negotiations to restore the Haitian president to office.

But this focus on individuals ignores the underlying continuity in foreign policy in the transition from the Bush Administration to the Clinton presidency. World conditions have changed dramatically in recent years, and Bush as well as Reagan was driven to begin altering many of his policies from the late 1980s onwards. In the case of Latin America, important policy changes occurred during Bush's term in office, and from all indications, the Clinton Administration will do little more than tinker with these basic changes.

Clinton's first foray into Latin American policy in the case of Haiti reveals just how much he is impelled to sustain the policies of his predecessor. During the campaign, Clinton staked out a clear difference with Bush when he called for a more lenient immigration policy for the persecuted refugees from Haiti. But even before he took office, he reneged on this pledge and declared that the Bush policies on immigration would remain in place. The Clinton team became concerned that the flood of refugees would become overwhelming, that it would set off a backlash within the United States that would undermine the new Administration's initiatives, particularly in domestic policy.

The general policy towards the Haitian military regime has also not fundamentally changed. Clinton may be pressuring somewhat more intensively than Bush for the return of Jean Bertrand Aristide as

Roger Burbach is the director of the Center for the Study of the Americas. He was a NACLA staff member from 1973 to 1980. He is currently working on a new book, The New World Disorder.

Haitian president. But as under Bush, the terms of Aristide's return will severely circumscribe the Haitian leader's ability to implement the social and economic reforms he was initially elected to carry out. And in the interests of "reconciliation," few if any of the backers and members of the military regime are likely to be prosecuted for the barbarities they inflicted on the Haitian people. This overlap in Haitian policy between the two administrations was reinforced by Clinton's retention for an interim period of Bernard Aronson, Bush's appointee as Assistant Secretary of State for Inter-American Affairs.

Bush made two basic changes in Latin America policy that serve as a foundation for Clinton's policies. First, the Bush Administration set a course of searching for negotiated solutions to end the civil wars and guerrilla conflicts, particularly in Central America. Bush and Secretary of State James Baker saw early on the need for a policy that went beyond the insistence of the far right wing of the Republican Party on all-out war against leftist and guerrilla movements. This was highlighted by Baker's selection of Aronson, a Democrat, to fill the key Latin American post, and to preside over the policy of negotiating an end to the civil wars in El Salvador and Nicaragua.

The second basic change in policy occurred when the Bush Administration began erecting a new economic framework for exploiting Latin America's human and material resources. Bush ardently pursued the North American Free Trade Agreement (NAFTA) and launched the export-promoting Enterprise for the Americas, thereby moving from an obsession with covert wars to economics and trade as the fundamental concern of the United States in Latin America and the Caribbean.

Clinton's first foray into Latin American policy in the case of Haiti reveals just how much he is impelled to sustain the policies of his predecessor. As under Bush, the terms of Aristide's return will circumscribe the Haitian leader's ability to implement reforms.

Basic changes in Latin America policy have previously been undertaken by Republican administrations and then consolidated by Democratic presidents. Franklin Roosevelt's Good Neighbor Policy, which formally ended the early twentieth-century policy of gun-boat diplomacy, was actually begun by Henry Stimson, the Secretary of State under President Herbert Hoover. Stimson realized that U.S. intervention in Central America and the Caribbean had become counterproductive. He endorsed the renunciation of the Roosevelt corollary to the Monroe Doctrine—that the United States had the right to police "chronic wrongdoing" in its own hemisphere—which had been used to justify repeated U.S. interventions in Latin America.

Later, in the 1960s, much was made of John F. Kennedy's Alliance for Progress and the emphasis he placed on Latin American development. But it has generally gone unrecognized that this policy finds its seeds in the second term of Dwight D. Eisenhower. In 1958, Eisenhower's brother Milton was sent on a fact-finding trip to Latin America and returned advocating that more attention be paid to the region, and that more economic aid be given to stave off the growing political ferment he encountered. The Inter-American Development Bank was set up and President Eisenhower himself undertook a trip to Latin America in 1960. Eisenhower's trip resulted in the Declaration of Bogotá, which called for basic social changes, now with the more immediate goal of containing the spread of the Cuban Revolution which had triumphed in 1959.[2]

The Latin America policy changes of the Bush-Clinton period are driven by new international realities. The first and most important is the end of the Cold War, combined with the failure of the United States to defeat Central America's revolutionary movements on the battlefield in the 1980s. In the case of Nicaragua, diplomatic reports and documents make it clear that Gorbachev collaborated with Bush to push for an end to the war. The Soviets wanted to curtail their assistance to the Nicaraguan Revolution because of their own internal political and economic problems, while Bush and many of the officials around him came to view the Contra war as a liability, especially in view of the political damage they had suffered from the Iran-Contra affair. And in El Salvador, in the wake of the FMLN's November 1989 offensive, and the killing of six Jesuit priests by military officers, the Bush Administration realized that a military victory was beyond its grasp. Only a negotiated settlement could end the conflict and bring the military under control.

Transformed world conditions also explain why the Bush Administration launched its Enterprise for the Americas and negotiated NAFTA. Due to growing competition with Japan and the European Community, and the general weakening of U.S. economic power, the Bush Administration began to look to the Western Hemisphere as the region where it could develop a stronger economic base by expanding U.S. trade, investments and markets.

The Administration was able to launch this economic offensive in part because Latin America's debt crisis had decimated the region's economies, making the governments amenable to any new economic proposals from Washington which held forth the hope of a renewed flow of private and public capital. Often referred to as the "lost decade," the 1980s saw capital and resources flow outward from Latin America, resulting in negative economic-growth rates.[3]

With the continent economically and politically prostrate, a new group of market-oriented politicians and finance ministers, many of whom were groomed at Harvard, MIT and the University of Chicago, came to power in Latin America. Presidents in countries with political traditions as diverse as Mexico, Argentina and Brazil began following the Reagan-Bush economic recipes that called for free trade and the privatization of the public sectors of their economies.[4]

At the behest of the International Monetary Fund (IMF) and the international banks, Latin American governments enacted severe austerity programs to pay off their debts. Latin America's schools, medical facilities and social infrastructure were gutted while malnutrition and hunger increased. The number of people living in poverty increased 39%—seventy-one million people—over the course of the 1980s.

Clinton, who has often invited comparisons between himself and John F. Kennedy, is not calling for anything analogous to the reformist policies pursued under Kennedy's Alliance for Progress.

The Clinton Administration has issued no basic critique of this period of economic devastation in Latin America. Indeed, if anything, it has proclaimed its readiness to further the economic policies of the Bush Administration with only minor changes and adjustments. There is no talk of dealing with the ever-widening gulf between rich and poor in the region. Clinton, who has often invited comparisons between himself and John F. Kennedy, is not calling for anything analogous to the reformist policies pursued under Kennedy's Alliance for Progress.

In fact, Clinton's declaration that he will focus on the U.S. economy "like a laser" has its Latin American counterpart in his efforts to make economics and trade the centerpiece of his policy towards the region. During the transition period, the Clinton team put out the word that it was searching for people with strong backgrounds in economics and trade issues to fill the important Latin American policy posts. This is, in part, why the Administration selected Richard Feinberg to fill the Latin American post at the National Security Council (NSC) [See "Anthony Lake and Richard Feinberg: The Best and the Brightest?"

Lake and Feinberg:

The appointments of Anthony Lake as National Security Council Adviser and Richard Feinberg as the Council's officer on Latin American affairs are among the best ever made to these posts. Both have largely non-dogmatic positions, both opposed hard-line interventionist policies when they worked in the State Department in the 1970s, and both used their years out of power to criticize Reagan policies and to rethink their own positions.

Anthony Lake has an especially striking career among foreign-policy officials in that he has consistently taken stands on principle rather than simply trying to advance his own career or ambitions. He resigned from his first position on the National Security Council under Henry Kissinger when Nixon invaded Cambodia in 1971. And because of his independent positions on the Council, Lake, along with Morton Halperin, who now works under Les Aspin at the Defense Department, had his phone tapped by Kissinger.

Lake resurfaced in the Carter Administration when he became head of the Policy Planning office at the State Department. There he formed part of the more liberal wing led by Secretary of State Cyrus Vance and Under Secretary of State Warren Christopher, which pushed for pro-human rights policies and sought to move the United States away from its historic insistence on seeing all Third World liberation movements as orchestrated from Moscow. They were often at loggerheads with then-National Security Council Adviser Zbigniew Brzezinski, who tried to outdo Kissinger with his Machiavellian approach to foreign policy and his like-minded fixation on the Soviet Union.

Richard Feinberg is in large part a product of the generation of the 1960s. He joined the Peace Corps and went to Chile in 1969, where he wrote *The Triumph of Allende: Chile's Legal Revolution*, which is unabashedly "sympathetic to the aspirations of Allende's supporters."[1] When Nixon and Kissinger embarked on their efforts to bring down the Allende

the Best and the Brightest?

regime. Feinberg collaborated with Elizabeth Farnsworth and Eric Leenson to write the special NACLA Report, "Facing the Blockade," which exposed the full extent of U.S. economic and political aggression against Chile.[2]

In 1977, Feinberg joined Anthony Lake at the Policy Planning office in the State Department where he was in charge of Latin America affairs. At the end of the Carter Administration, he went to work at the Overseas Development Council, a liberal think tank in Washington, where he wrote extensively on Latin American and Third World issues until 1992, when he became President of the Inter-American Dialogue.

During the 1980s both Lake and Feinberg came out with major studies that scrutinized U.S. foreign policy, attempting to draw lessons from their own experiences and from the bellicose policies of the Reagan years. Feinberg's major work, *The Intemperate Zone: The Third World Challenge to U.S. Foreign Policy*, calls for a new "neo-realist" foreign policy.[3] He no longer identifies with socialist governments or policies, but he does argue for policies that would try to accommodate the interests of Third World governments. Lake in the introduction to *After the Wars*, published in 1990, surveys the wreckage of the Third World wars that the United States helped create, and recommends an "International Fund for Reconstruction" that would "foster economic justice" and assist the poor.[4]

The main limitations that both Lake and Feinberg bring to their offices is that, after a couple of decades in and near the seats of power, they have become part of the Washington establishment and operate within its ideological parameters. Feinberg now focuses on economics and free-trade agreements as the way to deal with Latin America. These economic policies are inherently biased in favor of multinational corporations, the same forces that Feinberg once saw as the antagonists of the Allende government.

This approach in essence marks a return to the era of "Dollar Diplomacy" when it was believed that what was good for the United States economically was good for Latin America. Then, as now, U.S. policy-makers argued that U.S. investments in Latin America and the Caribbean would foster economic progress. And then as now most of the elites in the countries to the south were willing collaborators.

Lake likewise fails to realize that U.S. economic relations with the Third World are inevitably exploitative. In *Somoza Falling*, he portrays foreign policy failures and crises as often due to a lack of vision and to policy "mistakes" made by individuals in Washington or U.S. embassies abroad.[5] One of his major conclusions is that future revolutionary crises can be avoided if the U.S. government increases "the number and influence of career experts in important positions."

While Lake and Feinberg are warm and personable individuals not given to arrogance, they both embody the old liberal hope that Washington, with the "best and the brightest" in power, can make the world a better place. Until there is a basic analysis and critique of how the U.S. political and economic system is itself part and parcel of the growing disorder that our world faces, we cannot expect policies to come out of Washington that will fundamentally improve the conditions of the world we live in. ■

1. Richard E. Feinberg, *The Triumph of Allende: Chile's Legal Revolution* (New York: Mentor Books, 1972).
2. Elizabeth Farnsworth, Richard Feinberg and Eric Leenson, "Facing the Blockade," NACLA's *Latin America & Empire Report*, Vol. VII, No. 1 (January 1973).
3. Richard E. Feinberg, *The Intemperate Zone: The Third World Challenge to U.S. Foreign Policy* (New York: W.W. Norton & Co., 1983).
4. Anthony Lake and Contributors, *After the Wars* (New Brunswick and Oxford: Transaction Publishers, 1990).
5. Anthony Lake, *Somoza Falling* (Boston: Houghton Mifflin Co., 1989).

above]. Although Feinberg's early political-economic views tended to reflect a liberal-left perspective, his writings in more recent years have become more establishmentarian and often mirror the concerns of institutions like the IMF and the World Bank.[5] Even the *Wall Street Journal* has accepted him into the fold, anointing him as a "moderate."[6]

The perception in Washington is that the NSC, led by Anthony Lake, will play a pivotal role in formulating the broad goals of U.S. policy, while the State Department under Warren Christopher will implement those policies. Clinton's hands-on role on all policy issues will be reinforced by this approach, since the NSC is based in the White House. Lake, like Feinberg, comes from the more liberal wing of the Democratic Party. But Lake has also adopted a more centrist policy orientation in recent years, and it is not anticipated that he or Feinberg will be pushing bold new initiatives in their positions at the NSC.

The new Administration's focus on trade and economic affairs and its view of the State Department as an implementor of policy explains why it initially picked New York-Cuban Mario Baeza to be Assistant Secretary of State for Inter-American Affairs. Vernon Jordan, a key member of Clinton's transition team, backed Baeza because he was black and an official of the NAACP. Baeza's nomination for the post was also looked upon favorably by the new Administration because he was a lawyer at the powerful Debevoise & Plimpton law firm in Manhattan, where he specialized in helping U.S. investors buy up many of the large public corporations that were being privatized in Latin America.

Left: A peasant farm near Cuzco, Peru. Below: Members of the Inter-American Dialogue, an influential moderate-to-liberal thinktank. From left: unidentified reporter; Peter Bell, Chair; Pedro Aspe Armella, Mexico's Secretary of Finance; Richard Feinberg, the National Security Council's officer on Latin American affairs; Alejandro Foxley, Chile's Minister of Finance.

The importance of Latin America in Clinton's grand economic strategy is reinforced by the fact that a number of his Administration's key personnel come from the Inter-American Dialogue, a moderate-to-liberal think tank founded in the early 1980s that focuses on hemispheric issues. The Dialogue initially served as a source of perspectives at variance with the policies of the Reagan Administration. But in recent years, the Dialogue, which contains many members from Latin America and Canada as well as the United States, has become a high-level forum at which political, academic, business and even military elites from the Western Hemisphere meet periodically to exchange ideas and discuss policies. Ex-presidents of Argentina, Uruguay, Panama and Ecuador number among its members, as do high-ranking diplomats and politicians from the United States.[7] Key Clinton Administration officials drawn from the Dialogue include Feinberg, who became the Dialogue's President in 1992, Secretary of State Warren Christopher, Under Secretary of State for Political Affairs Peter Tarnoff, Secretary of the Interior Bruce Babbitt, Secretary of Housing and Urban Development Henry Cisneros, and Secretary of Transportation Federico Peña. The Dialogue plays a role similar to that played by the Trilateral Commission in the 1970s by bringing together key U.S. and international leaders who either serve in high-level government positions, or who, as powerful outsiders, try to influence their government's policies in order to stabilize the capitalist world.

The recent report issued by the Dialogue, *Convergence and Community: The Americas in 1993*, can be seen as a reflection of the issues that are foremost in the minds of many members of the Clinton Administration.[8] It is similar in importance to reports drafted for previous administrations at their inception. At the start of the Carter Administration, the Linowitz report on Latin America called for a human-rights policy toward the region, and for the renegotiation of the Panama Canal treaties. Carter implemented both. Then, during the first year of the Reagan Administration, hardline conservatives drafted the Santa Fe report which served as the ideological and political blueprint for the offensive launched against the revolutionary movements in Central America and the Caribbean.

Convergence and Community is less audacious than the earlier reports, and more of a consensus document. As such, it reflects the lessening importance of the liberal versus conservative framework on many foreign policy issues. Its major proposals differ little from the policies of the Bush Administration. The document's first section is a ringing endorsement of the NAFTA accord, and calls for similar trade agreements with other Latin American countries, starting with Chile.[9]

The second section calls for a "collective defense of democracy," but deviates little from the policies of Bush and Baker. There is no discussion of popular democracy, nor of creating new democratic institutions that would truly incorporate the region's excluded and impoverished masses. If military regimes do come to power, the document emphasizes negotiations, *a la* Haiti, in an effort to pressure the military strongmen to return the government to civilian democratic rulers. The report envisions no fundamental change in the traditional military or political institutions that lead to military takeovers in the first place.

The final section of *Convergence and Community* does call for dealing with "the problems of poverty and inequality" in the hemisphere. But there is nothing new or innovative in this section, and its proposals are milder than those proclaimed by the Alliance for Progress three decades ago. Indeed one of the first planks of this section reads like a page out of neoliberal economics in its assertion that the bottom line for dealing with poverty is fiscal restraint and keeping government spending "in line."

While the core of Clinton's Latin American policy will remain similar to Bush's, there will of course be changes in emphasis and approach. This reflects the reality that the Democratic Party contains some interests and political forces that differ from those of the Republican Party. This is evidenced in the special protocols on the environment and labor that the Clinton Administration intends to draft to complement NAFTA. Labor and environmental concerns are simply much stronger in the Democratic Party, and Clinton cannot ignore the groups behind these concerns.

One can also expect that under Clinton and Gore, the Agency for International Development (AID) will devote more attention to "appropriate technology" and "sustainable agriculture." The appointment of environmentalist Timothy Wirth, the former Senator from Colorado, to head the new office of Under Secretary for Global Issues in the State Department means that more attention will be paid to environmental concerns in development programs.

It will be interesting to see if the Administration goes so far as to follow the recommendations of a White Paper called "Reinventing Foreign Aid." Drafted and endorsed by a wide range of individuals from Congress, Washington think tanks, and non-governmental organizations (NGOs), the paper calls for the abolition of the Agency for International Development and its replacement by the Sustainable Development Cooperation Agency. It would end many old-style aid programs, like direct security-related subsidies to foreign governments, and focus on assisting efforts to implement grass-roots development and sustainable agricultural programs. The report calls for Vice-President Albert Gore to head up a Development Coordination Group that would oversee all aid programs and organizations in which the U.S. government is involved.[10]

One of the key areas of tension and debate that will probably come to a head early in Clinton's first term will be over how strong an approach to take on environmental issues. In Latin America policy there is an implicit conflict between the Administration's concern with the environment, and its desire to expand U.S. markets and investments in the region. Even if a relatively tough NAFTA protocol on the environment is drawn up, it is questionable how rigorously it will be enforced.

The massive problems of poverty and underdevelopment are likely to be ignored, while the United States continues to cultivate economic policies that primarily benefit the multinationals and the economic elites of the hemisphere.

In recent years, the Mexican government, in response to U.S. concerns in the areas of human rights and the environment, has enacted a series of protective decrees, though they are honored more in the breach than in practice. But such laws do give grass-roots organizations in Mexico and the United States more leeway to pressure for change. The same dynamic of pressure from below will be needed during Clinton's tenure to counteract attempts by multinational corporations to ignore environmental concerns as they intensify their southward expansion with the free-trade accords.

Another difference between the Clinton and Bush presidencies is the diminished influence and clout of the far Right. In the case of Nicaragua, Jesse Helms and the Republican Right were able to block the flow of U.S. aid during the last year of Bush's presidency because the government of Violeta Chamorro refused to remove Sandinistas from key military posts. The new political alignment and the decline of the far Right were demonstrated immediately after Clinton's electoral victory when Bush released the funds for Nicaragua rather than suffer threatened congressional cuts in some of his pet projects. The extreme Right in Latin America also felt orphaned by Bush's defeat. Right-wing politicians in

Central America in particular denounced the incoming administration immediately, with one Nicaraguan political leader declaring that "the world is headed for disaster with these homosexuals and Communist liberals in power under Clinton." Chamorro's decision in January to bring several Sandinistas into cabinet positions and to break decisively with the more right-wing parties was also facilitated by the far Right's lack of a patron in Washington.

U.S. drug policy towards Latin America will also shift under the Clinton Administration. More attention will be devoted to the internal causes of drug abuse and less will be focused on the international drug cartels. In the presidential campaign, the drug war was practically a non-issue. Bush had no interest in discussing it because of the perceived failure of his drug policies, while Clinton largely ignored it because he viewed international drug trafficking as a diversion from his efforts to focus attention on domestic economic and social problems. During his first month in office, Clinton slashed the size of the "Drug Czar's" office in the White House. Under Bush, the Drug Czar was supposed to orchestrate the international campaign against drugs. Unlike Bush, Clinton has also given no signs of wanting to use the marines in Latin America against drug traffickers.

Of all the policy issues Clinton is faced with in Latin America, Cuba is the one that has the greatest potential for tearing apart his Administration. The Inter-American Dialogue, in *Convergence and Community*, did break new ground in calling for a softening of the blockade against Cuba. It argues for establishing better mail and telephone communications, and for allowing U.S. tourism in the island. The document notes that additional steps to improve relations could be taken if they are met with reciprocal measures by Cuba.

But Clinton himself undermined his Cuba policy options when he sought the support of the Cuban exile community in Florida during the presidential campaign. He called for tougher measures against Castro and he received millions of dollars in campaign funds from Jorge Más Canosa, the head of the right-wing Cuban American National Foundation (CANF). The donations to Clinton may, however, carry relatively little weight since Clinton did not carry Florida, and since Más Canosa also contributed to the Republican Party.

But the Cuban issue is one that arouses deep passions within the Democratic Party and the United States as a whole, making it an issue that Clinton is unlikely to broach. The attempt to nominate Mario Baeza revealed just how divisive the Cuba issue is for his presidency. Upon hearing of Baeza's nomination, CANF launched an offensive against him because he had attended a trade conference in Cuba in 1992. And more to the point, Democratic Representative Robert Torricelli of New Jersey, the head of the Inter-American Affairs Sub-Committee, and Senator Bob Graham of Florida led the charge of a group of influential anti-Castro Congressional Democrats opposed to Baeza's nomination.

In the end, Clinton turned to a senior State Department career officer, Alexander Watson, to fill the post. Watson served as ambassador to Peru and has been a deputy ambassador at the United Nations. Because of his position, Watson has taken no public stand on Cuba policy, and thus his nomination offered a way for Clinton to avoid additional controversy.

Clinton simply has no new policy agenda for Latin America or the Caribbean. The controversy over Baeza reveals that Clinton is unlikely to do anything to overturn the decades-old policy of trying to isolate Cuba. The massive problems of poverty and underdevelopment are likely to be ignored, while the United States continues to cultivate free trade and economic policies that primarily benefit the multinationals and the economic elites of the hemisphere. But the Clinton Administration's refusal to address the fundamental structural problems that the hemisphere faces does not mean that these problems will go away. The Central American wars of the 1980s may be winding down, but political and social explosions cannot be ruled out in any one of a number of countries, including Mexico, Guatemala, Venezuela, Brazil and Peru.

During the past several years there has been an upturn in the economies of many Latin American countries after the disastrous years of the 1980s. In 1991 and 1992, annual economic growth for the region was 3.2%. But this is a fragile recovery, just barely ahead of the population increase, and it may be raising far greater hopes than it is able to fulfill. A large part of the growth has been due to the influx of short-term and speculative capital, much of which has gone into the major Latin American stock exchanges. As the U.N.'s Economic Commission on Latin America and the Caribbean (ECLAC) noted, this is a recovery with "potential volatility": the capital that is coming in today could quickly abandon the region.[11]

This is an unstable period, one that is increasingly contradictory. The Right in the United States and Latin America has lost some of its clout, and this change opens up political and social space for the growth of popular forces. Whatever the next chapter in the long history of conflict and struggle in the Americas is, these popular movements from below will have a great deal of force. They have the potential to upset the new framework for Latin American relations that the Bush Administration put in place, and that the people around Clinton seem bent on following. ■

news release

Inter-American Development Bank
1300 New York Avenue, N.W., Washington, D.C. 20577 (202) 623-1000

NR-66/93

FOR IMMEDIATE RELEASE March 31, 1993

IDB PRESIDENT CALLS COMPLETION OF ECONOMIC REFORM REGION'S MAJOR PRIORITY

Iglesias highlights social reform as key to sustained development

The need to complete the process of economic reform, based on the imperative of social reform and the modernization of the State and the private sector, are the great tasks facing Latin America and the Caribbean, Inter-American Development Bank President Enrique V. Iglesias declared on March 29.

Speaking at the inaugural session of the XXXIV Annual Meeting of the Bank's Board of Governors in Hamburg, Germany, Iglesias said that social reform is necessary because poverty "represents an ever more intolerable anachronism and an affront to the principled conscience and to the political responsibility" of all those who managed public affairs.

Breaking down the walls of poverty, he emphasized, "is a task that has yet to be managed anywhere in the world, and in human terms, much more important from an ideological viewpoint than the demolition of the Berlin wall."

Iglesias, who has just completed his first, five-year mandate as IDB President and will begin his second term of office on April 1, reviewed the region's 1992 economic results and emphasized the challenges that will confront Latin America and their implications for the IDB. Both the region and the institution, he said, are immersed in a world where "the reality changes more rapidly than ideas," requiring that change be undertaken as an ongoing process.

"The old world of recognized certainties and closed utopias, of global models and mutually exclusive ideological schemes, is giving way to a world which is pluralistic, libertarian and diversified: a world of societies that allow more freedom to their citizens, but demand more creativity and empower individuals to attain fulfillment in the context of greater social cohesion," declared the IDB president.

Within this new global framework, said Iglesias, the potential contribution of the Bank in addressing the economic and social modernization process as a whole must be expanded. This contribution should have three main elements: social reform; the creation of a new culture of production and the modernization of the State.

In Iglesias's view, social reform must address the historical causes of poverty, aggravated by the crisis produced by the "lost decade" of the 1980s. Social reform, in turn is part of a broader reform, "integral and unique, since there is not one social face and one economic face, but a single face which focuses singlemindedly on fostering the development of society, human dignity and man's capacity to accelerate progress."

For the IDB president, social reform will be successful only if it is made a national objective that springs from a "crucial internal political consensus that grows up around what must be a true national objective in pursuit of a greater social integration."

Among the measures to be taken, Iglesias distinguished those that must be taken over the short term - assistance policies, restructuring of public expenditures and the fight against the "new poverty" - from medium and long-term measures, such as the incorporation of broad sectors of the population into the productive process and the improvement of living conditions in the cities and rural areas.

Economic and social reform must be accompanied by changes in the entrepreneurial sector, in microeconomic reforms based on a new productive culture and a new kind of enterprise founded on research, information, production and market principles.

Iglesias warned that this transformation cannot be carried out by entrepreneurs alone, but requires above all an "adequate macroeconomic climate, price stability and well functioning markets," among other factors.

"The strengthening of democracy and the quality of the political process are not separated from this productive culture," he added.

Another dimension of the reform is the modernization of the State, because: "It is not possible to carry out a sustained restructuring of the productive apparatus, an in-depth social reform and a determined effort to increase our international competitiveness," emphasized Iglesias, "without the guidance and support of the State, but of a renewed State that is more enterprising than bureaucratic."

The measures to modernize the State must be sustained and comprehensive, he added, since it would an illusion to think that "it is possible to maintain a vigorous pace of development so long as action by economic agencies is impeded by bottlenecks in the legislative process, in regional administration or in the environmental situation."

The Bank, said Iglesias, has always had its finger on the pulse of such concerns, but it now faced formidable new challenges and should be prepared to respond to new requests for support from the countries of the region."

During President Iglesias' first term of office, the Bank increased significantly its lending thanks to the Seventh Increase in Resources, which was approved by the IDB governors in Amsterdam in 1989. Similarly, it expanded its sphere of action and carried out the largest internal reorganization in its history.

The XXXIV meeting begun today in Hamburg and will end on March 31.

1/4

Distr. General
BID.INTAL/DP 461/92
Publ. Nº 398

INTER-AMERICAN DEVELOPMENT BANK
INSTITUTE FOR LATIN AMERICAN INTEGRATION
IDB-INTAL

THE LATIN AMERICAN INTEGRATION PROCESS IN 1988/1989/1990

Buenos Aires
1992

Latin American Integration: Experiences of the 1980s and Outlook for the 1990s

1. The Experiences of the Eighties

From the onset, the eighties in Latin America and the Caribbean witnessed a dividing line between trends. The decade started with the 1979 second oil crisis while the 1980-81 recession in the industrial countries prompted them to design a joint strategy consisting of tax reductions and an expansion in public expenditures, particularly in defense appropriations.

These new conditions became highly perceptible on both the local and the international fronts. Although the developed countries achieved economic recovery -seven years of uninterrupted expansion even though at growth rates lower than those recorded in the sixties- there was a counter reaction in the form of a chain of events that brought about substantial shifts of the burden of the crisis to the developing countries, particularly commodity exporting countries. High real interest rates, a decline to new lows in the prices of primary commodities, severe constraints in the financing available to developing countries and a tightening in the developed world of "non-tariff" protection mechanisms are events that clearly show the disproportionate burdens that fell on the debtor countries thus hampering their growth.

Necessary adjustments were made in most Latin American countries in order to accommodate to the new circumstances. The countries that fared better were those that had some sort of "entrance" mechanism into industrial nations, through political connections, a strategic geographic situation, or by means of their capacity to supply labor-intensive manufactured goods, especially if they were able to "digest" well the internal conflicts emerging from the new difficult situations, from both the political and the social standpoints. On the other hand, those countries which had to suffer a combination of high interest rates, net negative financial flows, unfavorable terms of trade and market failures, had to face severe adjustments that put pressure on their economic, political and social structures. This has resulted in a severe crisis, often accompanied by high inflation (or hyperinflation), disarray and the onset of social disintegration. Production structures that had been established in a context of less competitive strategies, as a response to prevailing circumstances, strongly resisted the adjustments and turned the decade into a period of increasingly serious conflicts.

Between 1979 and 1981, the Latin American non-oil exporting countries borrowed heavily, especially from private commercial banks, at a real annual rate of almost 10%, with the idea of wiping out a current account deficit caused by high interest rates and capital flights. The capital flight was particularly significant in the larger economies of the region due to existing macroeconomic imbalances and an eroding confidence in the future capacity to meet outstanding obligations.

Since 1982, the additional amounts borrowed were not enough to meet the external debt service and it was, therefore, necessary to make severe adjustments in order to provide the required surplus in current account that would permit an adequate compliance with external obligations. Since then, net financial transfers became persistently negative; they amounted to an annual average equivalent to almost 4% of the region's GDP. Furthermore, due to a deterioration in the terms of trade, this percentage would be even higher, by almost 2% of GDP.

The Latin American countries responded by contracting real investment and diminishing expenditures in social services and infrastructure, thus affecting long-term growth and sowing the seeds of future social tensions. At the same time, not always successful attempts were made to increase taxes, diminish consumption and increase productivity.

All the above was made worse by the fact that Latin America marched into the heavily-mined environment of the crisis debilitated by an overdependence on exports of primary commodities (almost 80 per cent of total exports). In spite of efforts made to increase the volume of exports, the drop in world prices not only adversely affected import opportunities, but also reduced the possibility of increasing tax revenue, which in the region frequently depends on export taxes and customs duties. Faced with a reversal in capital flows accentuated by "the terms of trade effect", savings did not increase at a rate capable of compensating for capital exports and, consequently, the obvious and serious result was investment contraction.

Public sector deficit in the larger economies of the region had already increased by the mid-seventies and during the first half of the eighties tended to remain high and even to grow, due not only to the difficulty in raising tax revenues, but also to the lack of elasticity in public expenditure, particularly noticeable in some capital-intensive investment programs, such as electric power supply works, which cannot be easily curtailed in a short span. The widespread reduction in public investment had adverse effects on the social infrastructure

and due to lack of maintenance there is a serious deterioration in the highways infrastructure, as well as in other public sectors.

The difficult years of the eighties can then be summarized as follows:

(a) The 1980-1982 recession in industrial countries lashed the markets, partly due to a slowdown in growth and, also, to erection by these countries of protective non-tariff barriers.

(b) As a result of substantial increases in real interest rates, the external debt became a heavy burden that was shifted to the economies of the region. The financing that most debtor countries had obtained from private commercial banks was adjusted to soaring floating interest rates, which resulted in a persistent increase in debt and in debt service as a percentage of GDP and exports. Furthermore, private debt carrying exchange risk protection was in many cases accepted by the Latin American governments and this in turn worsened the fiscal situation.

(c) Direct foreign investment shrank, especially after 1982. External loans declined; the pro-cyclical performance of banking operations contributed to worsening the situation of debtor countries; and, furthermore, flows from financial markets were only possible in less favorable conditions. Net capital inflows dropped steeply and, at the same time, there was strong evidence of net financial outflows. Capital flight also increased.

(d) Commodity prices tended to decline sharply in spite of boom and bust periods and the terms of trade deteriorated.

(e) GNP in the region showed declining rates; per capita GNP and investment diminished as well. Inflationary pressures were difficult to restrain and in several countries there was a threat of hyperinflation that still lingers. Industrial production dropped as did the sector's share in GDP.

(f) There was a contraction in imports and at the same time an increase in exports. Intraregional trade experienced a distinct regression until the mid-eighties, but 1985 marked the beginning of a sustained recovery.

(g) All these adverse circumstances led the Latin American countries to take strong adjustment measures. Even if there was agreement that adjustment measures were necessary, their asymmetrical application caused frequent resistance in the respective societies. In recent times, Latin America and the Caribbean have lived with the constant and distressful ghosts of severe inflationary pressures, purchasing power erosion, capital flights, unemployment and underemployment. These circumstances have created conflicts of interests among the economic agents, hardships for the less protected sectors, dangers that threaten economic and social harmony and hamper the consolidation of new democracies. Under these conditions, the problems encountered in the business cycle have turned the transition into a complex issue and have not permitted an adequate and timely consideration of underlying structural imbalances. The paradox is that, unless the latter are corrected, it would be practically impossible to overcome short-term upheavals and long-term development would be sacrificed.

2. The Outlook for the Nineties

It would seem that in recent years Latin American economic integration has started to follow a more steady path than in the past. Perhaps, the conflictive elements that have mushroomed in the external sector in recent years have made it necessary to think about a way to conquer better conditions for the benefit of all. Among other things, this has resulted in an expansion of the region's international bargaining power. At the same time, joint action may permit improving macroeconomic stability and increasing the region's efficiency by means of higher competitiveness and greater access to economies of scale.

The outlook for the nineties suggests that it would be advisable to take the necessary steps to achieve a more active integration than in the past. Latin America and its integration process will in all probability have to face, and coexist with, some of the following circumstances:

(a) The collapse of the Bretton Woods agreement and its repercussions on international monetary and exchange systems was a situation that exploded at the beginning of the seventies and its effects still linger. The shift from economies with fixed interest rates to economies with floating rates brought uncertainty and the need to reach international cooperation agreements to keep the fluctuations in parity prices under control, particularly among the more developed nations. One element that should not be forgotten or set aside is the assessment of the frequently negative effect of the policies of industrial countries on the economies of developing countries. This is a fact that has been repeatedly pointed out by developing countries at international fora.

It would seem advisable to return in the nineties to some sort of stable worldwide monetary agreement. The members of the Group of 24 have been reiterating this call at Interim Committee meetings with a view to

achieving a more "automatic" coordination of the monetary policies of the member countries of the international community.

(b) The effects of the prices of oil and raw materials during the seventies also brought along important changes that can still be felt in several issues that will be the focus of attention in this new decade.

On the one hand, price increases in critical production factors had a strong repercussion on markets and ultimately manifested themselves in inflationary pressures. Existing pressure groups (especially the labor market) opposed the transfer of income (domestic and international) that had been triggered off by the impact of prices. Sectoral struggle -very well known and analyzed by Latin American structuralization efforts- became one of the main concerns of analysts in more advanced countries.

The cracking of the consensus has been complicated by internal disagreements stemming from adjustments of the economies due to the new conditions prevailing in the world. A well-known fact is the painful adjustment that debtor countries have had to endure in view of the increase in real interest rates. Another issue that will have a greater import in years to come is the need to curtail military expenditures in many countries in order to reduce fiscal pressures and facilitate development and investment. In the same way, growing strains are being perceived as a result of the generalized downsizing of the Welfare State that had become widespread and consolidated after World War II.

(c) Two elements are nowadays gaining importance: (1) technological advances which are conducive to substitution of raw materials and labor, together with breakthroughs in communications and information systems, which has permitted a decentralization of production, as well as innovations that would provide a better basis for competitiveness in international trade, and (2) a relocation of industrial activities to make use of abundant and cheap labor for off-shore manufacturing of components, which contributed to an expansion in "intra-industrial trade". It is worth noting that the abovementioned relocation of manufacturing industries was not fully understood by many developing countries that could have profited from participation in the process. Also, labor unions and other interested groups in activity-exporting countries did not welcome the idea of distributing in other nations some of the elements of the manufacturing industry. The "new non-tariff protectionism" and "reciprocity" laws, frequently supported by concoctions and legal swindles started to carry more weight in the international context, in part as a result of the tendency to international distribution of productive activities. Voluntary Export Restrictions (VER) and Orderly Marketing Arrangements (OMA) have been part of this game of political and economic constraints that have plagued international trade.

(d) Another alternative considered in this context has been attracting domestic or external capital, rather than exporting capital by means of relocation. Some possible candidates have been interested in this possibility due to the substantial international mobilization of capital. Sometimes, foreign exchange revaluation in conjunction with a threat of future constraints on trade has induced foreign investors to establish themselves locally ("preventive tariff jumping") as is now the case with the European Community and the United States, particularly with regard to Japanese investments. In other cases, an attempt was made to establish economic regions that could offer basic conditions for becoming centers of capital attraction on the basis of the possibilities they offer and the increasing danger they face of becoming locked in ("Fortress Europe"), with political stability and the potential of acceding to a "megamarket" -320 million in the case of Europe. Practically all countries have become players in this game to attract capital (and the technology that comes alongside). All feel stimulated by the possibility of expanding and of placing themselves as close as possible to the technological frontier. Good examples are China's "special zones" during the first half of the eighties and Hungary's "joint ventures" and the possibility of attracting capital to Eastern Europe.

(e) In some instances, and continuing with the trends of previdus years, during the seventies and eighties, an attempt was made to overcome the cost of labor by means of international (and sometimes local) immigration. This alternative resulted in a great mobility of the human factor. Masses of people crossed frontiers looking for better economic opportunities. But this movement had counter effects, many of which are still felt and probably will become more noticeable in the future. Immigration flows have aroused resentment stemming from cultural adjustments; they have rekindled political positions that oppose foreigners and in general they have produced social, economic and political frictions in many of the beneficiary countries.

Nevertheless, it should be borne in mind that in some cases migrations have been caused by pressures resulting from the adjustments made in developing countries which tended to "export" any excess labor made available by the new strategies being applied. In Latin America there are clear examples of these situations.

(f) The recessive trend at the beginning of the eighties led to a wide reassessment of the role of the State, in addition to a generalized race towards achievement of economic growth. The following are examples of this tendency:

i. On the one hand, the appropriate size of the State has been questioned in view of its participation in income distribution struggles and the excessive burden that this has placed on the private sector (through expenditures, level of efficiency, interference with private decision-making processes).

As a result of new technology available in the field of communications, the need has been stressed for a new "fiscal pact", decision-making decentralization and privatization. Efforts have been made to slim down the Welfare State but as yet it has not been possible to clarify the ambiguity that still persists in the international field. We refer to the fact that those countries which have clearly shown that they are against State interference are not the ones that are ahead in economic recovery. In Japan, the State follows the strategy of giving support to private enterprise rather than playing an interventionist function in the context of long-term planning. Nevertheless, it cannot be said that it is a minimal State.

ii. The role of the State has also been examined in view of the so-called "Asiatic shock": "Chinese" for the former Soviet Union and "Japanese" for the United States and Europe. China, with the "four modernizations" reform (late seventies and early eighties) aroused serious doubts about systems based on a wholly centralized planning. The system of "responsibility" that gives more economic freedom to the people, the "special zones", the attraction of foreign capital, the winning of international markets, were all factors which improved efficiency and brought an air of increased freedom to production that has doubters had some impact in Central European and former Soviet Union countries. To remain isolated means economic and technological backwardness.

Those countries with larger military budgets and commitments started to undergo expansion problems difficult to justify. The persistent fiscal deficit in the United States is a clear example. The painful situation of the Russian economy seems to be another one. On the other hand, "trading countries", those with minimal military commitments, have shown important signs of advancement. What has been called "economy of peace" is giving clear indications that the "spender" countries seem to be more willing -at least they have shown the intention- to curtail military expenditures in order to give impetus to a more dynamic economic development. From this vantage point, economic considerations overcome military conflicts. In the nineties, the results and future of these trends will be more noticeable.

(g) In international trade, the formidable awakening of a keen competition among nations brought along a series of new trends in trade. The following are some of the areas that may define future trends:

i. Product differentiation and flexibility to find "niches" in the markets requires the capacity to design a commercial strategy. The adaptation capacity to find loopholes in the legal aspects of protectionism in potential markets is one element in the array of schemes used by the "competitive" countries. "Ecology" has also been used to refrain the advances of a competitor. There are multiple and diverse possibilities in this game. In some instances, the services of an associate or intermediate country are used to try to penetrate markets that otherwise would be restricted.

ii. Technological advance is part of the modern competitive game. Human capital is another important factor that will continue receiving attention in future years. Therefore, emphasis on education continues to increase. It has been pointed out in this respect that technological differences rather than "factor allocation" define with increasing precision the direction of international trade. Unfortunately, adjustment processes in Latin America have eroded the educational systems and have greatly weakened the possibilities for the development of the region's scientific activity.

iii. The economies of scale, the "learning curves" and the possibility of developing external economies have also been considered in detail in relation to international trade. Naturally, these issues have been a permanent matter of concern for those authors that have insisted on the need to advance with suitable "industrial policies" to improve the relative positions of countries in the context of the international economic environment.

iv. The growing weight of services in international trade is another modern topic that will often appear in what is left of this century. This has been an important factor in the Uruguay GATT Round of Negotiations. Services encompass an increasing gamut of activities (legal, economic and entrepreneurial advice, telecommunications, health, tourism, training of paramilitary groups, etc.) In view of the importance of services in various fields it seems that time will come when they will be analyzed not only from an economic point of view but also form several other vantage points (cultural, social, legal, political, etc.).

v. The impact of human activities on the environment has aroused a growing concern and has generated public and private actions to increase awareness and to spread knowledge on environmental issues that include the protection of natural resources (soils, water resources, air, forests, etc.), industrial and urban wastes, etc. Another issue increasingly discussed is the problem of drugs and something similar happens with the arms trade.

vi. Other issues particularly important to those Latin American countries seeking integration, are those related to the regionalization trends that have appeared on the international scene. The European Community and the advances and uncertainties of 1992 are an example. The latest events in Central and Eastern Europe add concerns as to the possibility of establishing an European Confederation that would include the former socialist countries, according to the "European House" formula proposed by Gorbachov. Other examples are the front made up of Canada, the United States and Mexico, the NICs of Southeast Asia (probably under the leadership of Japan). Latin America should probably imitate these trends to attain more solid advances and to consolidate its integration efforts.

3. Conclusions

Without attempting to exhaust all the issues that most probably will be present in the decade that has just started, we have mentioned above many points that will in all probability contribute to defining the future. As is always the case with the economic arena, the issues that have not been mentioned will probably be the most important ones. Trying to cover as many aspects as possible, we have included some factors that linger from the immediate or the distant past and that have enough self-contained dynamism to assure a future presence. We have not covered other aspects that will no doubt draw attention in the future. Ecology and its impact on globalism (and relations between national states) and trade relations, strategic moves among nations and enterprises, population increase, and the debt problems of the Third World.

Many of the signs of the future are already latent nowadays. Latin America, ideally as a whole, will have to meditate in order to advance with a certainty of success along the path of this most complex decade.

Ways Out of the Debt Crisis

Perspectives and Optio
for Latin America's Major Debtor Natio

by Walter Eberl

Studies and Documents by the Foundation Development and Peace and the Institute for Development and Peace

1. Latin America's debt burden: A never-ending crisis?

For Latin America, the 80s were a "lost decade" in which economic and social development made no progress in most of the continent's countries - a decade in which these countries at best stagnated and in some cases even declined. There is little to suggest that the 90s will be any better. On the contrary: "a vivid imagination is not required to envisage a pessimistic scenario for Latin America in the 90s - a scenario whose hallmarks are economic stagnation, environmental degradation, increasingly violent conflict over the distribution of wealth and political instability" (SANGMEISTER 1990: 29).

A variety of endogenous and exogenous factors are responsible for Latin America's on-going development crisis. The debt crisis ranks first on the development policy agenda - it has turned into a "blockade against development" of utterly insurmountable dimensions (NUSCHELER 1991: 143). It is preventing economic development, making it impossible to achieve any sort of social balance, threatening democratic systems, and its consequences are contributing more than any other factor to environmental destruction in the countries of South and Central America. The debt crisis is therefore rightly being characterized by many analysts as the central factor responsible for the "lost decade" of the 80s (for a typical example, c.f. SOUTH COMMISSION 1990: 55-70). Finding a solution to this problem should certainly not be viewed as a sufficient condition for renewed and sustainable development in Latin America; nonetheless, it is a necessary condition.

In August 1982, Mexico, one of Latin America's major debtor nations, declared itself insolvent, sending shockwaves throughout the world of international finance. The debt crisis is generally considered to have begun in that year. Ten years have passed since then - ten years in which "crisis management" has primarily been formulated and determined by the international community of creditors. The situation to date:

- Latin America's long-term external debt more than doubled in the 80s (to around US $ 339 billion in 1990) even though Latin America paid over US $ 380 billion in debt service (interest and principal) over the period 1983 to 1990.

- There has been a negative net transfer (new loans minus debt service) since the beginning of the crisis. Altogether, Latin America paid about US $ 168 billion more in interest and principal to its creditors than it received in the form of new loans over this period (1983-1990).

- For Latin America the ratio of debt service payments to export earnings is still far above the level considered to be tolerable from a development perspective. In 1990, 27 percent of the continent's export earnings were siphoned off through debt service.

- As a whole, the countries of Latin America have not been able to reestablish their credit-worthiness on international financial markets. In 1989 these countries received just one-sixth of the total amount of bank loans they had received in 1980.[1]

These few statistics demonstrate that there is no question of the debt crisis being defused. The view of leading analysts in the creditor nations that Latin America's debt crisis merely involved a short-term liquidity crisis, and that the debtors "should be able to return to a sound financial footing within two to four years" (CLINE 1983: 122) has turned out to be a blatant mistake.[2] Meanwhile, creditors have begun to grasp that Latin American debtors are not only suffering from illiquidity, but are, in effect, insolvent.[3]

Approaches to debt management have been changing accordingly for some time now. The so-called "Brady Plan", in particular, is being viewed as the signal for a new debt strategy because it recognizes that debts cannot be (completely) repaid (c.f. BRADY 1989). The taboo of a debt write-off has thus been broken. But the results of the Brady initiative have been more than disappointing so far (c.f. KAMPFFMEYER 1990: 109 and SANGMEISTER 1991a: 21). There has been no tangible or sustained relief for debtor countries. In view of the debt burden, the reductions in debt and debt-service achieved within the framework of the Brady Plan can only be characterized, on the whole, as marginal. Even the World Bank, which had at first ecstatically hailed the Brady Plan as "a new approach to the debt crisis" (WORLD BANK 1990a: 31), has regained its grip on reality. In its 1991 World Development Report, it admits that the results of the plan have turned out to be quite meagre. The need for "new debt reducing initiatives" is cautiously hinted at without any further comment (WORLD BANK 1991: 150).

The Latin American crisis requires new solutions if another "lost decade" is to be avoided. A bewildering array of alternative proposals on ways to solve the crisis have been thrust into the discussion over the past few years.[4] These approaches can first be grouped into two categories - leaving aside the question of their crisis diagnoses and proposed therapies. On the one side are those schemes which (implicitly or even explicitly) assume that a solution to the crisis can be agreed upon and put into practice by debtors and creditors on a cooperative basis (as a result of rational insight). On the other side are those proposals which (for the most part explicitly) assume that a cooperative agreement to solve the debt crisis is not possible and therefore recommend that debtor countries opt for confrontational strategies. The following analysis revolves

1 All data used here pertaining to Latin America's foreign debt comes from: WORLD BANK 1990a and 1990b.

2 The study quoted here by William CLINE of the Washington Institute for International Economics formulated the perspective on which the official crisis management of the years 1983-1987/1988 was based.

3 The terms used to describe the world's liquidity and solvency crisis are borrowed from the field of business administration. At the firm level, illiquidity means a temporary "lack of liquid funds" (GABLER BANKLEXIKON 1988: 1070). Insolvency, on the other hand, is "a long-term inability to meet debt obligations upon their maturity" (GABLER BANKLEXIKON 1988: 1111). With respect to the debt crisis of the DCs, the distinction between illiquidity and insolvency has been used since the beginning of the 1980s (cf. LÖSCHNER 1983: 73).

4 There are now said to be about 200 or more proposals for solutions to the debt crisis (cf. NUSCHELER 1991: 160). Overviews of the alternative strategies can be found, for example in: BORIS et al. 1987; HOBBS 1990: 204-209; HOLTZ 1988; NUSCHELER 1991: 160-169; ROETT 1989: 66p; SCHUBERT 1985: 240-272.

451

around this dichotomy. The central question for both sets of strategies is how realistic their implementation is in the 90s.

The following discussion is especially concerned with the situation of the "major" Latin American debtor nations. "Major debtor" is not a technical term but refers here to the six Latin American countries with the greatest amount of outstanding debts: Argentina, Brazil, Chile, Mexico, Peru and Venezuela. These six countries alone account for almost a third of the total external debt of all the developing countries put together. If one looks only at the debts of these countries with commercial banks, more than half of total claims on the developing countries is accounted for by these six countries. If the debt crisis is indeed a "debt earthquake", as it has been termed (NUSCHELER 1991: 144), then the epicenter of this earthquake is right here - in these six major debtor nations.

Cooperation or confrontation - which perspective offers the major Latin American debtor nations a way out of the "debt trap" in the 90s?

4. Conclusions and perspectives

The socio-economic, political and ecological consequences of the debt crisis make it Latin America's central development problem. The solutions offered by creditors thus far have also changed very little in this regard. Banks and governments in the industrialized countries are still not prepared to assume **responsibility** for making a suitable contribution to a solution of the debt crisis. There has been no lack of viable plans to overcome the debt crisis (c.f. 2.1). The problem, however, is that the interest of the creditors currently stand in the way of implementing these proposals and will continue to do so in the foreseeable future. For the commercial banks and the IC governments, the financial constraints are still too restrictive for significant voluntary concessions to be made to the debtors, especially to the major debtor nations, and this situation is unlikely to change significantly for years to come (Mexico may prove to be the sole exception as a result of its special situation). Unilateral actions to reduce debts therefore appear to be the only alternative to a continued policy of "muddling through." The most recent results achieved by Brazil's debt policy (1989-91) demonstrate that unilateral action on the part of debtors can definitely be a realistic policy option under certain conditions. Unilateral defaults by debtor countries can be expected to occur more frequently in the next few years - with the major debtor nations Brazil and Argentina at the head of the pack. A solution to the debt crisis in the 90s could follow historical parallels: In earlier debt crises as well (e.g., the Latin American crisis in the 1930s) it was initially necessary for debtors to take unilateral action for several years before a cooperative solution to overcome the crisis could be found.

***

Finally, the debt crisis is a part and parcel of the development crisis faced by the South - but that is not all. Beyond this, it is an essential component of the crisis in North-South relations as a whole and ultimately has pronounced negative consequences for the industrialized countries (the oft-cited relationship between debt crisis and the destruction of the tropical forests is only one example among many). The recognition that we live in an interdependent world - the context in which the debt crisis must be grasped - has recently been given increasing attention (c.f., for example, BRANDT 1985: 173; SOUTH COMMISSION 1990: 268p). This argument is not new. An almost certainly forgotten passage out of a book published in 1972 (!) - a point in time when no-one could have foreseen the dimensions of today's debt crisis - is worth quoting here. The under-secretary of state of the German Federal Ministry for Economic Cooperation, Karl Heinz Sohn, formulated the following viewpoint, which is still valid today:

> "Market strategy is sufficient reason for the industrialized countries to view the developing countries as tomorrow's trading partners. They cannot afford to simply exclude four-fifths of the world's population and two-thirds of the globe from the ecónomic relations. If, however, they include the Third World as a normative power in their deliberations in the future, it would be foolish to let these countries collapse under the weight of their debts. More prosperous developing countries are much more attractive than abjectly poor ones. If tomorrow's potential partners are driven into financial agony, the chances of coming to terms with them will be lost. A generous and long-term solution to the debt problems of the developing countries is thus in the industrialized countries' own properly perceived interests."
>
> (SOHN 1972: 100).

Many developing countries have been in a situation of "agony", and not only financial agony, for almost a decade now. The term "agony" used by Sohn in the above quote basically amounts to a death struggle and is an extremely accurate description of conditions faced by the poorest of the poor in the 80s. These conditions partly result from the debt trap in which many developing countries have become ensnared. To pry open this trap and make development possible is the task in the 90s - for humanitarian and developmental reasons, for reasons of international law and in the interest of "One World": "...in the interest of sustainable development worldwide and the promotion of global peace and and security." (SOUTH COMMISSION 1990: 268).

Latin America and the Caribbean
Technical Department
Regional Studies Program

The World Bank

December 1992

Report No. 27

Poverty and Income Distribution in Latin America:

The Story of the 1980s

by

George Psacharopoulos, Samuel Morley, Ariel Fiszbein,
Haeduck Lee and Bill Wood

Executive Summary

This report presents the findings of a regional study on poverty and income distribution in Latin America and the Caribbean. The study has been undertaken because of the significance of the issue and the paucity of statistical information on recent trends in poverty and income distribution in the LAC region. Moreover, there is a great need to assess the impact which the economic recession of the 1980s has had on the poor, particularly in light of reduced spending per capita on public social programs.

The primary focus of this study is descriptive in nature, in an effort to expand the existing state of statistical knowledge on these important issues for the region. As such, it should not be interpreted as demonstrating that adjustment has disproportionately hurt the poor. Poverty is a chronic problem and without adjustment, the condition of the poor would probably have been worse than is described in the study.

The analysis put forth is based on micro data obtained from thirty-one household surveys for a total of eighteen countries in Latin America and the Caribbean. For twelve of these countries, the availability of comparable data at two points in time has made it possible to examine how income distribution and the extent of poverty have changed between the two survey periods.

For each data set, the principal basic statistics pertaining to income distribution and poverty are presented. These include the decile income distribution, the Gini coefficient, the Lorenz curve, the headcount index, the poverty gap and the Foster-Greer-Thorbecke (FGT) P_2 measure. These statistics are based on per capita household income from all sources, as determined by the household surveys.

The data for Argentina and Paraguay are for metropolitan regions only, while the data for Bolivia, Colombia, Ecuador, El Salvador, Peru (Lima) and Uruguay refer to urban areas only. Therefore strict comparability between countries is not possible in all cases. Geographical coverage of the underlying surveys must be taken into consideration when interpreting the findings of this study.

As a complement to the per capita household income distributions, an analysis and decomposition of income inequality based on workers' income only is also presented. The former examines the distribution of income across the entire population, which is a reflection of individual welfare levels. The latter analyzes the prevailing income structure in the labor market. The decomposition of workers' income inequality highlights the individual characteristics which are associated with success in the labor market, as proxied by earnings.

Finally, a set of social and demographic indicators are presented for each country. When possible, these indicators are disaggregated by various criteria, including income quintile and urban/rural place of residence; health indicators are also disaggregated by level of mother's education. These disaggregations highlight the within country variability of social and demographic conditions, and demonstrate associations of these indicators with region of residence, income group, and education level.

Income Distribution

From a general perspective, income inequality remains high in the Latin America and Caribbean region relative to other areas of the world. The mean Gini coefficient from the most recent surveys in this study is 0.50, while the mean income share for the bottom 20 percent of the distribution is 4 percent of total income. These statistics reflect a significantly greater degree of income inequality in Latin America and the Caribbean relative to other regions.

According to the latest data, Brazil, Chile, Guatemala, Honduras and Panama all have Gini coefficients which exceed 0.55. The bottom 20 percent of the income distribution receives less than 3.0 percent of total income in Brazil, Guatemala, Honduras and Panama. At the other end of the spectrum, Paraguay (Asunción) and Uruguay (urban) demonstrate the least degree of inequality, with Gini coefficients of 0.40 and 0.42, respectively, and 6 percent and 5 percent of income accruing to the bottom 20 percent of the distribution.

Changes in income inequality show mixed results for the time period examined. The Gini coefficient worsened in Argentina (Buenos Aires), Bolivia (urban), Brazil, Guatemala, Honduras, Panama, Peru (Lima) and Venezuela. By this same measure, income inequality diminished in Colombia (urban), Costa Rica, Paraguay (Asunción) and Uruguay (urban).

Trends in income inequality appear to have been significantly influenced by trends in per capita income. Of the seven countries for which the data span the entire decade, the three countries which showed reductions in income inequality (Colombia - urban, Costa Rica, Uruguay - urban) had an average <u>growth</u> of 3 percent in per capita income for the entire decade, while the four countries which experienced an increase in income inequality (Argentina - Buenos Aires, Brazil, Panama, Venezuela) had an average <u>decline</u> of 12 percent in per capita income for the same period.

The income share of the bottom 20 percent of the distribution went up in all countries where the Gini coefficient declined, and it went down in all countries where the Gini coefficient increased during the decade. Not surprisingly, changes in the share of the top 20 percent of the distribution demonstrated the exact opposite trends - rising and falling with the Gini coefficient. Given that most countries in the region which experienced a rise in inequality also showed a drop in real per capita income during the decade, the evidence indicates that the wealthy were better able to protect themselves from the impact of the recession than were the poor.

The inequality estimates of this study, when combined with outside sources, indicate that income inequality rises during recession and falls during recovery. An examination of twenty-six economic cycles corresponding to at least two years of either recession or recovery shows that, in all but three cases, recession was associated with increased inequality while recovery has been associated with lessened inequality.

Workers' Incomes

Information on the distribution of earnings is available for ten countries. The workers' income distributions are based on all individuals 15 years of age or older who were in the labor force and had positive income at the time of the survey.

These distributions are important because labor represents the principal asset of the poor. A subsequent decomposition highlights those characteristics which are most associated with poor earnings performance. This decomposition analysis underscores the relevant factors for targeting in order to improve the earning potential of the poor.

According to the Theil index, workers' income inequality is found to have increased in six of the ten countries (Argentina - Buenos Aires, Bolivia - urban, Brazil, Honduras, Panama and Venezuela), and to have decreased in the four remaining countries (Colombia - urban, Costa Rica, Guatemala and Uruguay - urban). Guatemala is the only case whereby inequality of workers' income moved in a different direction than inequality of the population overall.

Among the countries with the most unequal distribution of workers' income, Colombia (urban) registered a significant improvement between 1980 and 1989. Having ranked first in inequality during the early period, Colombia (urban) ranked fifth during the late period. Brazil, which ranked second by the Theil index in the early period, exhibited the greatest degree of inequality during the late period. Bolivia (urban), Guatemala and Honduras also continued to demonstrate very high degrees of workers' income inequality.

There have also been changes regarding the ranking of countries with the least inequality. In the late 1970s/early 1980s, Argentina (Buenos Aires) and Panama had the lowest levels of income inequality among the ten countries. This was no longer true by the late 1980s, and by 1989 Argentina (Buenos Aires) presented a moderately high level of income inequality.

Costa Rica and Uruguay (urban), which already presented relatively low levels of income inequality in the early 1980s, exhibited the least inequality by the end of the decade.

The decomposition of workers' income inequality shows that variations in educational attainment has the highest contribution to income inequality out of four variables examined (age, educational attainment, employment category and sector of employment). On average, differences in individual educational levels account for approximately 25 percent of total income inequality in the workforce in Latin America. Furthermore, in eighteen out of twenty country cases examined, education also demonstrates the highest marginal contribution to total inequality.

A further decomposition of the workers' income distribution indicates that the contributions of selected characteristics towards the probability of belonging to the bottom 20 percent of the distribution varied little between the beginning and the end of the decade for each country. Low educational attainment was the factor most associated with the probability of belonging to the bottom 20 percent of the labor income distribution.

Absolute Poverty

A regional poverty reference of $60 per person per month in 1985 purchasing power parity (PPP) dollars has been established as the cut-off to distinguish the poor from the non-poor in Latin America. This methodology follows the approach used in the World Development Report, 1990 and was chosen to minimize problems in comparing countries across the region. This measure should not be viewed as an arbitrary effort to provide the definitive measure of poverty. Subject to the qualifications discussed in the report, the poverty headcount index for Latin America and the Caribbean increased from 27 percent to 32 percent for the region as a whole between 1980 and 1989.

At the country level, three poverty measures are presented for each household survey data set included in this report: the poverty headcount, the poverty gap and the FGT P_2 index. For each of these measures, Costa Rica and Uruguay (urban) consistently ranked as the best performers, while Guatemala and Honduras (urban) consistently ranked as the worst. The poverty headcount was above 50 percent of the population at the end of the decade for Bolivia (urban), Guatemala and Honduras (urban). Costa Rica and Uruguay (urban) had the lowest poverty rates at 3 percent and 5 percent of the population, respectively.

Each country for which data were available at two points in time registered a change in the same direction for all three poverty measures. With respect to these measures, Argentina (Buenos Aires), Bolivia (urban), Brazil, Guatemala, Honduras (urban), Panama, Peru (Lima) and Venezuela deteriorated during the decade, while Colombia (urban), Costa Rica, Paraguay (Asunción) and Uruguay (urban) improved.

During the 1980s, poverty shifted from being a predominantly rural phenomenon to a predominantly urban one. Though the probability of being poor in 1989 was more than double in rural regions (53 percent) than in urban regions (23 percent), the absolute number of poor was higher in the cities (69 million) than in the countryside (64 million). This contrasts with 1980, when the probability of being poor was also double in rural regions (45 percent) than in urban regions (17 percent), but the majority of the poor lived in rural areas (53 million) rather than in urban centers (38 million).

The bulk of poverty in Latin America is concentrated in a distinct set of countries. In 1989, over 44 percent of the poor lived in Brazil alone, although that country had only one-third of the region's population. Mexico and Peru had 11 and 9 percent of the poor, respectively, while an additional 19 percent lived in a group of relatively small countries. (Included in this group are Bolivia, El Salvador, Guatemala, Haiti, Honduras and Nicaragua.)

A decomposition of the regional increase in poverty during the 1980s indicates that this rise occurred in a concentrated group of countries. A staggering 44 percent of the total increase in poverty for all of Latin America took place in the cities of Brazil, though part of this is due to the migration of rural poor to urban areas. An additional 14 percent of the total increase during the decade occurred in Peru.

The poverty estimates of this study, when combined with outside sources, indicate that absolute poverty rises during recession and falls during recovery. Recession was defined as any time period where there were at least two years of falling per capita income; all other time periods of two years or longer were classified as recoveries. In fifty-five out of the fifty-eight recession periods identified, poverty increased. Of the thirty-two recovery periods, poverty fell in twenty-two cases, was essentially constant in three cases, and increased in the remaining seven cases. Thus the evidence supports the not very surprising proposition that poverty is sensitive to the level of income.

Social Indicators

While income is the most common measure of economic well-being, it hints only indirectly at many "quality of life" indicators such as infant mortality, malnutrition, access to health care and educational attainment. Though these social indicators have generally been improving during the 1980s, intra-country breakdowns show high levels of variability across several criteria. Strong correlations are found between social indicator performance and mothers'/women's educational level, urban/rural setting, ethnicity and income group. In particular, disaggregations of health indicators show the greatest variations in health indicators to be associated with educational attainment of mothers/women.

These factors are often interlinked. Indigenous communities tend to be situated in rural areas, and rural areas tend to have a higher proportion of poor people than urban areas. Poor women generally complete fewer years of schooling, on average, than women from wealthier families; in turn, low schooling levels are interrelated with high concentrations of poverty in indigenous and rural communities.

Unfortunately, data limitations severely hamper the ability to assess the links between income, health, education, region of residence and ethnicity in a comprehensive manner. However, the available evidence demonstrates that the substantial variability behind aggregate social indicator statistics is due to observable variables which can then be targeted through specific poverty reduction programs as well as through more general policies which incorporate targeting mechanisms into their overall design.

Agencies Develop Platform on Advocacy for Haiti

On the surface, the situation inside Haiti appears intractable. Human rights abuses and political repression continue despite a year-and-a-half long economic embargo against the military junta in power. Refugees continue to seek asylum, mainly in the United States. The US has responded by building legal and physical barriers stopping the would-be refugees from even fleeing the country. To date, the international community has been unable to develop strategies or policies to improve political conditions or provide hope to significant portions of the Haitian population. There has been neither a return of representative government to Haiti nor the alleviation of economic pressures on the poorest of the poor.

For the more than 20 agencies that met to discuss these problems at an early morning meeting April 28 at the Forum, one of the most serious consequences of the September 1991 *coup d'état*, and the failure to return President Aristide to power, has been the systematic destruction of Haiti's emerging civil society and democratic institutions. "The destruction of these institutions and organizations will make any reconciliation and reconstruction that much harder," said John Hammock of Oxfam America. "At the local level, it is often these grassroots organizations that are the underpinning of economic and political development. The current regime has seriously damaged this foundation."

Echoing the overall theme of this year's forum, participants agreed that the re-building of civil society in Haiti was critical to its future and that NGO advocacy efforts should be more focused toward this goal. "These groups and people's movements were the core of Haiti's move to democracy," said one participant. "They are our partners at the local level and we should be focusing our efforts on helping them regain a voice in Haiti's future."

At the same time, however, several agencies reported difficulty in making in-roads with grassroots groups since the coup. While it was agreed that the economic embargo was absolutely essential to pressuring the military leaders, agencies also expressed frustration over the way that the embargo has been exploited and manipulated. "The main question," said one participant, "is how to maintain the embargo in a way that hurts the military but still allows vital humanitarian aid to reach the poorest groups of society. So far, the only real impact of the embargo has been to inflict even more suffering on the same people that the US says it is trying to help."

PVO representatives expressed concern that licensing procedures and the criteria being applied were making it harder for NGOs to provide humanitarian help or training at the grassroots level, but that a lack of strict enforcement was still allowing the military regime to continue to buy arms, oil, and luxury items.

With these needs in mind, participants developed a platform statement that stressed the following recommendations:

1. The on-going abuse of human rights and widespread political repression are having dire effects on Haiti's economy and development and should be considered a matter of utmost urgency for the international community.

2. Recent steps of the Clinton Administration to work within a multilateral framework should be supported. The United States should continue to play a lead role — in close coordination with the OAS and United Nations — in seeking a diplomatic solution to the crisis and restoration of democratic rule.

3. Stronger economic and diplomatic sanctions that target the perpetrators of the coup are critical to pressure the military leaders in Haiti; all efforts must be taken to cut off the supply of arms and other military equipment to the coup leaders.

4. Increased emergency humanitarian assistance programs for the general population should be facilitated to mitigate any negative effects of the embargo; programs aimed at the poorest of the poor and in support of grassroots organizations should be actively promoted.

This platform was endorsed by 46 participants at the Forum and sent to President Clinton in letter form.

Participants also discussed their experiences in working in Haiti during this cycle of unrest. Several agencies were able to continue operations with little interruption. Others, however, reported that programs had been curtailed. It was agreed that current conditions in Haiti posed unique challenges to NGO staff. Several agencies suggested that InterAction should schedule a series of seminars and training sessions on how to work in areas of civil unrest. For more information on InterAction's advocacy work on Haiti, please contact Tim McCully at InterAction. ■