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Financing *for* Sustainable Development

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International Institute for Environment and Development

The Ring alliance of policy research organisations

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ABOUT IIED

The International Institute for Environment and Development (IIED) is an independent, non-profit research institute working in the field of sustainable development.

IIED aims to provide expertise and leadership in researching and achieving sustainable development at local, national, regional and global levels. In alliance with others we seek to help shape a future that ends global poverty and delivers and sustains efficient and equitable management of the world's natural resources.

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ABOUT THE RING

The Regional and International Networking Group (Ring) is a global alliance of predominantly Southern independent research and policy organisations. It was formed in 1991 to stimulate preparations for the 1992 Rio Summit. There are now 14 Ring member organisations based in 5 continents. More information on the Ring is on the back inside cover page.

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CONTENTS

INTRODUCTION

If the world is viewed as a single country, the nature of the question changes completely. Instead of asking what is needed for national development agendas, one needs to ask how the agenda of global sustainable development can be furthered – not how resources can be transferred from one country to another, but how resources can be mobilised for the equitable development of the entire 'country'.

The goal of sustainable development is a difficult one to begin with. Without the availability of adequate sources of financing it will remain an elusive one as well. Southern governments and sympathetic NGOs have long feared that sustainability and development might be incompatible, and in particular that existing economic trends as well as the fallout from international agreements could freeze global economic and political inequalities in the name of sustainability and thus stifle Southern hopes of progress or socio-economic parity. As a result, financing (along with technology transfer) has always been the top Southern priority in international negotiations on environment and development. At the United Nations Conference on Environment and Development (UNCED), popularly known as the Rio Earth Summit, financing and technology transfer were the two 'cross-cutting issues' pressed by the South. A decade later, in 2002, these two continue to provide central themes for the Johannesburg World Summit on Sustainable Development (WSSD) process. In addition, the UN Conference on Financing for Development (FfD) is being convened in Monterrey – again, reputedly at the behest of developing countries – to focus directly on financing.

Notwithstanding the persistence of the issue, the trends since 1992 have been disappointing to say the least. At the Rio Summit, the UNCED Secretariat estimated the financing needs of Agenda 21 to be in the region of US$600 billion per year, including $125 billion per year on grant or concessional terms. In the event, despite growing economic prosperity in the North and repeated commitments to 'new and additional financing', there was a net decline even in existing (that is old and non-additional) official development finance. In 2000, official development assistance (ODA) fell to its lowest level ever, declining to $53 billion from $56 billion a year earlier. The aid level in 2000 represents only 0.22 per cent of the GNP of DAC countries, less than a third of the UN target of 0.7 per cent. Even this low volume of aid is not spent primarily in countries whose population is in absolute poverty nor on measures that directly benefit the most disadvantaged groups. The OECD's special committee that reports on the aid performance of its members provided a stark conclusion in a recent review: 'It might well be argued that if more donors had met the ODA target (0.7 per cent of GNP), the mass poverty and humanitarian emergencies which persist in many parts of the developing world today might have been largely avoided' (OECD Development Assistance Committee, 2000). Simms (2000) considers this to be the clearest statement yet of the consequences of rich countries failing to meet their international development obligations.

While foreign direct investment has increased sharply during the same period, there are persistent concerns both with regard to its distribution and its side effects. The reasons for the decline of official finance are well documented. They extend from 'aid fatigue' – the erosion of legitimacy of foreign aid amongst populations in industrialised countries – to the end of the Cold War – which provided a major justification for foreign aid on security grounds – to the growing concern with corruption in recipient countries – and consequently, the potential for misuse of resource inflows – to a generalised pessimism regarding the effectiveness of aid.

More importantly, while the fears and concerns of the South have not abated, they have been supplanted by far more potent sources of anxiety. In retrospect the two worlds of 1992 and 2002 are very different from each other, and it would be naïve to continue to engage in discussions of development or finance as if nothing had changed. In less than a decade, the hopes, trust, and confidence built during the Rio process have dissipated. In place of a peace dividend, there is the threat of war; instead of the visions of uniform and broad-based growth there is the experience of unequal and unstable development; in place of faith in inter-governmental agreements there is growing cynicism and despair.

A theme that runs through all these reversals is the nature of globalisation. Rarely has a word captured popular imagination so rapidly or gone through so many reversals in symbolic import so quickly. In 1992, it had scarcely entered the lexicon; less than five years later, it was ubiquitous. Between 1997 and 1999, the major publishing houses alone published over 700 books containing this word – the vast majority of them celebratory in tone, albeit even then with a hint of defensiveness. Over the same time span, a process that envisaged global stewardship, economic prosperity (through economic liberalisation and integration), a unified global civilisation, and the communication revolution, has turned out to bring in its wake inequality, economic instability, economic concentration, the unfettering of corporate power, and more recently global crime, terrorism, and insecurity. Today, it is a word laden with menace.

How is the world to think of financing and sustainable development in this new situation? The discussions surrounding both the WSSD and the FFD process indicate an absence of creative thinking on the issue. These discussions continue to dwell on the need to mobilise new and additional resources for sustainable development, and although there are persistent differences between the North and the South over the issue, these differences pertain mainly to the preferred source of the new financial resources. The South argues that these resources should come primarily from official development assistance (ODA) or from a more equitable distribution of foreign direct investment (FDI) across the globe. The North on the other hand contends that the bulk of the developmental resources need to be mobilised from domestic sources – that is, within the countries themselves – or through policy reforms within developing countries to make them more attractive to foreign investors.

This, however, is a very limited way of approaching a rather complex issue, besides being singularly designed to undermine consensus. It assumes on the one hand that the goals of sustainable development are defined clearly and accepted broadly, and on the other hand, that the channels for moving financial resources towards these goals are effective, responsible, equitable, and efficient; and therefore, that all that is needed is to mobilise additional resources from somewhere, move them through the same channels, and bring them to bear upon the problematique of sustainable development. In actual fact, neither of these assumptions is likely to be valid. Most observers express concern that the concrete meaning of sustainable development remains elusive even after decades of discussion and debate; that the channels of financial intermediation (especially insofar as sustainable development is concerned) are ineffective, wasteful, costly, opaque, and fraught with perverse incentives; and that the paramount need is to create a popular legitimacy for mobilising resources as well as undertaking action.

What is needed at this point in history is not the treatment of symptoms but a fresh look at the underlying problems – one that can facilitate agreement and common understanding. The Ring, an alliance of policy institutes from the North as well as the South[1], has floated a number of ideas with a view to expanding the range of options under discussion and resolving the impasse in the negotiations. We begin with a number of inter-related thoughts.

First, rather than focus on the sources and uses of finance, we suggest that it is more appropriate to begin with the actors and institutions involved in the system of resource mobilisation. This focus enables a clearer understanding of the optimal role that each actor can play. This transformation invites attention to the potential role of international financial institutions, transnational corporations, governments of industrialised countries, developing country governments, public and private institutions engaged in activities that promote sustainable development, and private citizens – of which two groups are especially important, the émigré or 'non-resident' populations of developing countries (i.e., those residing in industrialised countries); and the taxpayers in developed countries.

Second, a theme that pulls together the actions of the various individuals and institutions is that of responsibility. Instead of asking how to mobilise more resources to entrust to the various institutions and individuals involved purportedly in sustainable development, it is more fruitful to ask how these institutions and individuals can be made more responsible, and thus how a popular basis can be created for sustainable mobilisation of resources over time. The issue of responsibility brings up such dimensions as disclosure, advocacy, consumer action, transparency, and commitment.

Third, and most importantly, there is a need to take globalisation at face value, and look at the entire world as if it were a single country. While this is not a country in the traditional sense – especially since it does not have a single government – it is not much different from many developing countries, which also comprise many ethnicities and nations, and where also the writ of the central government often does not run far beyond the broad avenues of the capital city. If the world is viewed as a single country, the nature of the question changes completely. Instead of asking what is needed for national development agendas, one needs to ask how the agenda of global sustainable development can be furthered – not how resources can be transferred from one country to another, but how resources can be mobilised for the equitable development of the entire 'country'.

The perception of the world as a single country transforms the question of global public goods. The traditional approach to global development is to separate global needs from local or national ones, and to argue that international aid flows should be allocated exclusively for the creation of global public goods (protection of global environmental resources, for example), while the creation of local or national public goods needed for development should be left entirely to domestic resource mobilisation. We take up this theme in Chapter 1, which introduces the issue of public goods creation in order to demonstrate the strong linkages between global and national/local resources. It goes on to examine the relationship between the creation of public goods and the role and responsibility of international financial institutions.

The term 'development finance' covers a vast range, from official development assistance (grants and concessional loans by governments and multilateral financial institutions), to commercial loans by multilateral financial institutions and private banks, foreign direct investment, domestic credit, investment and government transfers. These provide financial resources to an equally broad range of programmes: high-tech start-up projects, industrial investment, public infrastructure, and small-scale human development projects. Finance, in general terms, fills an intermediary function between surplus and deficit entities. By performing two specific functions – channelling money and distributing risks – the intermediary mechanism makes the movement of finance simple and rewarding for the surplus 'household' and feasible and efficient for the deficit 'household'. The intermediary institutions take responsibility for the movement, allocation, and accounting, and, by offering a menu with various levels of risk, they help distribute risk across society. Thus, in looking at the issue of development finance, it is important to look at its institutional structure in addition to its volume, direction, and use.

This approach brings to the surface a theme that has remained tacit in all the traditional discussions of financing and development, namely responsibility. What is the responsibility of the governments (or taxpayers) of rich countries? Do they owe anything to the poor countries? In the absence of any concept of responsibility, either foreign aid will continue as a form of charity, to obtain which poor countries have to degrade themselves; or it will become an instrument of domination, an extension of foreign policy. Demands for increases in official development assistance have always and everywhere invoked some concept of responsibility – in some renderings as compensation for past harm, and in others as a form of global solidarity.

Following from the above line of reasoning, we take a fresh look at four 'sources' of financing: official development assistance, debt forgiveness, foreign direct investment, and individual contributions by expatriate groups in industrialised countries. This is done in the chapters by Adil Najam (Chapter 1, on international financial institutions), Jens Martens (Chapter 2, on official development assistance, with one section by Action Aid), Ann Pettifor and Andrew Simms (Chapter 3 on debt forgiveness), Konrad von Moltke (Chapter 4 on the fiscal overhang and the fiscal crisis in developing countries), Nick Robins (Chapter 5 on socially responsible investment), and Tariq Banuri (Chapter 6 on expatriate philanthropic activity). The fresh look consists primarily of placing the issue of responsibility at the centre. In the case of International Financial Institutions (IFIs), responsibility entails reorienting their actions towards promoting sustainable development instead of pushing money, supporting and enhancing disclosure, and strengthening smaller institutions which can provide credit at smaller scales and at local levels. Similarly, for ODA, responsibility entails making aid flows predictable, transparent, untied, and conducive to sustainable development. In the case of foreign direct investment, they refer to the new approaches in socially (and environmentally) responsible investment.

However, it is not sufficient to approach the issue of global responsibility from the perspective of sources financing, addressing the supply side alone. The other side of the coin is the responsibility of recipient groups and countries. Our take on the demand side approach to responsibility emphasises capacity building. This emphasis and the consequent recommendations are pursued in the chapters by Tariq Banuri and Erika Spanger-Siegfreid (Chapter 7) and by Nicola Borregaard (Chapter 8), which focus respectively on strengthening the capacity of governments and communities to access, absorb, and use finances effectively; and creating capacity to use trade regimes as facilitators rather than obstacles to sustainable development.

Finally, this argument brings us full circle to the issue of globalisation. Taking globalisation seriously means recognising the interdependencies and connections between countries and peoples. It means imagining the entire world as a single community. It means invoking and supporting the concept of responsibility for the entire human population, not only for one's parochial community. The evolution of the concept and meaning of globalisation and its implications both for sustainable development and development finance is discussed in Chapter 9.

[1] Regional and International Networking Group (Ring) members: Africa Centre for Technology Studies (Kenya); Bangladesh Centre for Advanced Studies (Bangladesh); Centre for Sustainable Development (Iran); Centro de Investigacion y Planificacion del Medio Ambiente (Chile); Development Alternatives (India); Environnement et Developpement du Tiers Monde (Senegal); Instituto para o Desenvolvimento, Meio Ambiente, e Paz (Brazil); International Institute for Environment and Development (UK); International Institute for Sustainable Development (Canada); IIED América Latina (Argentina); Nigerian Environmental Study Action Team (Nigeria); Stockholm Environment Institute Boston (USA); Sustainable Development Policy Institute (Pakistan); Zimbabwe Energy Research Organisation (Zimbabwe)

LEGITIMACY AS A SYSTEMATIC CHALLENGE

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A meaningful emphasis on the goal of financing for sustainable development necessarily broadens the focus from just the amount of financing that is available to the goal of that financing – that is, sustainable development. Importantly, it allows for other necessary questions to be asked: for what purpose are the resources going to be used, who will it be channelled and disbursed through, and how will the effectiveness and legitimacy of this use be gauged? In the current discourse such questions, even when asked, are marginalised as the spotlight remains fixated on the quantity of financial flows – whether private or public, non-concessionary or concessionary.

The world of development finance is twice cursed. The persistent and deepening crisis about the amount of finance available for development assistance is compounded by the growing doubts about the efficacy, or even appropriateness, of the use to which these limited resources are put. In essence, it is not only that the pie is small and shrinking but also that it is being used ineffectively. The result is a vicious cycle – the lack of legitimacy that results from ineffective use of available resources serves to reinforce the existing tendencies towards shrinking financing (the debate on the effectiveness of aid has raged long and hard. A sampling of various arguments in the debate may be seen in Hancock, 1992; Bandow, 1994; Cassen, 1994; Rich, 1994; Smillie, 1995; World Bank, 1998; South Centre, 1999; and Randel *et al*, 2000).

Policymakers and academics who look at issues of financing for development, including sustainable development, tend to be principally concerned about expanding the resource flows into development, particularly through state-centric channels (for a critique of this approach, see Banuri and Spanger-Siegfried, 2001). For example, the discussions during the build-up to the UN Financing for Development (FfD) process have been preoccupied largely with resource mobilisation, both international and domestic (for more on the FfD process see www.un.org/ffd). Similarly, a key concern of those preparing for the World Summit on Sustainable Development (WSSD) is the abject failure of the international system to mobilise the resources needed even to begin implementing Agenda 21 (for more on the WSSD process see www.johannesburgsummit.org).

While some attention has begun to be paid to the effectiveness – or lack thereof – of the use of the resources that are available, the focus seems to be on the capacity of the recipient countries rather than the effectiveness, structures, and practices of the channels of financial intermediation. The time is ripe for an assessment of the efficacy of international financial institutions, and indeed, the entire global financial architecture as a mechanism for supporting sustainable development. The sizable endowments of the World Bank and the International Monetary Fund (IMF) seem not to have triggered a corresponding improvement in the global developmental profile; the world continues to become an ever more unequal and ever more unsustainable planet (UNDP 1999; South Centre 1999). The Global Environmental Facility (GEF) that had caused such anguish to Rio negotiators seems to be suffering simultaneously from not having sufficient resources to meet its mandate, and not being able to spend the scant funds that it does have (Agarwal *et al*, 1999). Something is terribly wrong, and it is not just the amounts of funds available.

The above is not to suggest that resource mobilisation is not important. It is. It does, however, suggest that questions of legitimacy and effectiveness of resource use are also important and have a direct bearing on questions of mobilisation. The first port of call in this regard is the variety of mechanisms created to channel resources into sustainable development. This chapter complements the analyses in Chapters 2 to 5, which look at the efficacy of ODA, FDI, and other private flows in engendering sustainable development.

This challenge is equally pressing to the agendas of FfD and WSSD but is currently peripheral in the discussions. It is suggested that issues of legitimacy be given a place of greater prominence in the systemic discussions at both forums.

Doing so will require rearticulating the discourse on at least three interrelated levels: the legitimacy of the goals of financing, the legitimacy of the actors involved, and the legitimacy of the measures by which we gauge success or failure.

1.1 Goals: What counts?

Financing seems to have become a goal in itself. The tenor of development discussions in general, and multilateral environmental negotiations related to sustainable development in particular, has become so routinised and the arguments so predictable that the issue of financing has become all but delinked from the goal that it is supposed to achieve. Rather than being tied directly to a global public good[1] – climatic stabilisation, maintenance of biodiversity, creation of sustainable livelihoods – financing has been reduced to nothing more than an act of charity. The North is implored by the South to throw a few crumbs of pity and benevolence because the South is poor; not in lieu of the South supplying a global public service (Banuri, 1992; Najam, 1995; Agarwal *et al*, 1999). While the North is understandably averse to any mention of 'compensation' for its environmentally irresponsible behaviour in the past (see Chapter 4), the result of distancing financing from the goal that it is directed towards is rather perverse. From the North's perspective, there is no compulsion actually to deliver on promises made nor any grounds for insisting on proper utilisation; after all, this is merely charity and charity cannot be accounted for or be accountable. For the South, there is the humiliation of having to hold the beggar's bowl but also the sense that how they use the alms given to them should ultimately be their own business (Agarwal, 1992; Najam, 1995).

A more useful way to conceptualise the issue would be through an explicit contractual arrangement between those who are to supply a global public good, and those who are willing to pay a certain price for that service. For example, Anil Agarwal and his colleagues at the Centre for Science and Environment in India (Agarwal *et al*, 1999; Agarwal and Narain, 1991) have proposed such a schema for considering the maintenance of the global climate system – a service that the poor of the world provide by keeping their emissions low; they then propose a transfer of resources from the 'over-emitters' to the 'under-emitters' as a fee for the provision of this service. Conceptually, the beauty of such a framework is that the transfer of resources would be made directly to those who are actually providing the service rather than to the treasury of the country in which they live. Properly implemented, such a mechanism would entail the transfer benefiting not the élites in the South whose own emissions may be no different from those in the North, but the poor in these countries who are actually providing the global public service.

While implementing any particular initiative, such as the one above, would require significant design innovations in the implementation regime, the point to be made here concerns the need directly to link the provision of financing to the goal that it is supposed to serve. This entails more than simply earmarking funds for particular purposes or creating financing mechanisms for selected priorities. It would require explicitly identifying certain environmental services as global public goods and setting up a mechanism where those who benefit from these public goods transfer resources to those who provide or maintain the services. Financing, therefore, would not be the 'end' but the 'means' to larger socially desirable goals.

The key goal of concern to us is sustainable development. Financing for sustainable development is particularly sensitive to questions of scale and scope –the availability of large amounts of money for a small number of large projects may be less useful than the availability of relatively small amounts of money for a large number of relatively small initiatives (Sachs, 1999). A meaningful emphasis on the goal of financing for sustainable development necessarily broadens the focus from just the amount of financing that is available to the goal of that financing – that is, sustainable development. Importantly, it allows for other necessary questions to be asked: for what purpose are the resources going to be used, who will it be channelled and disbursed through, and how will the effectiveness and legitimacy of this use be gauged? In the current discourse such questions, even when asked, are marginalised as the spotlight remains fixated on the quantity of financial flows – whether private or public, non-concessionary or concessionary.

1.2 Institutions: Who counts?

The principal systemic question related to financing for sustainable development concerns the institutions through which such financing is channelled. The legitimacy and efficacy of such institutions (including the World Bank, the IMF, the United Nations System, and NGOs) has been on the agenda of the FfD process and has also been discussed in the context of WSSD. The questions, however, have tended to be rather limited in scope, concentrating mostly on the familiar issues of governance including management, representation and transparency. While these are important questions, a set of more fundamental questions regarding the legitimacy and effectiveness of these institutions needs to be added to the debate. Two of these – scale and accessibility – will be addressed in this section, and a third – accountability – will be discussed in the next section.

Irrespective of other differences one may or may not have with international financial institutions (IFIs), it has become increasingly clear that they operate at a very different scale from that on which the problem happens. Efficient as they might be in disbursing amounts in the US$1 million-plus range, they tend to be not only uninterested but actually incapable of operating effectively in the range of thousands, let alone hundreds of dollars. Given their costly procedures and personnel such institutions do not have the ability to operate effectively at the medium- and small-scale – the scale at which so many sustainable development initiatives reside (Rich, 1994; Banuri and Spanger-Siegfried, 2001). Similar problems of scale apply to many national financial institutions and, indeed, to large international NGOs (Clark, 1991; Edwards and Hulme, 1996; Najam, 1999). The hurdle is not one of ideological persuasion or intent; it is simply a question of capacity. The institutions that are best suited for raising large amounts of international finance are least suited to disbursing money at a level where sustainable development is most likely to happen.

The problem could, of course, be solved by simply passing on this financing to a set of intermediate institutions (local NGOs) were it not for the significant problems of accessibility. Most discussions of institutional transparency focus on the operational secretiveness of international institutions, particularly IFIs (the main concern revolves around the danger of inappropriate decisions being taken, sometimes consciously, under the veil of secrecy). However, the issue of accessibility is intrinsically tied to transparency. In addition to being non-transparent, IFIs tend to be inaccessible – not only for would-be watchdogs, but also for potential beneficiaries. This relates directly to the question of scale raised above. While IFIs are incapable of operating at 'ground level' of sustainable development because of their inbuilt pathologies of scale, those who are operating at the ground level are denied entry to elevated levels by barriers of accessibility and often lack the capacity to operate in that environment (Clark, 1991; Hulme and Edwards, 1996; Najam, 1996).

The challenge here is that IFIs and their national counterparts have tended to be as resistant to learning to talk to intermediate NGOs as the latter have been hesitant to converse with IFIs. In essence, the institutional chain that could have been the conduit of financial resources flowing to the appropriate level has a huge gap within it which only entrenches the existing tendency, and even incentive, to siphon off the financing at levels higher than where it might make the most sustainable development impact. The challenge is one of mismatched institutional capacities. Institutions that can access global financial resources are constrained by their inability to operate at the level where sustainable development initiatives can most meaningfully be undertaken; and those who are able to operate at that level are either unable to raise the resources they need or are denied access to those who have such resources, often both.

A manifestation of mismatched competence comes in the form of cost escalations when the 'scale' of the financing institution does not match that of the problem being addressed. Critics have drawn specific attention to the wastefulness of such financing. For example, Arif Hassan (2001) draws upon the experience of development projects in Pakistan to argue that a service that costs a dollar when delivered by the community costs between 3 and 5 dollars when delivered by the Government, and between 7 and 30 dollars when delivered as part of a World Bank-funded project. One simple reason is the perversion of local cost structures because of external financing. Development projects often have to operate across a three-tier cost structure. Local nontradables (land, natural resources, labour), which cost as little as one-tenth of similar entities at 'national' (often meaning metropolitan) levels, and which in turn are again cheaper by the same order of magnitude than global resources. It is a common observation that large development projects are accompanied by massive increases in land prices, often to levels that are ten to twenty times higher than pre-project prices. This leads to and is often stimulated by an intense spiral of real estate speculation. The situation in labour costs is similar, although perhaps more justifiable. In Pakistan, for example, the wages of unskilled workers in rural areas are about 1,000 Rupees per month; in normal governmental projects, these are at least two to three times, and in bank funded projects, five to ten times as much (after including overhead costs). Workers with comparable skills in industrialised countries earn about 80 times as much (calculated at $7.50 per hour, which works out to $1,300 or Rs 80,000 at the current exchange rate per month). The differences for professional workers are similar even though they are more mobile.

The result of the cost differences is that a development project completely transforms service costs in project areas. The mere announcement of a development project sets off a speculative spiral in all resource markets. Besides adding to investment costs, it makes it virtually impossible for the local community to maintain and operate the resulting service. More critically, the process creates incentives for speculation, gambling, corruption, price inflation, and land grabbing, all of which undermine the social capital of the community.

A simple example of the significance of properly matched cost structures is the success of micro-credit operations. At their core, micro-credit programmes are no different from normal banks. The only difference is that their cost structures are still rooted in local prices and local competencies. The result is that these banks can effectively service small-scale loans, which are completely out of the consideration even of national banks let alone international financial institutions or transnational banks. Grameen Bank can employ the bulk of its bank staff at 5,000 Bangladesh Takas per month. The same person, if employed by the World Bank or Citibank would cost the institution ten times as much. An employee with comparable skills in their headquarters would receive a hundred times as much. In recent years, many of these banks have opened national branches, which can reduce costs, although not to local levels. However, even the reduction of costs to national levels would depend on real decision-making authority being transferred to people who operate at national cost levels. This has not happened and is unlikely to happen.

1.3 Information: How do we count?

Institutions involved in financing for development, including financing for sustainable development, tend to see themselves very much as part of the financial system, rather than a development system. The distinction is more than semantic. Financial institutions are assessed, and should be assessed, according to financial criteria. However, such criteria are not entirely appropriate for gauging the performance of development institutions. Unfortunately, it is not only institutions such as the World Bank and IMF but also those such as the Global Environmental Facility (GEF) and many NGOs that increasingly insist on measuring their efficacy and legitimacy in terms of their financial strength rather than their developmental impacts (for a discussion of performance and accountability within NGOs see Edwards and Hulme, 1996 and Najam, 1996. The latter proposes a conceptual framework for understanding accountability concerns within the NGO universe).

World Bank staff members, for example, are very fond of reminding their audiences that they are, after all, a 'bank' and that their rates of recovery would be the envy of any financial institution. It is quite clear that they would. What is less clear is how much of a virtue this is for a development institution (Rich, 1994). GEF reports are similarly detailed in terms of how much money has been put into the fund and how much has been disbursed. The impact this investment has had on fostering sustainable development is less clearly articulated (Agarwal *et al*, 1999). There seems to be a clear sense that those entrusted with development financing are far more comfortable being managers of money than facilitators of development. They certainly seek the validation of their 'performance' in terms of the former. To be fair, this tendency is not restricted to IFIs but is equally prevalent in agencies of national government and in many NGOs which are just as determined to highlight 'dollars spent' rather than meaningful discussions of how this relates to the actual achievement of – or even attempted achievement of – sustainable development (Clark, 1991; Najam, 1996). In all cases the 'means' (financing) are decoupled from the 'end' (sustainable development) not only in how claims are made for financing but also in how the institutional efficacy is accounted for. This tendency has contributed greatly to the deepening crisis of legitimacy of development finance.

Unfortunately, institutions at all levels (international, national, local) care most deeply about that which they can count. It is not surprising, then, that we find a fairly developed culture of accounting for finances but only half-hearted attempts at measuring development impacts. This is not something that can be shooed away by recounting the well-rehearsed lamentation about all the known difficulties in trying to 'define' sustainable development. It is a question of making explicit the sustainability goals that we seek to achieve, determining some measures (quantitative or qualitative) to gauge the achievement of these goals, and holding those responsible (IFIs, national governments, NGOs) accountable to these goals.

To use an analogy from the private sector, just as financial markets have well-developed systems of financial disclosures and credit rating, the development system needs corresponding systems of both disclosing the implementation variables and rating development impacts. While it is useful and necessary to have sound and accessible financial information and monitoring for development finance regimes, it is even more useful and necessary to have sound and accessible development information and monitoring of these regimes. Sustainable development reporting initiatives, therefore, are of prime importance in rationalising the discussions on financing for sustainable development and moving the discussion away from a preoccupation with financial performance to more fundamental concerns about sustainability performance.

In response to the emerging criticism in recent years, IFIs have started experimenting with disclosure and accountability mechanisms (Fox 2000; Woods 2001; Wood and Welch 1998; Polak 1998). The World Bank and the Asian Development Bank have established independent review panels, the IMF has set up an Independent Evaluation Office, and the IFC and MIGA have set up an office of the Ombudsman. These are concerned primarily with compliance of staff members with procedures rather performance evaluation – that is, whether the actions of the institution contribute to sustainable development[2]. However, while the newness of the institutions means that the jury is still out on their performance, initial assessments suggest that they are not genuinely independent mechanisms. They are appointed by the institutions themselves, which have generally sought to circumscribe and limit their role. More significantly, developing countries appear not to be enthused by these mechanisms, which they see as tools of powerful US-based NGOs. In other words, as in the case of ecolabels or corporate disclosure mechanisms, the primary audience is the pressure groups in industrialised countries – be they consumer organisations or activist environmental NGOs – and decidedly not the poor communities who are supposed to benefit from the investment. While there can be no argument that disclosure is the first step towards accountability, the distance between the hesitant first steps and the ultimate goal is far too large at this point.

1.4 A final word

The key point this chapter seeks to make is that the global community needs to take a fresh look at the entire system of financing for development and reorient it towards a decidedly (sustainable) development orientation. Here we have identified only a few key elements of such a reorientation.

Such an enterprise cannot be easy since it would challenge the now entrenched 'financing' orientation of the regime. One must begin with a rearticulation – or at least a reaffirmation – of the principal goal: sustainable development. Doing so with any degree of honesty will necessarily require a re-examination of the institutions that are entrusted with the financing for sustainable development agenda and lead to the conclusion that while these institutions are certainly a part of the institutional chain that might deliver sustainable development, they are incapable of doing so in and of themselves. An expanded institutional framework that incorporates intermediary and local NGOs (by providing them access and investing in their capacities) will be absolutely critical if the goal of sustainable development is to be taken seriously. Finally, such institutions (at all levels) will need to be invested in with a different set of performance measurements: measures which gauge the ability of institutions to deliver on their developmental goals rather than focus on financial accounting alone.

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[1] Global public goods' as a framework for international development finance has recently received increasing attention. For a sampling of the different ways in which such discussions are conceptualised see Kaul *et al*, 1999 and World Bank, 2001.

[2] The World Bank had earlier set up a number of mechanisms to involve independent NGOs in social and environmental evaluation. However, while these have certainly given voice to hitherto excluded groups, the process of their involvement is not fully transparent, and neither are the clean chits that these mechanisms routinely award to the institution.

SUSTAINABLE DEVELOPMENT AND THE EFFECTIVENESS OF ODA

{2}

Combining a progressive international income tax levied on eligible donor countries with a negative international income tax applied to eligible recipients would produce a scheme for funding and disbursing foreign aid that is transparent, fair, automatic, predictable and inexpensive to administer. The present system of foreign aid has none of these virtues – and it is also ineffective.

GRIFFIN AND MCKINLEY
1996

At the UN Conference on Environment and Development (UNCED) in 1992 governments recognised that the implementation of the huge sustainable development programmes of Agenda 21 requires the provision of substantial new and additional financial resources. At the time, the UNCED Secretariat estimated that over $600 billion per year was needed merely to implement Agenda 21 in the developing countries, including about $125 billion on grant or concessional terms from the international community. It is regrettable that since 1993 international flows of Official Development Assistance (ODA) have declined and stagnated. In the year 2000 net ODA from the OECD countries was a mere $53.1 billion, according to a 2001 assessment (from a 2001 OECD press release). This sum also includes contributions to multilateral environment funds, notably the Global Environment Facility (GEF).

Facing the seeming political inevitability of a decreasing quantity of ODA flows, the development debate (particularly influenced by the World Bank) has shifted more and more towards the quality of ODA, especially the effectiveness of aid. This includes issues of regional selectivity, strengthened ownership and reduced conditionality and more adequate forms and instruments of ODA. But the effectiveness of ODA also depends on the sufficient provision of resources. The effectiveness of a road construction project will suffer considerably if the funds provided for the maintenance of the road once it is finished are inadequate. Basic education projects will not be effective if they have to be terminated ahead of schedule owing to cuts in ODA. The widespread notion that raising effectiveness can compensate for cuts in development assistance budgets is completely misleading. Increasing the effectiveness of ODA in support of sustainable development entails:

- taking into account the widening range of tasks ODA has to fulfil, particularly for the provision of Global Public Goods (GPGs);
- breaking through the vicious circle of loan-based ODA and growing indebtedness;
- reconsidering the criteria of selectivity in development assistance; and
- boosting ownership and eliminating conditionalities.

At the end of the day, the issue is one of responsibility. In the first place, the responsibility of affluent countries and affluent groups within countries (including within developing countries) to ensure that the transition to sustainable development does not take place on the backs of the world's poor. And in the second place, mechanisms that can demonstrate that the institutions that have been established to channel developmental resources to the recipients are socially and ethically responsible, and that their actions lead to sustainable development rather than to dependency and sustained misery.

2.1 Increasing tasks – decreasing resources

Not only have official resource flows from the North to the South shrunk considerably over the last decade, but they were also used for an ever-widening range of tasks. Governments have brought a variety of public expenditures under the rubric of ODA and so considerably watered down the traditional OECD definition of development assistance. Today, a growing share of official development funds is not being used for specific national development requirements of the countries in the South but to finance Global Public Goods (GPGs) such as the protection of rainforests, the seas and the ozone layer, staving off global financial crises or promoting international security.

According to estimates by the World Bank and UNDP, at least 15 per cent of ODA is being spent on providing GPGs rather than for development assistance in the narrower sense (UN General Assembly, 2000 para.108 and World Bank, 2001b, p. 111ff. In a survey, Kunibert Raffer even arrives at the result that at least 40 per cent of ODA has been spent for GPGs over the last few years [Raffer, 1999]).

Adequate financing of GPGs is crucial to the survival of humankind, but the funds required should not be taken out of ODA budgets, since this represents a further reduction in already scarce resources. GPGs ought to be financed by new and additional means that are referred to separately from ODA in statistics. For this reason, Inge Kaul of the UN Development Programme and others have proposed that a distinction be made between conventional Development Assistance, ODA (C), and a new budget item, ODA (G), for the financing of Global Public Goods (Kaul *et al*,1999: 495).[1] Mobilising these funds would be accomplished both via the national budgets of the respective responsible ministries (environment, health, research and education, etc.) and via new international financing instruments. Here, internationally harmonised taxes and fees play a special role, particularly the Currency Transaction Tax (CTT), an international shipping tax, a kerosene tax in air traffic and an international CO2/energy tax.

In this context, raising the funds for the Global Environment Facility (GEF) is of particular importance. The GEF was founded in 1991 to support projects in the four core areas of climate protection, preserving biodiversity, and protection of the ozone layer and international waters. What is particularly disappointing for the developing countries is that the GEF funds have remained at a very modest level for the last ten years. For the period between 1998 and 2002 the GEF has a mere $2.75 billion at its disposal. Neither this absolute amount nor the outreach of the funds is sufficient to finance globally sustainable development. In 2002, negotiations on the replenishment of the GEF will once again be on the agenda. Several countries (including the UK and Switzerland) have already announced that they regard a substantial increase of the contributions by up to 50 per cent as necessary.

Given the widening range of tasks financed by ODA, the question arises as to what sense there is in still sticking to the 0.7 per cent ODA/GNP target as a guideline for the level of official resource flows from the North to the South. This goal was set up in 1970 for a more clearly delineated field of development tasks in a smaller number of countries and in more favourable framework conditions of the world economy (better terms of trade for the developing countries, smaller foreign debts, more stable exchange rate systems, and so on). Given the present conditions, the target would either have to be raised or new tasks that have evolved, particularly the financing of GPGs, would have to be taken out of the ODA definition. A separate quantitative target could be defined for them.

However, we should be even more fundamentally sceptical about the supply-side approach reflected by the 0.7 per cent target. The Gross National Product of donor countries is used as the basis of assessment for this target. The 0.7 per cent target has established itself as a guideline over decades in spite of the fact that no consistent justification exists either for this value or this basis of assessment (see for example Riddell, 1996). Although the measurement continues to hold a certain legitimacy for political reasons as an indicator of the solidarity of the rich countries with the South, the level of transfer of official funds to the South should increasingly be made dependent on a needs-based approach which derives from the real requirements of the recipient countries.

No doubt it is complicated to quantify such requirements. However, there are already estimates for certain areas, such as costs for the worldwide provision of basic social services. According to a study on the implementation of the 20/20 initiative (UNDP *et al*, 1998),[2] between \$206 billion and \$216 billion a year would be required to provide a minimum of basic social services (primary education, basic health care and food, reproductive health, drinking water supply and sanitation). Around \$136 billion was spent on this towards the end of the nineties, so that the financing gap has been put at \$70 to 80 billion a year (UNDP *et al*, 1998: 21).

More recently, the High-level Panel on Financing for Development, the so-called Zedillo Panel, estimated in its report that the additional annual costs for achieving the 2015 International Development Targets would be approximately \$50 billion per annum. In addition, the desirable spending on GPGs may be of the order of \$20 billion a year (UN General Assembly, 2001).

In sum, a needs-based assessment of the necessary North-South transfer could result in a potential financing volume considerably above that defined by the 0.7 per cent target.

2.2 From loans to grants

The effectiveness of development assistance is restricted by a large share of the funds being provided in the shape of loans that have to be repaid in the medium or long term.[3] Even if the conditions imposed here are well below those usually applied on the market, these funds are, at best, temporary assistance. In reality, more money flows back into the coffers of the industrialised countries than has been spent on assistance. The debtor will inevitably build up a negative balance. So any increase in this type of development assistance automatically also implies an increase in foreign debt on the part of the recipient countries.

This is not to say that foreign loans, whether from government or private donors, always have a negative impact. The question is under what conditions such loans can make economic sense and promote sustainable development. Some possible criteria include:

- The funds should not be used for consumptive purposes (such as mineral oil imports) or for unproductive assets (such as arms expenditure), but only for highly profitable investments, the yields from which can cover debt servicing.
- Since repayment has to be made in foreign currency, the foreign exchange required to this end has to be gained either directly or indirectly from the projects that are being financed (especially via additional income from exports).
- At the macroeconomic level, the recipient country's balance of payments has to improve because the measure has been financed to such a degree that the debt service is secured in the long term. Here, possible secondary effects of investments on the balance of payments also have to be taken into consideration (increased import of raw materials, primary products, spare parts and so on, as well as the possibility of import substitution by building up local production capacities).
- Finally, in assessing the compatibility of foreign loans with sustainable development, possible fluctuations in exchange rates, and especially the negative impact of local currency devaluation on the ability to repay, have to be considered. This is particularly important given the long period of such loans.

These criteria are necessary but by no means sufficient conditions for the compatibility of foreign loans with sustainable development. For even a highly profitable investment that will also yield the required foreign currency (such as a chemical factory or a plant to extract mineral oil) can prove detrimental to sustainable development in terms of its social or environmental impact.

Measured against the above criteria, particular scrutiny is needed of foreign loans to finance those projects that are regarded as sensible from a development policy angle but neither yield a sufficient profit nor sufficient foreign currency. This applies in particular to the field of basic social services but also to environmental protection measures, capacity building, and the support of agricultural production that is not export-oriented. Generally, ODA should only be provided for these purposes in the form of grants.

2.3 Reconsidering selectivity

Against the background of sinking ODA flows and a worsened economic and social situation in many countries of the South, the conditions for success of ODA have been discussed increasingly since the end of the nineties. What prompted this in 1998 was the World Bank publication *Assessing Aid: What Works, What Doesn't, and Why* (World Bank, 1998). The authors argue that aid only works in a good policy environment. They conclude that development assistance should focus on low-income countries with good political framework conditions and, above all, sound economic management, to reduce poverty more effectively.

It is of course entirely plausible for development assistance to flow to countries that are most in need of it, making the neediness of the recipients rather than the political and strategic self-interests of the donors the crucial factor in allocating ODA. And it certainly also makes sense to employ the money where it will have the greatest positive impact. Nevertheless, the strategy of greater selectivity in development assistance and above all the selection criteria 'poor country' and 'good policy' bear a number of significant weaknesses:

- Concentrating funds on low-income countries and (according to the World Bank's definition) favourable political framework conditions excludes both poor regions in less poor countries and those people living in poor countries under 'poor' political framework conditions from external assistance. For humanitarian reasons alone, a consistent use of such exclusive criteria therefore seems dubious.
- The degree to which the effectiveness of ODA depends on the quality of policies in the recipient country is controversial as far as empirical evidence is concerned. Recent surveys arrive at the conclusion that it is not policy but external framework conditions and the vulnerability of these countries towards exogenous shocks that are particularly relevant to the effectiveness of aid (Guillaumont and Chauvet 2000: 24ff). This would suggest that ODA is most effective in a difficult environment since it can reduce the latter's negative impact in a particularly perceptible way.
- Irrespective of the impact the political framework conditions may have on the effectiveness of aid, the question arises as to how 'good' policy is defined and who takes the decision on this issue. So far at any rate, the power of decision is not with the affected country but is above all held by the World Bank. It assesses 'good economic policy' with the aid of its Country Policy and Institutional Assessment (CPIA) (Collier and Dollar, 2001: 5), which comprises 20 components in the four categories of macroeconomic policies, structural

policies, public sector management and social inclusion. According to these assessment criteria, whether a policy is regarded as good depends, among other things, on whether the monetary, fiscal and exchange rate policy creates stable framework conditions for the economy, whether the trade, fiscal and sector policies offer good production incentives, whether public sector management effectively supplements private initiatives and whether the participation of all societal groups is ensured. All in all, this catalogue of criteria is strongly reminiscent of the 'Washington Consensus', with the addition of participation by societal groups.

What is particularly problematic here is that the selection criteria de facto act as conditionality. According to the World Bank, those countries that fulfil its conditions of a good economic policy should benefit particularly from development assistance. Alternative economic policy approaches and priorities are eclipsed as is the aspect of ownership in the development processes in the affected countries (Gunning, 2000: 11).

2.4 Ownership vs. conditionality

The failure of donor-dominated development projects has led more and more to the insight that self-determination and self-responsibility of the countries in the South are central criteria of success for their sustainable development strategies. Ownership has probably been the most often used term in the development debate over the last few years. The widespread notion is that the countries affected should at last be in the 'driver's seat'. World Bank President Wolfensohn's proposal for a Comprehensive Development Framework (CDF) and the World Bank's Poverty Reduction Strategy Papers (PRSPs) approach are regarded as examples of this new thinking.

In practice however, little has changed in terms of the dominance the donors wield. They are showing hardly any readiness to give up conditions for the allocation of funds. In its 2000/2001 *World Development Report*, the World Bank itself quotes a study of the relations between donors and African recipient countries with the words: 'In spite of some improvements, donors still tend to dominate the project cycle and pay inadequate attention to the preferences of the government or project beneficiaries.' (World Bank, 2000a: 193)

The practice of donor-driven micro interventions which focus on implementing individual projects is still predominant in development assistance. Here, the provision of funds is made conditional on constantly updated requirements and reporting duties that prevent those who are really affected from identifying with the project and result in considerable transaction costs. For example, at one point the Health Ministry of Mozambique alone had to deal with 405 projects from foreign donors, while in Tanzania there were more than 2,000 projects from 40 different donors at the beginning of the 1990s (World Bank, 2000a: 193).

In order to improve ownership and co-ordination of development projects, the UN Secretary-General demands in his report for the second session of the FfD Preparatory Committee that the recipient countries must not only be the chief architects of their development programmes but that they also assume the leading role in donor co-ordination (UN General Assembly, 2000: para.99). And he calls for more flexibility in providing ODA, explicitly referring to co-ordinated budget support and joint sector programmes as examples (UN General Assembly, 2000: para.102).

The original director of the 2000/2001 World Development Report, Ravi Kanbur, calls for a more radical reform of development co-operation. In joint essays with Todd Sandler, the authors criticise the existing practice of project-driven development assistance and state:

> What is needed is a more radical approach in which donors really do cede control to the recipient country government, advancing their own perspective on development strategy through general dialogue with the country and with each other rather than through specific programs or projects. The tying of money to specific projects, policy reforms, or procurement contracts should end. (Kanbur and Sandler, 1999a)

Kanbur and Sandler demand that the recipient countries first of all formulate their own development strategies, programmes and projects (in close consultation with their own population, but also in dialogue with donors), and that the donors subsequently place the funds required to this end into a 'common pool'. The tying of funds to certain programmes and control by the donors of individual projects would not be permitted. This would mean giving up the practice of detailed conditionalities.

But at the same time, conditionalities would continue to exist de facto. For whether and to what extent a government pays money into the common pool depends on how it assesses the development strategy of the recipient country. If it regards the strategy as 'good', it will provide a large volume of funds, while if it is viewed as 'bad', it will tend to pass the money on to another recipient. This, once again, leads us to the issue of 'good policy' and the selectivity of aid, which in practice has the effect of *ex ante* conditionality. In fact, in the common pool approach, it would have particularly far-reaching consequences, since it would not only relate to a project or a sector but to a country's entire development strategy. But this would defeat one chief objective of the new approach, that of strengthened ownership of the recipient countries. Although the country could take the driver's seat, the donors would keep the ignition key and determine how much petrol would be put into the tank (and of course they would carry on determining the traffic regulations).

There are two responses to this problem. One is that conditionalities requiring a certain policy be abandoned and that ODA instead be linked to outcomes-based or performance-based conditions (Gunning, 2000: 12). It is up to the government which policy it uses to combat poverty. What is crucial is that it really does reduce poverty. However, there are two arguments against this approach. Results also depend on the external framework conditions, over which a government has hardly any influence; and results can only be measured after a considerable lapse of time. So de facto, outcomes-based or performance-based conditioning of assistance will also be based on the policy of the recipient country.

A second response would be to drop conditionality altogether in the long term. Instead of unilaterally conditioned assistance, binding arrangements could be made leading to a quasi automatic transfer of resources, the level of which would be based on clearly defined development indicators. In a study of new approaches in development co-operation, Keith Griffin and Terry McKinley take up this notion and advocate a global safety net, the funds for which would be raised from a progressive income tax on the GNP of the rich countries to be made available to the poorer countries on the basis of a fixed ratio. Their summarised assessment of this approach is:

> Combining a progressive international income tax levied on eligible donor countries with a negative international income tax applied to eligible recipients would produce a scheme for funding and disbursing foreign aid that is transparent, fair, automatic, predictable and inexpensive to administer. The present system of foreign aid has none of these virtues – and it is also ineffective. (Griffin and McKinley 1996: 25)

Such a reliability of ODA flows in the developing countries would no doubt make long-term development planning in the countries of the South more effective. Development financing would then be accomplished in practice in the shape of a global country financing offset. Its basic concept could be oriented on the example of financial compensation among the Länder in Germany and the Structural Funds at EU level (a similar proposal was made by the South Centre,1999: 81).

It could be argued that an automatic funding system of the kind described above could be abused as a self-service instrument by corrupt élites. In order to prevent this, all countries participating in the compensation system should agree on a set of political and social minimum standards that would have to be fulfilled by all parties. Such commonly agreed criteria would have a different quality from that of the unilateral definitions by donor countries which have previously established conditionality.

Creating such a fundamentally new political framework for ODA of this kind would constitute a really New Global Deal between North and South based on solidarity and mutual respect – indispensable prerequisites for sustainable development.

2.5 Increasing aid effectiveness through aid untying*

Tied aid is given on the condition that it is used to purchase products and services from donor countries. The untying of aid will improve its effectiveness by increasing its value and helping to promote local growth.

Tied aid increases the costs of goods and services by between 15-30 per cent (Chinnock, 1998). An open tendering process that encourages bids from local industries has the potential to promote the emerging private sector in developing countries, generate employment and, if aid procurement is carefully targeted, it can help lift poor and marginalised people out of poverty.

Donors have at long last acknowledged that tied aid represents poor value for money for recipient countries by agreeing, in May 2001, partially to untie their aid to Least Developed Countries (LDCs)(OECD/DAC, 2001). The British Government went even

	DAC figures in $million (1999)	ActionAid figures in $million (1999)
Untied aid	22,486	22,486
Tied aid	3,081	19,881*
Partially tied aid	1,272	1,272
Total aid	26,839	43,639
% of total tied	11.5%	53%

*$3,081 reported tied +$16,000 technical co-operation +$800 food aid

further and untied all its aid from April 2001 (see www.dfid.gov.uk). However, the December 2001 decision by the UK Department of Trade to provide funding for a British military air traffic control system to Tanzania has called this commitment into question. The DAC decision is an achievement since it acknowledges the principle that tied aid devalues and undermines development assistance.

Much work still needs to be done. While DAC figures show that tied aid is declining, the overall picture shows that tied aid is on the increase. This is because an increased proportion of aid is granted as technical assistance (TA)[4] for large scale sector support programmes or technical co-operation (TC) to support institutional reform and this aid is generally 100 per cent tied[5].

The largest proportion of TC is found in the poorest countries, mainly in Sub Saharan Africa. This is sensible as TC is meant to support institutional change. However, it does not justify why TC remains tied. According to a World Bank report 'some 100,000 foreign technical experts are currently employed in Africa, tending to displace local experts' (World Bank, 2000b). TC produces greater dependence on expatriate expertise and can be used to increase donor influence over policies and projects. Furthermore, as the WB report puts it, 'it has probably weakened capacity in Africa'.

It is recommended that the donor community:

- Agrees to a broader definition of tied aid. Presently the definition excludes 'food aid' and 'technical co-operation'. These two categories are still largely and quite legally, tied. The poorest countries are the most affected by these exclusions; and
- Extends aid untying to all developing countries without restriction.

2.5.1 Reforming procurement regimes

Aid untying alone will not necessarily broaden the access of developing country firms to aid-funded projects, and hence will not automatically bring about the socio-economic benefits that could accrue under a more open procurement regime. Currently, the aid procurement market is monopolised by Northern firms. Southern firms capture only a tiny percentage of contracts. The proportion is even smaller with regards to the provision of (consultancy) services.

Aid untying must therefore be part of a package of measures designed to promote local firms' ability to tender in aid procurement markets. These measures include increased local sourcing and capacity building support. At the LDC III conference, donors explicitly agreed to 'enhance the value of their development assistance by increasing the proportion of goods and services sourced in the recipient LDC or from other LDCs or developing countries to help boost pro-poor economic growth' (UNCTAD website, para.84[e]).

It is recommended as a matter of priority, that donors increase local sourcing and capacity building support.

It is further recommended that donor funded technical assistance:

- is driven by government priorities and absorption capacity, and that governments themselves should select the consultants rather than the donor;
- reports primarily to government managers;
- supports government institutional capacity by focusing on skills transfer to civil servants in priority government functions;
- is not restricted to supporting individual donor projects or programmes;
- gives preferential treatment to national and regional consultants;
- employs local consultants on terms and conditions comparable to those in the public sector for similar work. This will help to avoid an outflow of civil servants to the consultancy sector; and
- ensures that expatriate assistance is complementary to and develops national and regional consultancy expertise.

2.5.2 Donor co-ordination

Increasing operational co-ordination is an obvious method of making scarce development resources work harder both for donors and, more importantly, for recipient countries. Donors and development partner governments should develop agreed codes of conducts that commit donors to work within the parameters of locally owned development strategies, and improve co-ordination at all levels of interaction with national governments by:

- ensuring that all relevant information on activity in the country is made available to governments and other donors. This includes consultancies, new project initiatives, requests for assistance made by governments, project appraisals, implementation and progress reports, technical assistance reports and evaluations. Donors must also ensure effective communications between the local donor office and headquarters; and
- conducting joint appraisal missions, joint monitoring and joint auditing and evaluation, in accordance with national government budget cycles and fiscal planning. Missions should be designed to fit the government's timetable and should be at a manageable level. Where a number of donors support a sector-wide programme, they should designate one lead agency which would be responsible for conducting appraisal missions and

monitoring and evaluation on behalf of all the agencies.

2.5.3 ODA and the Financing for Development process

The FfD process is an opportunity for donors to demonstrate their commitment to development by increasing the overall quantity of aid and by ensuring its more effective use.

Already, there is international agreement that more needs to be done on aid untying and procurement. At the conclusion of the first part of the 3rd PrepCom for FfD, the Joint Statement of the Co-Chairmen issued on 8th May identifies the need to ensure 'greater flexibility in aid provision, including in untying aid' and cites the need to 'build on recent developments, particularly, the DAC recommendation on aid untying to LDCs' (available on the FfD website at www.un.org/ffd: 8). The Zedillo Panel report also acknowledges the poor value for money represented by tied aid and some of the challenges posed by increased local procurement.

It is therefore recommended that NGOs working on FfD remind their respective governments, North and South, of their commitments to meet the international development goals and calls on all NGOs to lobby donor governments to:

- increase aid levels and
- improve aid effectiveness, including through aid untying, local procurement and better donor coordination.

This chapter (except for Section 2.5) was prepared by **Jens Martens**, Member of the Executive Board of World Economy, Ecology and Development Association (WEED), Germany.

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[1] ODA (C) = ODA (Country); ODA (G) = ODA (Global)

[2] In accordance with the 20/20 Initiative, the donor countries should spend at least 20 per cent of ODA and the recipient countries at least 20 per cent of their government expenditure on providing basic social services.

[3] In Germany, the Federal Government has begun to give non-repayable grants to the LDCs in 1978. In addition, since 1997, it has been possible to pay a further 25 per cent of financial co-operation funds to non-LDCs as grants for projects to combat poverty, to establish a social infrastructure, for environmental protection and for loan guarantee funds.

[4] We have used the DAC definitions of TC and TA.

[5] In 1999, TC accounted for 28.3 per cent or $16 billion. Some donors make extensive use of this type of assistance. In the United States for example TC accounts for 75 per cent of its aid budget; in Belgium and France it is 36 per cent; in Australia and Germany just over 30 per cent and in the UK, Austria, the Netherlands and Japan it is around 15 per cent.

DEBT AND SUSTAINABLE DEVELOPMENT: A NEW PARADIGM

{3}

Relations between debtors and creditors should be governed by the law. It is time for an international agreement on bankruptcy. A new independent, open and fair process for regulating international debtors and creditors is a missing link in the global economy. Without it, one of the best potential sources of finance for sustainable development will not be set free.

This chapter argues that two approaches are central to dealing with the debt crisis and promoting sustainable development. First, developing countries' unpayable debts create a basic obstacle to financing sustainable development and should be cancelled under an independent, fair and transparent process. Second, a global framework should be established to reconcile and eliminate rich country ecological debt. Climate change, which is a manifestation of the ecological debts of rich countries, threatens an end to human development *per se*. So industrialised countries need to plan the structural adjustment of their own economies toward environmental sustainability, and thus free up environmental space to allow poor counties to develop.

3.1 Why debt relief?

Sustainable development costs. We can argue over how much, and how to make sure that resources find their targets, but more resources are definitely needed. And, compared to other sources of finance, debt relief is still one of the most potentially important, effective and efficient means of tackling poverty and deprivation.

In 1992, the UNCED Secretariat reported that the implementation of Agenda 21 in low-income countries would require an additional $125 billion per year from rich countries in the form of aid or other concessions. Other estimates have been in the same range. *The Human Development Report* 1998 calls for additional annual spending of $40 billion on human development – including $6 billion on basic education, $13 billion on basic health and nutrition, $9 billion on water and sanitation, and $12 billion on reproductive health care for women (UNDP, 1998). UNICEF argues that effective care for children between birth and the age of eight – 'the crucible of sustainable human development' – requires 'a modest additional global expenditure of US $70 billion to $80 billion each year' (UNICEF, 2000). A recent estimate for the development needs of sub-Saharan Africa in 1998 came to $82 billion per year, which, 'given current trends' was considered out of reach (Botchwey, 2000).

There are only so many ways in which developing countries can generate finance – through trade earnings, borrowing, attracting investment or aid, or mobilising domestic finance. But, as is argued in other chapters of this report, especially for the least developed countries these are mostly unreliable and problematic in different ways. Aid flows are declining, foreign investment is concentrated in stronger countries, ill-advised borrowing from irresponsible institutions has created the debt crisis (as well as its failed solution, the HIPC initiative), commodity prices on key LDC exports are at historical lows, and according to many, including the UN Environment Programme, trade liberalisation has serious negative impacts on sustainable development (UNEP, 1999). In addition, the high debt overhang of developing countries combined with policy advice from the Washington Consensus institutions has created a fiscal crisis, as a result of which domestic developmental resources have been shrinking at the same rate as international resources.

Meanwhile the outstanding unpayable debts of the poorest countries stand at around $300 billion and continue to drain their resources even after several years of the international debt relief initiative, HIPC. The position of the indebted poor countries has also worsened. One assessment by Jubilee Plus made in July 2000 predicts that all 23 countries qualifying for the HIPC initiative are in danger of their debts becoming 'unsustainable' even after relief (Jubilee Plus, 2000). In this situation, genuine debt relief will continue to remain a vital potential source of finance for sustainable development. The scale of the funding gap is big, but given total global wealth (if not the political will) easily bridgeable.

3.1.1 Debt as a threat to economic stability, human rights and sustainable development

Several recent events reveal the significance of the debt issue as a threat to sustainable development, and inter alia, the inconsequence of the much-touted HIPC. Consider the current situation in three indebted countries: Nigeria, Thailand, and Zambia.

Nigeria, a country with a GDP of only $853 per person, diverts $1.7 billion of its resources annually to repay a debt of $28.5 billion. About 40 per cent of Nigeria's current debt obligations result from loans made to former military dictators – loans over which the people of Nigeria had no control, but Western creditors did. Another 50 per cent is 'phantom' debt, the result of falling into arrears on debt payments, again mainly by military dictators. To stand any chance of servicing its current debt Nigeria will have to continue to drain its finite oil reserves, further compromising its development prospects. Although in African terms Nigeria is a wealthy oil producer, after paying for production costs and foreign company earnings, the exploitation of this key natural resource yields only 27 cents per day per person for the people of the country, and inflicts enormous environmental degradation on the Niger Delta.

In the year 2000, three thousand employees of the Thai Petrochemical Industry disrupted a meeting in Bangkok. Foreign creditors were due to have obtained 75 per cent of the equity in TPI and effective control of this key Thai industry. These creditors included the World Bank's International Finance Corporation, Chase Manhattan and the US Government's Exim Bank. Protesters carried placards with slogans such as 'World Bank No Thanks' and 'Yankee Go Home' (Financial Times, 17 November 2000).

Around the same time, the Zambian finance minister Mr. Katele Kalumba, was protesting at a proposal for debt 'relief' negotiated by international creditors under the IMF and World Bank's Highly Indebted Poor Country (HIPC) initiative. After the 'relief' offered by her international creditors, the World Bank predicted that Zambia would transfer $235 million in the year 2002 in debt repayments to her creditors, nearly $100 million more than the country can currently afford to pay (Oxfam GB Media Briefing, July 2001). Four-fifths of Zambia's population lives on less than

$1 a day; 1 million of the 9 million inhabitants suffer from HIV/AIDS; life expectancy is only 40 years; and 13 per cent of children are orphaned – the highest rate in the world (Jubilee 2000 press release, 21 November 2000). In 1999 the Zambian government spent $123 million on the health of its people; in contrast, $137 million was transferred to foreign creditors.

These examples demonstrate the extraordinary power of foreign creditors over poor debtor countries, a power that deprives nations of independence and autonomy while transferring real resources from the poor to the rich. Indebted governments, regardless of their democratic mandates, are obliged by the IMF to prioritise foreign debt service payments over domestic spending on for example, health, clean water, sanitation, and environmental protection and improvement. Because of high levels of debt, governments are forced to ignore the human rights of their people, and subordinate local needs and mandates to the interests of foreign creditors.

3.1.2 One rule for the rich, another for the poor

There is another side to this picture as well. Recent developments in the global economy also changed the nature of the debt debate. Since the Latin American crisis of the 1980s, debt has been synonymous in the public imagination with the very poorest countries. But while Africa's debts have not gone away, the situation in Argentina and Asia has changed this perception. The treatment of Argentina in particular exposed the double standards of the IMF's global financial managers.

As 2000 drew to a close, the world of international finance held its breath, concerned that Argentina would default on its short-term debt, thereby precipitating what the Financial Times called 'a general loss of confidence' (Financial Times editorial, 18 November 2000). Argentina's predicament was serious, precipitated by the 'dollarisation' of its economy – namely pegging the Argentinean currency artificially to the US dollar – thereby maintaining the value of creditor assets while impoverishing Argentineans. The International Herald Tribune acknowledged in November 2000 that Argentina's 'various misfortunes… are not of its own making' (International Herald Tribune, 21 November 2000). Rather, they were the inevitable outcome of the investors' eagerness to reap high rates of return from investments in emerging markets. Indeed, the Argentinean government, while perhaps not always acting wisely, had faithfully followed the advice (and interests) of its creditors. Initially, the advice appeared to be working. Exports (which raise revenues for debt repayments) grew rapidly, inflation was held in check, and government debt and the budget deficit were only 50 per cent and 1.9 per cent of national income respectively. But Argentina had a high proportion of short-term debt, serviced at rates of interest ratcheted upwards by nervous creditors. The possibility of default was real. Investors looked over their shoulders to the IMF – an institution that provides protection to creditors while leaving 'taxpayers of major industrial countries to pick up the bill, and banks to pocket the profits' (Business Week, 11 October 1999: 72).

There has been a range of bailouts since Mexico's dramatic default in 1982. From the autumn of 1997 until October 1998, the IMF was forced to bail out short-term lenders by pouring $18 billion into Thailand, $43 billion into Indonesia, $57 billion into South Korea and $23 billion into Russia – a total of over $140 billion, which almost bankrupted the institution. The US Congress protested these bailouts by withholding a critical $18 billion to be used as leverage for further loans from other governments, forcing President Clinton to send a personal appeal for the release of the allocation: 'There is no excuse for refusing to supply the fire department with water while the fire is burning', he argued – although, as the Wall Street Journal had argued, 'the IMF had been treating fires with gasoline, rather than water' (Wall Street Journal, 12 October 1998). By late October 1998, Congress gave in. In early November, there were rumours that the IMF was using its new loans for a further $45 billion package for Brazil. In total, bail-outs and rescues transferred $200 billion of wealth from OECD taxpayers to international creditors and speculators – in just over a year.

Despite widespread criticism of the ways in which reckless lenders were protected from risks and from bad judgments during the South East Asian, Russian and Brazilian crises of 1997 and 1998, G7 finance ministers have set up another fund, the so-called $90 billion 'precautionary fund' under IMF stewardship (G7 communiqué 30 October, 1998; Financial Times 31 October and 1 November; David Snager, 1998). The purpose of this fund, according to finance ministers, is to deter 'financial turbulence spreading from country to country in a contagion process… to send a clear message to speculators that they may be taking big risks if they (short) sell a nation's currency'. However, as Michel Chossudovsky has pointed out, such a plan achieves just the opposite. 'Rather than "taming the speculator" and averting financial instability, the existence of billions of dollars stashed away in a "precautionary" fund is likely to entice speculators to persist in their deadly raids on national currencies…' (Chossudovsky, 1998).

3.2 Where next?

A large share of Africa's sovereign debt will never be paid, even at great human cost, massive exploitation of natural resources, and sacrifice of food security. The poor are being punished for mistakes made by élites in Washington as well as Africa. There is no reason to keep debts on the books – other than to keep poor countries on the leash, prise open markets, and pick up assets cheaply. It is time for creditors – not poor communities, nor taxpayers – to face up to their mistakes and write off debts.

Debt relief is a cheaper alternative to the human cost of forced debt repayment. The cost to each British taxpayer, for example, of writing off debt owed by 52 countries will be 4 pence a week. Given that they are unpayable anyway, the cost of course is nil, since no revenue will accrue. These calculations apply equally to other Western creditors.

There is also the question of double standards. Britain still owes the US $14.3 billion from the 20th century, and simply refuses to pay. It may be an old debt, but the US Treasury keeps it on the books. The amount of $14.3 billion is what all the poorest countries owe Britain. It is more than what the whole of Sub-Saharan Africa owes the US. So why should poor countries not follow Britain's example, and refuse to pay? In 1953 Germany was given massive debt relief by the Allies. This meant it had to divert only 5 per cent of export revenues to debt service. Today, the German representative on the IMF Board requires the poorest country in the world, Mozambique, to devote 15 per cent of its export revenues to debt service. Double standards.

Relations between debtors and creditors should be governed by the law. It is time for an international agreement on bankruptcy. A new independent, open and fair process for regulating international debtors and creditors is a missing link in the global economy. Without it, one of the best potential sources of finance for sustainable development will not be set free.

3.3 The ecological debt of rich countries

Giving the nations of Africa and other very poor countries the chance for sustainable development means more than removing the burden of foreign financial debt. It also means dealing with the ecological debts of industrialised countries. Unless the west shares global environmental space more equally there will be no ecological room for poor countries to develop (Simms, 1999).

Climate change is a major threat to sustainable development. It already hurts the poorest people most, costing the global economy at least an extra $300 billion in damages per year, forcing millions to become environmental refugees. Historically at least, industrialised countries are almost entirely responsible for the human-driven potential for global warming. Given that economic growth is hard-wired to the greenhouse gas emissions that fuel global warming, a new model of development is needed in which crude economic growth is not mistaken as a measure of progress.

According to the Global Commons Institute, 'The only effective framework in which past ecological debt can be resolved and a uncontrollable climate change avoided, is a deliberate framework of contraction and convergence. This requires agreement that there is a global contraction of emissions from human sources of 60-80 per cent within a specified time frame. It also means that the international sharing of this process is arranged so that entitlements to emit are pre-distributed in a pattern of international convergence so that shares become equal per capita globally.'

3.4 Conclusion

The management of debt, both financial and environmental, is fundamental to the prospects for sustainable development. Without the cancellation of unpayable foreign debt under an independent, fair and transparent process, developing countries will never free the resources with which to fund sustainable development. At the same time, unless there is a framework agreed to reconcile and eliminate the ecological debts of rich countries, climate change will ensure that there will be no development at all.

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{4}

The existence of certain institutions is critical if countries are to benefit from opportunities to develop in a structure of international competition. These are both private and public. The mostly private institutions include markets to allocate capital, adequate information flows, transparency, corporate accountability, and legal, financial, and insurance services. The public institutions are largely the institutions of good economic governance: they include oversight to ensure that markets function properly, measures for environmental protection, and the delivery of essential social services, including education and health care. This entire infrastructure of good governance is essential to the promotion of sustainable development, yet it depends on the availability of financial resources to ensure that it is strong and effective.
Few developing countries have the necessary resources to provide such economic governance.

Rich countries have relative flexibility in choosing their fiscal policy. They often have fiscal surpluses, but even when they run temporary deficits, their hands are not tied all the time by economic necessity. Their policy makers have grown accustomed to this luxury, which means that they can have their cake and eat it. Most developing countries, on the other hand, face a chronic fiscal overhang, which results in persistent deficits. The markets punish them quickly for any deviation from the economic norm – whether it is of their own making or not. In particular, they cannot engage in government interventions to correct market failures, stabilise markets, or promote sustainable development. The result is more market failures and a heightened risk of policy failure.

Consider the situation of the industrialised countries. Fifteen European countries, in the process of creating a new currency – the euro – have had to transfer adequate reserves from the national central banks to the newly created European Central Bank in order to provide backing for and ensure confidence in the new currency. After having done so, the fifteen countries were confronted by an embarrassing problem: more than 310 billion euros (more than $280 billion) in 'excess' reserves for which a use has to be found (Der Spiegel, 14 September 2001). By comparison, this sum is equivalent to the 1999 GDP of Argentina.

Around the same time, the United States has been trying to decide how to spend an apparent budget surplus, and has chosen a route of questionable economic sense, a tax cut that assumes that the surplus is real and will remain available (Krugman, 2001). Even without the events of 11 September, that surplus was fast disappearing. Now it is gone and deficit spending will again be the order of the day. Yet even while benchmark interest rates have been falling in the United States the dollar has remained relatively strong against other major currencies.

Japan presents the other extreme. It has been in a ten-year recession. It has engaged in massive deficit spending in an attempt to pull its economy out of the slump, with the result that its public debt is fast approaching 100 per cent of GDP. All this time, measures have not been taken to respond to structural imbalances in the Japanese economy or to reform the banking system. Nevertheless the Japanese yen trades steadily against most other currencies.

In developing countries, in contrast, the fiscal overhang has been many years in the making. From a situation of low public debt and close to balanced budgets well until the 1960s, many countries began to run fiscal deficits financed by domestic as well as international borrowing. By the 1980s, the debt crisis had begun to squeeze the flexibility of policy makers. While the international dimensions of the crisis have attracted the attention of the policy community, an equally serious problem is the nature of the domestic debt crisis, as a result of which many countries are forced to run surpluses in real terms. After accounting for debt amortisation and interest repayment, many developing countries spend less on goods and services than they withdraw from the income stream through taxes. Even so, the aggregate budgets continue to show high deficits. These deficits have several interlocking consequences for developing countries. They are linked to the balance of payments and the currency's stability. They limit institutional development. They contribute to corruption. And they impede the ability of governments to intervene to rectify market failures. Finally, they are self-perpetuating to a significant degree.

The fiscal policies of developing countries come under international scrutiny primarily when their currencies come under pressure from the markets. The need for additional funds to stabilise the currency generally leads to lending from the International Monetary Fund with the attendant structural adjustment programmes that are designed to promote better fiscal balance. The impact of structural adjustment programmes on sustainable development has by now been quite extensively analysed (see for example Reed, 1996). The effects are insidious, as resources are withdrawn from programmes that protect the environment or ensure the careful exploitation of natural resources and reduced funding further weakens government institutions critical to sustainable development.

Recent research has shown increasingly clearly that the existence of certain institutions is critical if countries are to benefit from opportunities to develop in a structure of international competition. These are both private and public. The mostly private institutions include markets to allocate capital, adequate information flows, transparency, corporate accountability, and legal, financial, and insurance services; and in some countries education and health care. The public institutions are largely the institutions of good economic governance: they include oversight to ensure that markets function properly, measures for environmental protection, and the delivery of essential social services, including education and health care. This entire infrastructure of good governance is essential to the promotion of sustainable development, yet it depends on the availability of financial resources to ensure that it is strong and effective. Few developing countries have the necessary resources to provide such economic governance.

In addition to limiting resources for essential institutional development, the fiscal deficit also makes it difficult to rectify some of the most serious market imbalances. This is perhaps most evident in the farming sector, which is subject to many conflicting pressures. The prices of commodities on international markets have been in secular decline since the middle of the 19th century. This has promoted industrial development – by providing low cost inputs and by keeping the cost of food for workers low. It has contributed to keeping inflation in check because in an industrial economy input prices are magnified through many stages of processing and distribution until they reach the final consumer. Many governments, faced with burgeoning urban populations have viewed low food prices as essential to political stability. At the same time this has created severe strains for farmers and the communities that depend on farming. Finally, this makes it virtually impossible for the transition to sustainable agriculture to take place.

In most wealthy developed countries it is now impossible to make an adequate living from farming. Yet raising agricultural prices or allowing farms to go out of existence on a large scale promises major social and environmental problems. In many places farming has shaped the landscape and its loss is perceived as a reduction in central cultural values of the community. Under these circumstances governments in wealthy developed countries – with the exception of Canada, Australia, and New Zealand – have resorted to subsidies to maintain farming and to keep consumer prices under control. Such subsidies have become the rule rather than the exception. While they may be reduced, there is no sign that they can be eliminated in the foreseeable future. Indeed, it is not clear that liberalising agricultural markets will actually result in a sustained increase in commodity prices. The goal of trade policy is increasingly to ensure that these subsidies are the least trade-distorting possible. Yet poorer countries are unable to match the financial resources that wealthy countries bring to bear on agricultural communities and consequently farmers in developing countries are left to face the pressures of the markets without government assistance. The results can be dire from the perspective of sustainable development: massive rural migration, the consolidation of agricultural holdings into very large units, and a continued expansion of the agricultural frontier into hitherto uncultivated lands.

The problems associated with the functioning of commodity markets are particularly clear in the case of agriculture, because of its direct link to food security for the urban populations, and because of its roots in the cultural traditions of most societies. Similar problems exist whenever biological resources are absorbed into the economy, in forestry and fishery in particular. In all of these instances some form of government action appears essential to move towards the goal of sustainable development. Yet governments without resources are unable to fulfil their essential functions in the economy.

In the 1960s, many developing countries strengthened or established elaborate networks of supportive institutions to bring about a transition to 'green revolution' agriculture. These included institutions for agricultural research, extension, education, policy, credit, inputs, and machinery. The result was a co-ordinated effort that produced one of the most significant contributions towards food security. Thirty years later, however, the very success of the green revolution has created problems, most notably an environmental crisis in agriculture. Over-reliance on chemical pesticides and fertilisers, over-use and wastage of water, and the narrowing of the biodiversity base of agriculture have led to endemic instability in yields, and a persistent dependence on external inputs – inputs that are becoming increasingly expensive and unaffordable. However, few developing countries have the fiscal flexibility to respond similarly to this crisis. Indeed, even the pre-existing institutions have deteriorated over time because of budget cuts, low salaries, poor incentives, inadequate maintenance of infrastructure, and inability to keep up with emerging technological developments.

Related to these developments is a generalised erosion of policy-making capacity in developing countries. The low salaries of government officials, especially those who have internationally demanded skills, have meant a continuous drain of talent from policy-making institutions. Economic ministries are the most affected in this regard. Many of the brightest individuals leave to join international financial institutions at annual salaries that are several times what they could expect to earn in their entire working lives. The result is the creation of an intellectual hierarchy between the personnel of domestic policy-making bodies and those of international financial institutions. Although a few of the latter return to their countries at the highest levels of decision-making, this too results in the narrowing of analytical approaches to policy-making, and the dominance of the so-called 'Washington Consensus'.

The lack of fiscal resources can be a source of corruption. A government official who handles large amounts of money or contracts worth millions may only be paid a salary that permits a frugal existence in his or her country. Many of these officials are connected to an international culture that requires much larger resources than their regular income provides. The temptation to use the (often limited) time in office to acquire wealth is strong.

The fiscal deficit is self-perpetuating to a certain degree. Countries with weak administrations are unable to operate complex revenue raising systems. Income and corporate taxes tend to be widely evaded, so that undue emphasis is placed on regressive taxes such as sales taxes or levies on certain commodities or services. Customs duties have been the traditional source of revenue for weak administrations because they are easy to collect and can be administered with modest means, in some cases even farmed out to private interests.

Many developed countries have seen a debate about the size of government, either in absolute terms or as a percentage of GDP. This debate is once again a problem of the rich. In most developed countries, government expenditures make up between 40 and 60 percent of GDP. In many developing countries government expenditures represent a smaller proportion of a smaller amount, resulting in too little government rather than too much and in a continuing inability to undertake technically demanding interventions to promote sustainable development. Yet the dependence of developing countries on international financial institutions has made them vulnerable to ideological pressure further to restrict the size of the government in a situation where the overriding need is to expand the resources available to the government and thus to improve the quality of governance in the country.

The upshot is that the fiscal overhang in developing countries has not only reduced the flexibility of countries in adopting policies to promote sustainable development, it has also placed beyond their reach to improvement to governance and correction of market failures. The situation has become so entrenched that the argument for further limiting the size of government has begun to win out by default. In order for the transition to sustainable development to take place, it is absolutely essential that the fiscal and debt overhang in developing countries be reversed. This requires action not only on international debt but also on domestic debt.

REFORMING FOREIGN CAPITAL FLOWS: THE ROLE OF SOCIALLY RESPONSIBLE INVESTMENT

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What is lacking is a coherent framework for financial policymaking that places investment in the context of sustainable development and seeks to raise both the quality and quantity of foreign capital flows to the South. The classically modernist project of the 'new international economic order' – stressing state control over international capital markets – has lost its legitimacy. But a new model has yet to be conceived.

5.1 Introduction

For more than a decade, attracting foreign finance has lain at the heart of most developing country strategies to boost their investment rate. Private capital flows have certainly grown substantially during the 1990s. Although a number of difficulties have long been recognised – such as the narrow range of countries benefiting from foreign direct investment and the fragility of much portfolio investment in developing country stock markets – the ruling assumption has been that these are essentially teething problems. Once sound domestic policies have been put in place to liberalise financial markets, so the argument goes, then capital will flow unrestricted to where it can generate the highest returns – which given the investment needs of the developing world, should result in the 'golden horde' heading South.

According to this view of events, the UN Financing for Development Conference in Monterrey and the World Summit on Sustainable Development in Johannesburg need only focus on ways of reforming the 1990s settlement at the margins, making incremental improvements to an essentially robust system. Even the widespread popular concerns about the behaviour of transnational corporations is argued to be manageable through voluntary commitments to principles of corporate social responsibility (such as the OECD guidelines for multinational enterprises or the UN Global Compact).

However, the financial shocks of 2001 suggest that the foreign investment agenda for the twin summits in Monterrey and Johannesburg should now become more ambitious. The pace and scale of the current global downturn is raising fundamental questions about the resilience and sustainability of the post-Cold War trinity of deregulated financial markets, privatised state assets and liberalised capital flows. Not only has the fragility of the financial system been exposed, but also its inability to direct capital towards the world's sustainable development priorities. The pricking of the stock market bubble in the USA and elsewhere has revealed the wasteful speculation of deregulated financial markets: the Dow Jones Industrial Average has now fallen over 30 per cent since its peak in January 2000. In the real world, the result has been a gross misallocation of resources, with massive over-investment in some sectors (notably telecom and technology stocks), and chronic under-investment elsewhere. The bubble also sucked in huge amounts of capital from the rest of the world (including from developing countries), thereby exacerbating the already entrenched investment gulf between North and South. A combination of high levels of consumer debt and continuing share price over-valuation suggests that this asset implosion still has some way to go. Equally, the faith placed in the privatisation of state assets as a necessary way to leverage investment and improved performance also looks open to revision. For example, the collapse of the UK's privatised rail infrastructure operator, Railtrack, has pointed to the need to rethink the ruling assumption that productive assets (particularly those in utility sectors, such as energy, transport and water) should always be placed in the private domain. The near-bankruptcy of Enron has also brought to a head the crisis that has plagued rich as well as poor countries in the wake of the privatisation of energy markets. Finally, the core belief in liberalised capital flows has been profoundly undermined not just by the direct legacy of the Asian crisis of 1997, but also by the realisation that the freeing of capital acts as a structural source of instability, which many countries simply cannot withstand. It was without a trace of irony that the IMF – the most pronounced supporter of capital liberalisation in the 1990s – stated in September 2001 that 'it would be a mistake for these [poor developing] countries to think that involvement with global capital markets offers a magic, near-term fix for their problems' (quoted in Elliott, 2001a).

All these shifts are generating a widespread appreciation – even within the financial community – of the design flaws inherent in the 1990s model of corporate globalisation. When the chief economist of Morgan Stanley points to the geopolitical tensions wrought by rising income inequality and highlights the tendency for globalisation to 'sow the seeds of its own demise' a significant watershed has been crossed (Roach, 2001). Yet, what is lacking is a coherent framework for financial policymaking that places investment in the context of sustainable development and seeks to raise both the quality and quantity of foreign capital flows to the South. The classically modernist project of the 'new international economic order' – stressing state control over international capital markets – has lost its legitimacy. But a new model has yet to be conceived. As with so many areas of global governance where markets have overstepped the state, current approaches to this investment conundrum are coming from hybrid initiatives that bring together market innovation, social action and enabling regulation. The challenge that is becoming more pressing by the day is how these micro-level experiments prefigure wider changes in the macro-policy framework. The rest of this chapter explores the implications of the socially responsible investment movement for financing sustainable development in the South, and proposes some lines for policy reform at the twin summits in Monterrey and Johannesburg.

5.2 The Rise of Socially Responsible Investment

With its origins in the 1970s, socially responsible investment (SRI) has now emerged in North America and Europe as an established companion to the 'green consumer' and 'fair trade' movements. SRI mutual and pension funds enable private and institutional investors to 'boycott' companies they view as unethical (such as arms or tobacco manufacturers) and direct their savings into those responding positively to the sustainable development agenda. Not only have global funds under SRI management now reached $1.4 trillion, but SRI has also generated a rolling wave of changes across the investment world. Initial scepticism that SRI would inevitably lead to under-performing funds has turned to grudging acceptance as SRI portfolios routinely beat their mainstream peers.[1] Perhaps to a greater extent than its 'green consumer' and 'fair trade' cousins, SRI has always been ferocious in linking sustainability concerns with a quality product – which has been a key factor in this fund outperformance. As a result, SRI is no longer a niche affair, with mainstream indices being established by the Dow Jones and Financial Times, and regulations being amended to integrate sustainability factors into mainstream investing. For example, the UK Pensions Act now requires the trustees of institutional pension funds to state what social, ethical or environmental factors they have taken account of in their statement of investment principles. Listing requirements on the London Stock Exchange have also been changed so that companies have to make an annual statement on their risk management systems, and the scope of what constitutes risk has now been extended to include social and environmental issues.

From the beginning, the quality of investment in the South has been a critical element of ethical and now socially responsible investment. Indeed, shareholder activism to divest from companies investing in apartheid South Africa was perhaps one of the most sustained and successful phases of early SRI. This essentially 'negative' approach continues to this day. Recent initiatives have included efforts to persuade British banks to stop funding an Indonesian pulp and paper company with allegedly poor social and environmental practices, and a campaign to force a German investment bank to pull out of financing an oil pipeline deal in Latin America.

Yet underneath this continuum lie three more structural developments that have potentially profound implications for investment in the South. The first is the accelerating trend for corporations to be owned by institutional pension funds on behalf of employees, rich and poor. This trend is set to challenge the conventional harmony of interest between firms and fund management companies. Both share a similar drive to profit maximisation and flexible labour markets, for example. But their ultimate client – the factory worker or local authority janitor – may have quite different interests, including perhaps a broader commitment to longer-term investing and the inclusion of social and environmental factors. To date, little has been done to reduce this investment dissonance, but the signs are that this sleeping giant is beginning to awake, for example, through the US trade union Workers' Capital initiative.

The second underlying trend is the pressure generated by the globalisation of capital for increased corporate transparency and accountability. Companies that want access to international capital are often required not only to disclose substantially more financial information, but also to put in place essentially 'Anglo-Saxon' models of corporate governance, with a greater role for shareholders as opposed to incumbent management. In the wake of the Asian financial crisis, research has shown that those Asian companies with the best standards of corporate governance also stood up best to the fluctuations in market fortune. From this essentially financial pressure for improved transparency, it is but a short step to enhanced reporting of social and environmental performance – especially when these factors can be shown to be material for investor risks and returns. While most of the pressure to date for corporations to report on environmental and social issues has come from civil society, investors are now becoming a powerful voice for disclosure. In October 2001, for example, the Association of British Insurers, whose members manage about $1.5 trillion in assets, published their guidelines for companies to report on social, ethical and environmental risks.

Building on these shifts is the third underlying trend: the growth in sophistication of the civil society-investment interface. Leading NGOs have now digested the message at the heart of SRI: 'if you want to make capitalism sustainable, then you might as well start with capital'. As David Korten, author of *When Corporations Rule the World*, admitted recently, 'contrary to the title of my book, it's actually the global financial system that's in charge'. Mobilising shareholder involvement is now a key element of corporate lobbying – not just to stop specific projects on a one-off reactive basis, but also to put in place positive programmes. The UK insurance company, Norwich Union, was thus the focus in 2001 of considerable pressure to use its influence as a shareholder in Cape plc to bring a settlement in the case of South African communities blighted by asbestosis at some of Cape's former facilities. BP's 2001 annual general meeting was also the focus of concern about the company's continuing investment in climate-damaging oil fields and the risk that its stake in a leading Chinese petroleum company linked it to human rights abuses in Tibet and Sudan. And when global development and health campaigners sought to pressure leading pharmaceutical companies, including GlaxoSmithKline, to withdraw from their case against South Africa's intellectual property regime, a primary focus was to alert investors to the 'reputational risk of biblical proportions' that these companies faced. When GSK eventually pulled out of the case and launched a revised programme of lower cost access to essential drugs, the chief executive officer admitted that it was not the NGO campaigning, but rather the concerns expressed by major investors that had tipped the decision.

To date, the impact of this still embryonic SRI movement on finance for sustainable development in the South has been mixed. In terms of SRI generating additional flows of sustainable finance, the direct effects have been marginal and perhaps insignificant. Few SRI funds invest in developing country stock markets for all the risk averse reasons given by mainstream investors, but with the added constraint of an absence of adequate analysis of the social and environmental performance of companies in emerging economies. The NPI Global Care Asia-Pacific fund was a first, but still invests largely in Japan, Korea and Taiwan, while the Calvert New Africa fund remains relatively small. In addition to these equity funds, a number of private capital investment funds have been established – often supported by multilateral development banks – to channel additional funds into environmental investments (such as the Terra Capital and Clean Technology funds in Latin America). Within the developing world, domestic interest in SRI is starting to grow, notably in the Asian region – where the Asian Sustainable and Responsible Investment Association was established in 2000 – and the first home-grown SRI fund was launched in Brazil in late 2001.

The indirect impacts of SRI on the South, however, could turn out to be quite profound. Many SRI managers now routinely assess the practices of corporate subsidiaries operating in developing countries as part of the process of analysing whether a particular transnational corporation should be approved for their funds. In addition, a growing number of sectors, starting with clothing and food retail, are expected to have well-developed supply chain policies in place to enter a number of SRI funds. This analytical interest in TNC relationships, combined with focused programmes of engagement to encourage transnationals to adopt good practice standards, makes SRI a potentially powerful lever for improving the quality not just of foreign investment, but also of foreign trade. One possible result is that a larger share of value added could stay in the South – an issue certainly worthy of further research.

5.3 Conclusions & Recommendations

Looking back, the policy bias of the 1990s tipped the balance too far towards investor rights and away from investor responsibilities. The socially responsible investment movement can be seen as a reform initiative within financial markets to try to right this imbalance. But like other similar efforts to improve world trade or encourage more sustainable consumption patterns, SRI ultimately bumps up against a regulatory framework that still allows most investors not to care, for example, about a mining company's treatment of indigenous peoples or the wage levels in a clothing company's subcontractors. As this chapter has shown, modest regulatory changes are starting to get underway in a number of industrialised countries – primarily to enable greater transparency of the SRI issues that mutual and pension funds take into account. But further efforts should be focused at the twin summits in 2002 on four key objectives:

Mobilising new resources: An investment gulf still looms between a capital-rich North and needs-rich South. However much official development assistance is increased, and however creative new instruments such as the clean development mechanism turn out to be, considerable additional flows of non-concessional foreign investments are required to finance productive activities in the South. Getting the investment climate right in the developing world should certainly remain a high priority, but much more could be done to boost the supply of funds. For example, much of the investment business in the industrialised world is supported by tax breaks to encourage saving and pension planning. Except in rare cases, however, these tax breaks are not linked to the need to demonstrate commitment to sustainable development – and certainly no government gives investors a fiscal incentive to finance projects and companies in the South. The twin summits could therefore explore and recommend ways in which a portion of industrialised country pension fund assets have to be channelled towards sustainable development funds in the South in order to receive tax relief. These funds would have to meet the highest standards of financial probity and sustainability analysis, and could be particularly targeted towards the financial needs of small and medium-sized enterprises, perhaps through partnerships with local banks.

Extending stock market disclosure: A number of high-profile initiatives are underway to stimulate greater disclosure by companies (particularly TNCs) of their sustainability record. However, most of these – such as the Global Reporting Initiative – are voluntary. One effective way to ensure wider disclosure is through stock market listing regulations. Here, the 'right to know' culture of the USA has meant that companies listed on the New York stock exchange have to reveal considerable amounts of information about their environmental liabilities. Environmental information is also required of firms listed on the Bangkok stock exchange. Thus, a straightforward recommendation for the summits would be to form a task force to agree core sustainable development disclosure requirements which could be adopted by all stock markets.

New models of ownership: In Britain, the home of privatisation, over a decade's experience has shown that while de-nationalisation can often bring rewards by removing political interference and budget constraints, a fully private model is not always appropriate. The transfer of Welsh Water from a private to a not-for-profit corporation in 2000 responsible to the 'stakeholders of Wales' and financed by bond issues could be the start of a wider wave in favour of 'stakeholder ownership'. In the developing world, such a model could offer a useful half-way house in the case of under-performing state management or unresponsive private operators of utility companies. The stakeholder ownership model could also be used to generate public interest solutions to the contentious issue of access to essential drugs in developing countries. Again, the twin summits could launch a process to recommend new models of ownership for utility sectors where the public interest can probably never be wholly achieved through regulation alone.

Building common standards: In their dealings with the South, SRI fund managers in North America and Europe are often operating with unclear legitimacy. Fund criteria are being introduced and implemented which could have profound implications for developing countries – both positive and negative – with external input coming, if at all, from Northern environment and development NGOs. As with the tense and mistrustful world of sustainable trade, the SRI movement now needs to develop governance frameworks that allow for the co-evolution of standards in place of unilateral imposition. This is perhaps something that the SRI community itself might want to bring to the twin summits – suggesting that a first global SRI congress should be held (in 2004?) to agree governance principles for SRI, against which different funds could be judged.

At this time of economic uncertainty, SRI holds out considerable promise as a lever for financing sustainable development in the South. But for this to happen, SRI will need to confront the investment gulf that divides the globe, and seek changes in the global financial framework in order to help steer the world's wealth towards sustainable livelihoods in the South.

This chapter was contributed by **Nick Robins**, Head of Research in the Socially Responsible Investment team at Henderson Global Investors in London. He writes in a personal capacity.

[1] For example, the NPI Global Care Managed Pension Fund, which is run by Henderson Global Investors, generated 76.79 per cent returns in the five year period to 03/09/01, compared with 41.4 per cent for its investment class, thereby achieving third percentile performance (Micropal Individual Pension Managed).

MIGRANT REMITTANCES

{6}

Given the sizable immigrant community in industrialised countries, their potential for earning and savings, their commitment to their countries of origin, and their philanthropic orientation, this source of development funds has considerable untapped potential. At this moment, the main obstacles to the realisation of this potential are the lack of information on viable developmental activities, trustworthy development institutions (generally outside the government), and reliable intermediation channels.

Since the 1960s, there has been an interest in the amount of money that expatriate workers send home to their families in developing countries. In the 1960s, economists noted the large and growing volume of unrequited financial transfers from Western Europe to Turkey, Yugoslavia, Morocco, Tunisia, and Algeria. In the 1970s, the oil boom led to a massive influx of temporary workers into the Arabian Gulf countries, and soon a large and growing volume of remittances most notably to Pakistan, India, Bangladesh, Sri Lanka, and the Philippines. In Pakistan, remittances grew from minuscule amounts in the early 1970s to as much as $3 billion dollars annually in the peak years of the 1980s. At that time, these constituted the largest single source of foreign exchange for the country. These pertain only to figures that pass through official channels. Some estimates suggest that a comparable amount was channelled through informal and unrecorded channels. In the other Asian countries, the amounts were smaller but still highly significant.

Similar trends have been observed elsewhere. Peter Bate cites figures from the Inter-American Development Bank's Multilateral Investment Fund (MIF) that the Latin American region receives about $20 billion from its migrants working abroad, and in six of these countries, income from remittances represents over 10 per cent of their GDP. In El Salvador, for example, remittance inflows dwarf the damage caused by the earthquakes that struck the country in January and February. In larger countries, like Mexico, while remittances do not represent such a large proportion of income, they still constitute the top sources of foreign exchange (Bate,2001).

Remittances generally lead to a consumption boom, especially in consumer durables and construction, and produce a positive impact on the distribution of income and consumption. They have also been associated with policy changes designed to encourage and sustain the inflows. These changes include the dismantling of capital controls, a shift to market-based exchange rates (thus lowering the premiums on black market exchange rates), expansion of banking operations into rural areas, liberalisation of import policies, and increase of foreign exchange reserves. An indirect impact was the development of informal financial markets.

Initially, there was considerable debate over the net benefits of remittances. Some observers argued that remittances encourage conspicuous consumption and thus undermine the savings potential. Also, many families find it more profitable to invest their savings in sending one of their offspring to foreign countries, instead of building productive assets in their own countries. Conversely, others argued that even though most migrant workers stay on indefinitely, they tend to use their savings to support their families in their countries of origin instead of building up their communities in the host countries. In other words, remittances could work at cross-purposes to the aspirations of an immigrant community to succeed and prosper in the host country. Concerns have also been expressed regarding the depressing impact of remittances on education. Having said this, however, on balance the assessment of remittances is highly positive. Even the consumer boom is said to have significant multiplier effects in local contexts.

Be that as it may, the relevance of remittances to sustainable development stems from the expectation of migrant investment in development projects in their home countries. Developing countries have used a number of policies to attract developmental resources from this community. The simplest and most obvious is a set of incentives to encourage migrants to invest in real estate. This corresponds with the consumption-orientation of most remittances, and benefits from the high mark-ups of real estate prices in state controlled housing developments. However, the experience of such investment is not very positive. In Portugal, the government is reputed to have squandered the resources on ill-conceived investments.

Besides real estate, direct investment in government-led development projects is rare. There is very little trust in government management. Corruption, incompetence, mismanagement, and lack of transparency are sufficient to destroy trust. A third approach through which governments have tried to attract resources is by high returns on foreign currency deposits in its banking system. Given the low rates offered on deposit interest rates in industrialised countries, even the 'high return' is lower than curb borrowing rates. In other words, foreign currency deposits are often a cheaper source of international borrowing for countries. More importantly, given the demographic and economic growth, countries expected a sustained secular increase in net inflows into these deposits. However, in countries that have re-imposed capital controls or frozen foreign exchange accounts because of an external emergency, the loss of trust has contributed to a neutralisation of this resource, or at least a cessation in the secular trend.

The upshot is that government attempts to channel remittance resources into public or private investment have rarely been successful, if at all. However, a different process has emerged recently to promote a similar agenda. In this process, expatriate groups have come together on their own to mobilise resources for development projects, anti-poverty programmes, social sector projects, and even venture capital for investment in their countries of origin. Some of these groups are organised under the rubric of hometown associations. These associations have channelled millions of dollars into small projects – elementary schools, basic health units, micro-credit schemes, and emergency relief are the most popular. Others are organised in the form of independent philanthropic associations allied with similar associations or community based groups in the countries of origin.

The Mexican Government has initiated a new three-for-one deal: for every peso migrants contribute to local community development funds, the federal and state governments will chip in two pesos (Bate, 2001). It is too early to judge the success or otherwise of this initiative, but the history of mistrust of the Government has stacked the odds against success.

Yet given the sizable immigrant community in industrialised countries, their potential for earning and savings, their commitment to their countries of origin, and their philanthropic orientation, this source of development funds has considerable untapped potential. At this moment, the main obstacles to the realisation of this potential are the lack of information on viable developmental activities, trustworthy development institutions (generally outside the government), and reliable intermediation channels.

To provide an example, the flow of funds into private investment is facilitated by the creation of institutional mechanisms that standardise disclosure and accountability – the stock market, public financial statements, balance sheets, auditing processes, and the like. The strengthening of such institutions in the countries of origin of the migrants could well attract investment into commercial activities.

Beyond this, however, the development world proper, namely the world of non-commercial investment, has none of these institutions. Even if an individual wishes to donate resources to developmental activity in his or her country, s/he will often find it very difficult to obtain the information needed to make the decision. A start can be made by creating the basis for such disclosure in the developmental arena. In other words, there is a need to create a set of public goods, namely institutions of financial intermediation, to encourage investment in public activities.

It has to be admitted that much of this will take place outside of the government sector, since the likelihood of engendering trust in governmental bureaucracies and procedures is not very high. As such, however, it provides an insight into the larger problem of development finance. Given that this is a situation in which the provision of resources is purely voluntary, and is driven solely by a sense of commitment and responsibility, it becomes clear that where the responsibility exists, the obstacle is that of credibility, trust, and legitimacy of the recipient institutions. Even if the governments of industrialised countries become willing to provide 0.7 per cent or even higher shares of their respective GNPs to official development assistance, there will still be the need to strengthen recipient institutions, to develop their capacity and credibility, and to engender broad-based trust.

This chapter was prepared by **Tariq Banuri**.

{7}

> *A significant gap exists between the traditional supply-oriented finance framework, and the potential users of sustainable development finance – a gap which could be filled by institutions, provided they have adequate support. Banks are not prepared to serve as the creditors of many small loans. Nor will finance reach the necessarily diffuse level of small credit in the form of FDI or even ODA. Smaller scale, intermediary institutions are essential – those to which modest lines of credit can be extended, for subsequent mini-credit distribution. The NGO community is well-poised to fill this niche, and the development of NGO capacity in this realm could essentially lead to the creation of a supplier network and small-scale credit market, and to the support of long-term supplier/purchaser relationships*

7.1 Sustainable livelihoods as a development goal

Sustainable development and poverty alleviation require not so much an investment in a handful of expensive, large-scale development projects, as in large numbers of sustainable livelihoods – best created by smaller, local, eco-efficient enterprises. Yet, when the distinction is drawn between development finance and sustainable development finance, it becomes clear that the former is inclined to benefit from current trends in supply, while the latter is likely to suffer.[1]

How, then, is sustainable development to be advanced? Both the literature and ground-level development practitioners are converging on a set of complementary principles that can serve to advance this work: Namely, that human and institutional capacity can create the collective ability to act, and that this ability, when directed toward building sustainable livelihoods, can go far toward realising the goals of sustainable development.

Today, there exists a widespread recognition among the international development community of the importance of financing sustainable enterprises in developing economies, but very few mechanisms are presently available on the ground to do so. The availability of grants is dropping, and conventional financing institutions remain inaccessible because smaller scale sustainable livelihoods projects generally have little collateral to pledge and no record to demonstrate a steady cash flow. Given the small size and weighty administrative costs of such allocations, and the sparse credit histories and high perceived risk of many borrowers and grant recipients, finance continues to be the missing link to widespread creation of sustainable livelihoods.

7.2 Enhancing demand for finance

A well-known example of a development intermediary producing a mechanism to support sustainable livelihoods is that of 'micro-credit'. A leading exponent of this approach is the Grameen Bank in Bangladesh. Grameen has established the legitimacy necessary to borrow at low interest rates, and the efficiency and cost basis to lend at extremely small scales at market rates. The success of this system lies largely in its institutional capacity and strong normative culture amongst its staff as well as its borrowers.[2] Much of this discussion as well as the bulk of the examples are limited to credit for the 'self-employed' – basically micro industries that range from street vendors and domestic helpers to manufacturers of handicrafts, industrial components and small products like packaged spices, garments and toys. Some are based in agriculture and animal husbandry, others provide components and inputs to larger industries. A large percentage are subsistence occupations – admittedly a great achievement for people who earlier could hardly survive on their earnings.

However, the 1996 UN Micro Credit Summit underlined what is still missing, namely mini credit. The next step in the credit revolution has to be the evolution of new kinds of enterprises that will mobilise resources and create steady jobs for larger numbers of local people, beyond subsistence activities or family-run enterprises. The Swiss Foundation for Sustainable Development in Latin America (FUNDES), a Swiss initiative that has pioneered financing mechanisms (based primarily on guaranteeing bank loans) in several Latin American countries, has over the past decade provided several examples of mini and small industries that can be made commercially viable with minimal financial support. However, it is also becoming apparent that the bank guarantee approach has its limitations.

A study sponsored by the Overseas Development Administration (now DFID) of the UK has clearly demonstrated that financing for mini enterprises (as defined here) is a critical gap in the development arena.

Regardless of scale, however, the system faces risks, both objective (through crop failure, for example) and stemming from moral hazard (wilful loan default, collusion between lender and borrower, expectations of bailout encouraging risky investments). As is discussed below, however, at these alternative scales objective risks can be overcome through capacity building and technical assistance to both borrowers and small-scale intermediaries. Moral hazard can similarly be avoided through the development of a normative culture as well as sophisticated monitoring of lending practices. The result can be a highly legitimate process that brings finance to sustainable development activities that would otherwise go unsupported.

When applied to the question of development finance, the innovative attribute of this perspective is again that it implies a focus on demand.[3] The reduction in risk and handling costs (essential to successful lending) and restoration of grant-maker confidence (essential to aid) cannot be addressed through changes in supply. Movement on both fronts is central to future small-scale sustainable development activities, and each must be approached through a strengthening of project efficacy and accountability and, in the longer term, records of credit-worthiness. In other words, risk reduction, efficiency and restoration of legitimacy can only be achieved by strengthening the demand for finance.

7.3 Capacity building and institutional strengthening

Numerous alternative finance models exist, such as micro-credit, franchising and partnering.[4] Expansion in the use of these instruments – in the process, and in proving their soundness and utility – is arguably the cornerstone to more effective use of development finance. However, increased use of various forms of credit and aid requires an increase in the capacity of recipients and the strengthening and support of intermediary institutions.

The notions of building capacity and strong institutions have received significant attention in recent years, mainly in the context of national development and environmental management. It is now widely held that capacity is required to meet a variety of challenges in these domains.[5] While attention has been directed toward capacity building in the NGO community, this effort has not addressed the issue of small-scale finance with adequate rigour. Little direct attention has been geared toward the capacity building of non-governmental organisations to handle and administer this level of development finance, a factor which may have served to slow the evolution of development work in general.[6]

A significant gap exists between the traditional supply-oriented finance framework, and the potential users of sustainable development finance – a gap which could be filled by institutions, provided they have adequate support. Banks are not prepared to serve as the creditors of many small loans. Nor will finance reach the necessarily diffuse level of small credit in the form of FDI or even ODA. Smaller scale, intermediary institutions are essential – those to which modest lines of credit can be extended, for subsequent mini-credit distribution. The NGO community is well-poised to fill this niche, and the development of NGO capacity in this realm could essentially lead to the creation of a supplier network and small-scale credit market, and to the support of long-term supplier/purchaser relationships.

Strong institutions, in the context of development finance, would mean that the handling costs of large numbers of small grants or loans could be borne less expensively, at the NGO level.[7] A number of NGOs are currently capable of stepping into the role of small- or mini-scale intermediary creditor, creating the institutional skeleton of a supplier's market for this type of credit, and the role of project finance monitor.

In addition to institutions, the capacity of recipients to use finance – from identifying, applying for, spending, accounting for and, in the case of loans, paying back – also entails the strengthening of demand. The demand for finance to launch small enterprises is thought to be vast, but this demand does not always translate into the capacity effectively to use the money. Nor does the ability to launch a small enterprise mean that it will be a sustainable one. Both require skills, support, marketing channels, and access to technology.

The two groups – intermediaries and recipients – possess a number of the tools to build and run alternative scale finance and monitoring systems. They do, however, require increased capabilities – through technical and networking assistance, access to technology, training programmes, and so on – to do so. Two factors in particular beckon such an international capacity building effort for both intermediaries and recipients. First, the scope of demand for this sort of credit framework – estimated to be in the millions of borrowers in India alone; and second, the existing capacity and potential which can be capitalised on through network building, mutual learning, and so on.[8] In short, not only is finance needed to meet sustainable development's goal of strengthened capacity – of the individual, the community and the institution – but capacity is needed now in order to mobilise and utilise this finance.

7.4 Reducing risk and building legitimacy

Legitimacy is a cornerstone of development activities, and with its deterioration come a number of impediments to the development process. These impediments tend ultimately to impact the movement of finance: the approval and release of funding can be obstructed, and finance can be ineffectively disbursed and under-utilised. With a breakdown in legitimacy, the process of financing development activities can fail at a number of points.[9]

In many ways, legitimacy and risk are similar commodities: to the commercial lender, the level of risk determines the viability of a loan; to the supplier of aid, legitimacy of both the players and the goal itself weighs heavily on funding decisions. Approaching again from the demand side, a boost in small-scale commercial lending requires efforts to reduce risk, just as a reversal of the slump in bilateral grants requires a restoration of legitimacy to charitable aid. This decline in confidence is not unwarranted, but comes at a time when real advances in monitoring and accountability have been made in a number of countries. Similarly, empirical studies by the Government of India, the World Bank and others show that among the potential clients for small credit, a significant proportion have high levels of credit worthiness. The paradox of our global economy is that there is virtually no source of funding today that can actually deliver adequate financial credit in this intermediate range where it has the greatest potential impact, both on the generation of employment and on national economies. Carefully designed lending programmes that fill this gap can therefore be both financially profitable and socially worthwhile.

Thus the framework through which both lender and donor funds are brought to bear on a development issue needs to be made more efficient, through niche-filling in the supplier chain, greater transparency, and improved monitoring and institutional strengthening; and more effective, by bringing finance to the level of the economy where the greatest number of new jobs and real income are generated.[10] The connection of these 'legitimacy frameworks' requires an effective, transparent intermediary mechanism.

The process of coupling these ends of the development finance chain can be initiated with the fostering of:

- small-scale credit suppliers' markets which would borrow from the lender below market rates and at conventional scales, and lend to the ground level at market rates and appropriately small scales, and
- monitoring mechanisms which combine the strengths of normative models (such as Grameen Bank) to build borrower/recipient track records, and network-based reporting systems (such as the Global Reporting Initiative) to increase corporate investor accountability.

For many nations, efforts to provide quality services and products that contribute to national development through strengthened capacity are quickly countered by the larger issues of social instability and economic crisis. A number of socio-economic and political constraints can affect the performance of the public sector in countries that have experienced economic recession and social conflict.[11] Again, just as the supply of finance for development services can be inhibited – in this case by malgovernance and decayed legitimacy – the demand for development services can also be depressed. Essentially, the use of development finance can be impeded through a loss of trust on the part of prospective recipients in the loan- or grant-making process. Potential consumers of credit are less eager to purchase credit when it is supplied through channels – public sector or private – that have displayed an inability or unwillingness to confer with civil society over development objectives, or worse, have exhibited signs of corruption and mismanagement.

These are longstanding issues, not quickly overcome, which many nations experience to varying degrees. Efforts are ongoing within the UN and other multilateral agencies, to address the impacts of these constraints. However, the particular impact of malgovernance and mismanagement not only on supply, but also on demand of development finance is an area of focus that is currently underdeveloped. Both a reduction in lending risk and an increase in legitimacy of the development finance process, in the eyes of both supplier and consumer, can be achieved, but will require programmatic efforts to enhance:

- efficiency, transparency and competence of the public, private and NGO groups involved in the aid and credit processes, through increased managerial and institutional capacity;
- public policies that encourage and facilitate private sector investment in alternative scale enterprises;
- communication of credit options and alternatives to the pool of potential borrowers;

- the process of exploring and developing alternative credit mechanisms;
- research capacity in the study of development finance reform;
- capacity and network building geared specifically toward a civil society-based intermediary lending community;
- capacity and network building geared specifically toward a civil society-based monitoring mechanism;
- networking and debate among process participants toward increases, at all levels, of development management capacity;
- visibility of the process and its outcomes both for civil society (domestic and international) and for the aid and commercial lending communities; and
- communication of success stories, and the dissemination of best-practice knowledge.

7.5 Conclusions

The credit and aid mechanisms through which sustainable development is most greatly advanced are of multiple scales – the most productive of which can tend, in developing countries, to be quite small. Despite considerable policy-level recognition in many countries of the importance of making finance available through alternative mechanisms and at alternative scales (beyond the micro-credit market), formal mechanisms to provide financial support to them are quite limited. Where such support exists, it is often limited in scope to financing very traditional economic activities, most of which offer little potential for generating surplus, savings or reinvestment.

Many small-scale potential clients are manifestly more profitable, less risky and better in tune with the needs of the local and regional economy than their larger, well-financed counterparts. These borrowers include a wide range of industries, trades, and communities capable of 'boot strapping' local, and consequently national economies. Among these, a large number could contribute to sustainable development by enhancing coping strategies and protecting communities from shocks, by fulfilling basic needs, creating livelihoods, generating purchasing power and conserving natural resources.

The body of projects and enterprises that create sustainable livelihoods can grow rapidly provided the infrastructure is built up to provide them with the necessary support. Both the tenets of UNCED and conventional development wisdom call for action in this direction. Successful models exist which can be readily replicated, yet real action on the ground remains limited. In its response to the questions of future development finance, the international community should widen the opportunities for sustainable development by encouraging these alternatives, and placing the development of this type of framework and the capacity of participant groups at the centre of its strategy.

This section was prepared
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1 Development policy continues to centre on industrialisation. Current technological options are skewed in favour of the industrial sector. As a result, the capital cost of creating the millions of jobs needed each year in poorer countries, in the modern industrial sector, could be many times higher than a country's GNP. Given the present ecological price tag of modern industry, this approach is clearly not among the solutions to global environmental problems, and given the expense, simply cannot be the solution for eradicating poverty.

2 It may be useful to point out a similarity between the Grameen Bank and the World Bank, namely that both have succeeded in offering loans to their clients at rates below what they would get on the open market. Whereas commercial banks have historically viewed developing country borrowers as high risk and have offered reflectively high rates, the World Bank is considered an inviolate borrower. It has been able to borrow from commercial lenders at below market rates, add its premium, and pass the loan on to the developing country borrower at market rate.

3 Indeed, while the policies of key entities on the supply side of the finance issue – the World Bank, commercial banks, aid agencies – are important factors, the key determinants of a lasting solution may be identified through analysis and strengthening of demand.

4 The variety of available supplier/purchaser relationships confirms that development finance need not enlist traditional models in order to be effectively utilised and can, in fact, be hindered through limitation to these models. In cases where proven, smaller-scale applications of development finance are deemed too expensive an undertaking by conventional creditors such as the banking sector, valuable opportunities for job creation and growth are lost.

5 Agenda 21 states, for example, that the 'fundamental goal of capacity building is to enhance the ability to evaluate policy choices and modes of implementation of development options, based on an understanding of…specific needs as perceived by the people of the country concerned.

6 It is through the framework of the NGO community, after all, that various target groups – rural populations, ecologically vulnerable groups, the informal sector, women – are most readily accessed, and it is through these groups, then, that small-scale development finance can be most effectively utilised.

7 Strong institutions could also create confidence among large lenders, lowering the rate at which loans can be made, and thus the rate at which the loan can be passed on to small-scale projects and entrepreneurs.

8 A third may be new international calls for a global grant-making institution on the scale of the World Bank – if not the Bank itself. Though unlikely, a strong renewal in this type of aid could be greatly encouraged by stronger recipient capacity.

9 In reality, the division employed here, between recipient and intermediary, may be a misleading dichotomy, as the strengthening of demand means a strengthening of the many layers of the finance process. In a strong and transparent system, in other words, an NGO may borrow money from commercial vendors to lend to a community, which may in turn lend to individuals. The issues of scale and layering require exploration and research, ideally through the experiences of an international capacity building effort.

10 At a bi- or multilateral level, trust of the public of the donor countries, the members of a donor foundation, the overseeing agency of the donor government, the public or private recipient agency, and even the financial conduit can be lost. Domestically, the generation of development finance can be hindered by government corruption or public disapproval in the use of taxes, and thus the process of tax collection itself.

11 Similarly, efforts aimed at bringing credit to the small-scale entrepreneur can help domestic development transfers by restoring legitimacy to domestic, public sector activities, such as tax collection.

12 These constraints include fiscal instability, the effects of income/employment reforms and workplace survival strategies on public sector performance, the impacts of centralisation and decentralisation on public sector accountability, and the ineffectiveness of emerging democratic governance in crisis-ridden countries.

SUSTAINABLE TRADE,

VALUE CHAIN GOVERNANCE, AND RESOURCE MOBILISATION FOR SUSTAINABLE DEVELOPMENT

{8}

The market for sustainable trade has evolved to a large extent without policy support, it has displayed significant growth rates, and its economic, social and/or environmental benefits are unquestionable. The potential contribution of sustainable trade to sustainability and its financing is enormous. The challenge lies, on the one hand, in increasing the amount of sustainable trade, and on the other hand, increasing both its benefits and the equitable distribution of these benefits. Key to both is the analysis and management of the value added produced throughout the life-cycle of a sustainable product.

8.1 Introduction

The question of how trade can be put to work in favour of environmental and social rather than purely economic objectives is crucial for sustainable development and for its financing. More concretely, concerns include questions such as:

- How can negative environmental and social impacts from trade liberalisation be minimised, and positive effects be encouraged?
- What effects does tariff escalation have on the environment and on equity?
- How has trade in environmental goods and services evolved and what type of support has been provided?
- How do different patterns of trade impact sustainability?

At UNCED the debate on financing sustainability still centred on development aid. Even so, in addition to requesting financial help through the creation of a new 'green fund', developing countries also called for a removal of trade barriers and improved market access especially for agricultural products, as well as for substantial technology transfer on preferential terms (see for example U.S. Office of Technology Assessment, 1992). Ten years later, the policy arena has not advanced significantly on any of the trade-related demands. Agricultural trade liberalisation has not moved forward significantly, the terms of trade of the export commodities of developing countries have suffered further, and tariff escalation still persists.

Nevertheless, pressure for change on these fronts continues. The UN´s High Level Panel on Financing for Development recently recommended, on trade-related issues, that the WTO should launch a Development Round, to provide immediate assistance to the least developed countries to improve their position in the world trading system, and to increase funding to WTO, especially on labour and environment-related issues (UN General Assembly, 2001).

These are important challenges. At the same time, however, changes are slowly taking place outside the policy arena, in the market place. These have to be recognised, catalysed to the benefit of sustainable development, and, where adequate and possible, supported by public policies. Consumers have increasingly become aware of the environmental and social impacts of their decisions on the market, producers themselves have very often realised the potential for input savings and increased profits through the use of clean technology, companies have developed environmental, social and ethical standards for suppliers, and individual entrepreneurs have taken on the challenge of environmental and social performance as an element of competitiveness. The concept of 'sustainable trade' has taken shape against this background. First and foremost, sustainable trade is the link between sustainable consumption and sustainable production, Chapters 2 and 4 of Agenda 21.

'Sustainable trade' can be defined as trade that generates economic value, reduces poverty and inequality, and regenerates environmental resources. As such, all trade should, finally be sustainable trade. In the context of this publication, however, our consideration of sustainable trade shall be limited to trade in products that are explicitly distinguished for their positive social, environmental and/or ethical implications. Sustainable trade exists at many levels and presents many facets. Some of these emphasise environmental objectives, others social objectives, some have very high standards and strict criteria, others, realising that most producers cannot live up to the highest standards but do have a commitment to more sustainable trade, have elaborated standards and criteria that can be considered first, second or third steps to sustainable trade.

8.2 The evidence: sustainable trade in practice

The oldest formal initiative along this line, fair trade, dates from the early 1970s, but during the 1990s environmentally centred and ethically centred trade have been added. Today, several thousand organisations, producers, traders and alternative marketing companies are grouped under the Fair Trade, Eco Trade or Ethical Trade Associations. Worldwide sales under the fair trade banner amounted to about $400 million in 2000, which is about 0.01 per cent of global trade (See www.fairtradefederation.com). Traidcraft plc, a major British fair trade organisation, has a turnover of approximately US$16 million annually. Growth in the fair trade sector has been 10 per cent annually since the 1970s (See IIED Sustainable Markets Group, 1999).

Eco-labelling is found at national, regional and international levels. It can be third party certified – public or private – and it can be based on self-declaration. Worldwide there are an ever growing number of schemes, especially those that are independently certified. The most cited examples of ecolabel schemes are the German Blue Angel, the Nordic Swan, the EU label and the Green Seal in the USA. Networks have been set up in the recent past to co-ordinate and exchange information. However, these networks consist, in general, only of the most important independently certified schemes (See for example the Global Ecolabel Network. www.gen.gr). The product range included in ecolabelling schemes includes almost all conventional products, but has traditionally focused on the agricultural market.

The global market for products from organic agriculture is estimated at around US$20 billion in 2000. Estimates of the growth of this market in various countries range between 5 and 40 per cent. Shares of organic produce in the markets for agricultural products in Europe and the US range between 1 and 5 per cent, with projections of reaching 8 to 12 per cent by 2005 (ITC, 1999 and Willer and Yussefi, 2001). It is more difficult to keep track of products sold under the integrated pest management label. Beyond individual news,[1] little overall data is available.

The two major international labelling schemes for sustainable forest management, the Forest Stewardship Council (FSC) and the Pan European Forest Certification (PEFC), had certified 25 million and 37 million hectares respectively by 2001 (www.fscoax.org and www.pefc.de). Companies accounting for about 15 per cent of the UK wood market had, in 1999, only FSC certified wood products in stock. Similar numbers can be found in different markets for forestry sub-products.

Specific cases of fair or environmentally driven trade are numerous and range from organic honey from Tanzania; fair trade coffee from the Andes; tagua nuts from Ecuador (sold as buttons in the international market); flowers from sustainable production in Columbia; and citrus fruits from integrated pest management in South Africa, to mention just a few (IIED Sustainable Markets Group, 1999).

Whilst the markets are patchy, information about them is even patchier. What is clear from the numbers is that the market for sustainable trade has displayed significant growth rates over the last decade, and in some sub-sectors sustainable trade has become rather sizable. Overall performance of fair and eco trade, certified and labelled products has not yet been quantified, though organisations such as the Global Ecolabel Network (www.gen.gr) are striving to obtain better statistics. Taken as a whole, however, it can be assumed that formally declared sustainable trade still does not amount to more than a one-digit share of global trade. Even so, it has evolved to a large extent without policy support, it has displayed significant growth rates, and its economic, social and/or environmental benefits are unquestionable. The potential contribution of sustainable trade to sustainability and its financing is enormous.

The challenge lies, on the one hand, in increasing the amount of sustainable trade, and on the other hand, increasing both its benefits and the equitable distribution of these benefits. Key to both is the analysis and management of the value added produced throughout the life-cycle of a sustainable product.

8.3 Value chain management

Beyond the economic benefits from the mere existence of new markets and their direct profit implications, two factors are crucial:

- the understanding and management of the value chain of the products and
- the analysis of the distribution of rents during the whole cycle of organisation, conception, production, delivery and re-use or recycling of the product.

Several studies have pointed out that increasingly the rents from export production in the developing world have accrued to market participants in industrialised countries (See for example Kaplinsky, 2000). They have also shown that whereas market access barriers in production have gone down, these have centred on other areas of the value chain, including the design, development, or marketing phases, as well as environmental requirements.

Whereas the principal aim of fair trade organisations is to maximise the benefits accruing to developing country producers, benefit-sharing is not a key issue (and sometimes is not an issue at all) in environmentally driven or eco trade. Thus, whereas in fair trade up to 40 per cent of the average retail price accrues to the producer, (see www.fairtradefederation.com) this share is substantially lower in other types of sustainable trade. The goodwill towards developing country producers that exists in fair trade marketing channels and consumers is markedly absent in other sustainable trade arrangements. As a result, producers have to struggle to find ways to capture more of the rents in sustainable trade.

The value chain approach is designed to analyse the issues involved in the above situations. Even though most developing country producers – and their governments – are not in a position to govern the value chain of a product, they will have to start analysing the sources and distribution of the rents in the chain, identifying benefits they obtain by creating closer long term collaboration with the predominant agents in the value chain, and trying to establish agreements that would allow the producers to upgrade their production – perhaps through gradual environmental and/or social certification. They will have to identify and lobby against explicit (and often implicit) market access barriers around marketing, development of the product (notably focusing on the patenting regime), and certification procedures. They will also have to think of establishing greater cost-effective presence in major consuming countries, and will have to invest in new areas such as eco-design and partnerships with industrialised country businesses (see first examples of conventional products in Kaplinsky, 2000 and in IIED Sustainable Markets Group, 2000). International organisations and development agencies should provide assistance in these efforts.

Different authors have provided evidence that conformity with criteria and certification processes can be costlier for developing countries than for industrialised country producers (see for example Ewing and Tarasofsky, 1997). Others have shown that labelling programmes have negatively affected exports of developing countries (see for example Grote and Kirchhoff 2001 and the example of the label on fine paper in Norway cited therein). Even though many have pointed out that developing countries have a 'natural' competitive advantage for the production of environmentally friendly products, (see for example UNCTAD/DITC/TED/3, 1999) given for example the minimal and often non-existent reliance on chemical inputs, today this type of production is still dominated by industrialised countries. It is interesting to note for example that in none of the developing countries does the share of organic production in the total agricultural area go beyond 0.5 per cent (with the exception of Argentina where it amounts to 1.7 per cent), compared to between 1 and 18 per cent in the industrialised countries.

Certification schemes have been elaborated that do not leave space for country-specific differences in terms of absorption capacities or different environmental or social priorities, thus often discriminating against developing countries. The ever-increasing numbers of eco-labelling programmes have contributed to a reduction in transparency, confusion for consumers, and a reduction in credibility, especially of schemes elaborated by developing country producers (Grote and Kirchhoff, 2001).

Marketing channels for environmentally friendly products are often difficult to penetrate, given that these products are mostly sold by small-scale retailers.

UNEP and UNCTAD, and research institutes such as IIED have, in recent years, implemented a series of initiatives and projects to analyse further the relationships and distributional effects in production chains in sustainable trade. The scope of these initiatives is, however, limited considering the importance of this issue.

Another related key issue behind the expansion of sustainable trade focuses on the question of how to bring consumers in the industrialised world and producers in the developing world closer together, of how to bridge the distance in the production chain, and of how to raise an interest for the 'other' parts in the supply chain:

8.3.1 Bridging distances and increasing transparency

Two recent initiatives are worth mentioning in this context:

- The 'Tracing Russian Wood Imports' initiative by Otto Versand, Axel Springer Verlag, and UPM-Kymmene
- Garstang – the world´s first Fair Trade Town

The first initiative looks at the paper chain. Otto Versand, one of the world´s largest mail order companies, and Axelcompany, and Springer Verlag, the principal newspaper and magazine publishing house in Germany, co-operated with UPM-Kymmene, a Finnish paper company, and were assisted by Greenpeace Russia, the Russian State Forest Administration and Det Norske Veritas in this undertaking towards increased traceability in production chains. Whereas previous initiatives in this sector had aimed primarily at assessing the environmental and social effects of paper production, especially applying life-cycle analysis (see for example VDZ, FAEP, FIPP, 1996 and Axel Springer Verlag, Otto Versand, Norske Skog, 1999) here the main aim was to develop a completely transparent system of traceability from the Russian wood supplier to the paper mill, which in turn supplies the paper to Otto Versand and Axel Springer Verlag, using the internet as the means of transmitting and handling the information. Documentation is presented in a transparent way, and includes, besides the certification reports, testimonies from auditors and producers, photos of the production sites, and the possibility to interact directly with those involved. For the first time, the internet is introduced as a medium for connecting the forest to the end-user, the Russian producer to the German newspaper reader or mail orderer (an interactive internet demonstration of the tracing system is shown at: www.upm-kymmene.com/tracingimports).

The second initiative promotes the purchase and use of fair trade products. After several years of campaigning by Garstang citizens with the local Oxfam Group and a gradual increase in the use of fair trade products in a town of 4,000 inhabitants, in August 2000 the Garstang City Council officially adopted a policy to use and promote fair trade products as far as was practicable. By the beginning of 2001 over 90 per cent of the entrepreneurs had signed up to the initiative, and most of them have started to sell fair trade products or have increased the range of fair trade products on their shelves. A commitment at the level of the citizens and their institutions is implied: the local Youth Club has set up a Global Issues Group, the High School has embarked on a Go Global Project, involving amongst other activities a visit by students to fair trade producers in Ghana. A Garstang Fair Trade Guide has been produced, and road signs declaring Garstang the world's first Fair Trade Town have been erected.

These two examples, different as they may be in the main actors involved and the specific benefits they imply for the various market participants, illustrate possibilities of co-operation, increasing transparency and bringing consumers, clients and producers closer together, of shrinking distances and of understanding the realities at the other end of the supply chain.

This is a crucial step for global sustainable trade.

8.4 The other challenges

Beyond the central issues described above, there are several other issues that the public sector, the private sector and the NGO community have to confront on the way to making sustainable trade a significant tool.

Preliminary recommendations for action:

Industrialised countries have to assume their responsibility in the trade regime in different respects.

Whilst it has been suggested that eco-labelling might square the Process and Production Method (PPM) circle, it might, according to European Commission officials, 'open the door to a panoply of barriers to market access for developing country products' (DG Trade, 2001). This issue cannot be by-passed any longer, but has to be seriously discussed considering the effects on all participating parties. The thin line between environmental conditionality and market opportunity, between obligatory requirement imposed by governments, falling under mandatory WTO rules, and voluntary requirements by governments or other market participants, falling solely under Annex 3 of the Agreement on Technical Barriers to Trade, referring to the Code of Good Practice for the Preparation, Adoption and Application of Voluntary Standards, has to be better understood. There is, however, no indication as to how this Code relates to non-product related PPMs involving for example life-cycle assessment.

Research is urgently required regarding the kind or method of technical and financial assistance envisaged under the WTO rules on technical barriers and sanitary and phytosanitary standards.[2] There are recent examples of new forms of co-operation between industrialised countries and developing countries from which lessons and recommendations can be drawn. In the case of textiles, EFTA implemented a project to inform, train and provide testing facilities, going clearly beyond the traditional functions of mere information provision (see IIED Sustainable Markets Group, 1999).

Whilst it is a success for Argentina to be the only developing country in Europe's third country list of equivalency status for organic production, for Europe it can be considered a failure. The EU should see this as an urgent challenge to expand the number of developing countries on that list.

A careful look and analysis is also required regarding the measures proposed by the EU with regard to agricultural support. The decision between green box measures and the multifunctionality approach has direct implications for sustainable trade, which should be analysed.

Developing country capacity in the development of markets as well as in the management of supply chains has to be increased.

Whilst the UNEP-UNCTAD initiative on capacity building on trade, environment and development, including the area of sustainable trade, is a very positive one, the amount of the total budget is very limited – and actual available funding even more so (so far $270,000 out of total budget of $1,100,000 has been funded – see www.unep-unctad.org/cbtf). Funding for this initiative has to be secured as soon as possible. Other, additional initiatives should be elaborated and funded.

Support has to be provided not only for individual co-operatives or producers, but for more integrated and comprehensive or nation-wide initiatives (in Chile, for example, the government has recently launched an initiative to set up two province-wide clean production programmes). Here, governments could provide the support they have announced to increase sustainable trade with developing countries (see for example DFID's announcements, cited in IIED Sustainable Markets Group, 1999). The sustainable trade link should not be forgotten in programmes directed at domestic market transformation regarding sustainable consumption and production.

Good practice examples will have to be disseminated – whilst individual companies can provide the examples they are, in general, not in a position to disseminate them widely, analyse the lessons learnt, or make suggestions for future industry-wide or even country-wide strategies.

Co-operation between companies and the public sector or international organisations should be strengthened – information sharing and responsibility sharing should be promoted. Concerted efforts can generate more significant outcomes than dispersed or overlapping individual initiatives.

Public policy has to support sustainable trade with clear regulatory instruments, market-based as well as non-market based.

Where sustainable trade offers well-defined public goods which the traditional market fails to provide, policy mechanisms have to ensure that these goods are adequately financed.

Clear accountability rules have to be elaborated in order to provide the companies with the necessary regulatory framework to take action towards creating systems of accountability and traceability.

Consumer preferences have to be cultivated. Whereas the private market might be able to detect short term business opportunities, there is a role for public policy to establish and cultivate more lasting demand for sustainable products.

Certification schemes, fair trade and eco trade associations have to upgrade their schemes.

There has to be more active collaboration amongst different certification and labelling schemes. The establishment of the Partner Data System amongst Fair Trade and Eco Trade organisations will help. But there has to be further integration, mutual recognition, harmonisation of data collection, and strengthening of the comparability between schemes. Information sharing between schemes can for example lead to significant cost reductions.

Even though emphases can be different, minimum environmental, social and ethical criteria should be present in all schemes. Efforts for increased collaboration are ongoing (and have been described in IIED Sustainable Markets Group, 2000).

Upgrading does not imply increasing the entry hurdle – too often producers cannot accede to a certification scheme even though they have an interest in environmental or social upgrading of their production. Graded certification schemes in which producers can progressively move to higher scales, might often be feasible alternatives.

Certification schemes should not be dominated or defined exclusively by industrialised countries.

Corporate responsibility has to be enhanced

Supply chains are very often dominated by multinational companies – these have to assume their responsibility in the governance of the supply chain.

Companies should endeavour to elaborate innovative traceability schemes that bring consumers and producers closer together, making use of modern information and communication technology

Companies should endeavour to construct long-term partnerships with producers, building trust and a commitment to quality production.

Industry associations in developing countries can be key players in enhancing eco-design and new production process methods.

Information on the market for sustainable trade has to be generated

Last but definitely not least, more information has to be generated on sustainable trade and its impacts, thus improving management and marketing as more information is available to the consumer about different schemes, their effects, their benefits and the problems they face.

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[1] For example Sainsbury's, an important supermarket chain in Great Britain, report that 49 per cent of overseas crops are covered by products coming from Integrated Crop Management.

[2] The TBT and the SPS Agreements (Articles 29,30) for example require countries to set up national enquiry points and provide technical and financial support to developing countries in the preparation, implementation and enforcement of standards in developing countries.

THE AGE OF GLOBALISATION

{9}

The conventional treatment of financing for sustainable development was premised on a pre-globalisation world view. Its preoccupations were the relationships between nation states, the flows of funds between countries and particularly between governments, national economic growth, and intra-national income inequality. In a globalised world, the pertinent questions are different: they relate to the legitimacy of mobilising resources for development, for depressed areas, for the protection of vulnerable regions and communities, and for reducing global (not national) inequalities in income and wealth.

Financing was a central theme in UNCED in 1992, and ten years later it remains an outstanding issue, the resolution of which will determine whether the world begins to move towards sustainable development. But 2002 is not 1992; even in the long sweep of history, a decade can make all the difference.

This is the age of globalisation, with all the hope, danger, and cynicism that have come to be associated with this word. In contrast, 1992 can only be described as the age of optimism and innocence: it came at the end of the deepest depression in industrialised countries since the 1930s; it was also the end of the lost decade for development. It marked the end of the Cold War and according to some the end of history. Optimism was in the air; there were visions of a new global compact between the North and the South producing a future of tranquillity, justice, co-operation, and development. In retrospect at least, UNCED negotiations (as well as, albeit to diminishing degrees, the UN Summits that followed soon after) appear remarkable for the optimism of the participants, their willingness to place trust in agreements, their faith in the ultimate commitment of the global community to the ideals of justice and equity, and consequently their dedication to co-operative action.

These hopes and commitments have evaporated – not because the promised economic growth did not take place, but precisely because it did. 2002 marks the end of a decade of dramatic economic expansion led by extraordinary developments in information technology. But this has led to more problems than solutions: a wider gap between the rich and the poor, recurrent global economic instability, increasing economic concentration, and in addition to all this, as the countdown begins for the first two summit meetings of the new millennium, the shadow of war, a shadow that makes ideals superfluous, replaces trust with instrumentalism, and engenders anxiety and fear.

The political mood is also different. Jean Baudrillard dubs the politically quiescent 1990s as the period of 'la greve des evenements' (literally 'an events strike', translated from a phrase of the Argentinean writer, Macedonio Fernandez) to suggest that in the new millennium the strike is off. Baudrillard's preoccupation is with the terrorist attack of 11 September – which he interprets as anti-globalisation – as well as its immediate fallout, the Afghanistan war, which could well go down in history as the first war of globalisation, nearly a century after the imperial war of 1914-18. Regardless of how one interprets 11 September, however, the fact is that challenges to globalisation have been growing. Increasingly militant protests at Seattle, Nice, Genoa, and elsewhere have already forced the élite of the world to shift their meetings to less public venues and more authoritarian countries.

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9.1 Taking globalisation seriously

In order to be able to talk about global development or global finance, let us imagine the world as a single country.

What would this country look like? To begin with, it is a 'multi-national' and unevenly governed country. It is also an unequal country – indeed, more unequal than any country in existence today. It is in many ways, an apartheid country, where the élites invoke liberty and fraternity but secure their privileges through unabashed instrumentalism and naked power; where people are not free to travel from one region to the other, and if they do, are subject to arbitrary search and harassment; and where the affluent areas are protected from the poor hinterland by sophisticated disciplinary mechanisms. It is also a country with a dual economy, the shiny factories and offices of the élite world contrasting sharply with the slums and sweatshops of the non-élite regions – the former affluent, generally large in scale, well organised, and economically aggressive; and the latter a host of informal and semi-formal enterprises, organised under traditional arrangements, based principally around biomass, and integrated minimally if at all into the larger market.

Yet it is not a country without hope. Like other developing countries, which saw an optimistic ideology, 'development', sweep across their societies at their tryst with destiny – independence from colonial rule – the world too has acquired a language to nurture optimism. It is called globalisation.

In short, the world would look very much like many developing countries – not a country like Switzerland or Norway; rather, an amalgam of apartheid-era South Africa, pre-liberalisation China, and contemporary Afghanistan.

9.2 Caveats and questions

Many people have difficulties with the notion of the world as a single country. The world is far too chaotic and diverse, they would argue; it has neither a legitimate government nor a 'political community' – that is, a shared sense of solidarity and responsibility (Banuri, 1994). But when it comes right down to it, this messiness, diversity, weak government, and low level of solidarity are not dissimilar to many developing countries. The extreme examples are war-torn countries (Angola, Afghanistan, Liberia), which are crisscrossed by ethnic, religious, linguistic, and other divisions, some areas run by warlords, others self-governed by local communities, leaving a fairly small area under the direct control of a 'legitimate' state. Even countries that are otherwise peaceful come close to this image. On paper they have formal governments but in practice the writ of these governments does not run much beyond the brightly lit streets of the capital city; elsewhere, they cede authority to an informal system of governance run by landlords, politicians, policemen, and businessmen, often with the tacit support of external interests.

Furthermore, notwithstanding the impression of messiness, the world does have order, a system of governance – even if not a single formal government. Oran Young (1994) argues, for example, that 'the achievement of governance does not invariably require the creation of material entities or formal organisations of the sort we normally associate with the concept of government. Once we set aside our preoccupation with structures of government, it is apparent that governance is by no means lacking in international society, despite the conspicuous absence of a material entity possessing the power and authority to handle the functions of government for this society as a whole' (Young, 1994 cited in Bigg, 2001: 23).

The problem of political community is trickier. The prevailing wisdom denies the existence of any solidarity and responsibility at the global level; it describes relationships between states as lying exclusively in the domain of instrumentalism and naked self-interest. According to Tom Bigg, 'The notion that some form of order exists at the global level constitutes a direct challenge to the various realist schools of international relations, which share the supposition that relations between states are characterised by anarchy which is only mitigated by some form of equilibrium in the power at their disposal' (Bigg 2001: 21). Bigg goes on to argue that although neo-realist theorists would recognise the possibility of co-operation between states, this is more likely in areas of 'low politics' (environment, welfare, human rights) than high politics (Bigg mentions only security, but presumably finance would be included here); and that the extent of such co-operation is limited by the benefit participating governments expect to accrue to them, or the damage they might expect to avert by participating.

Having said that however, it is now increasingly recognised that global decisions are determined by more complex processes, and that they involve a larger group of actors besides governments – NGOs, business and labour groups, academic scholars, and the media. The rise of global public policy networks (Reinicke, Deng, Benner, Gershman, and Whitaker, 2000) suggests that global decision-making has moved out of the exclusive domain of governments. At the global level, the conventional test of government – the demonstration that decisions taken or conclusions arrived at are more than a reflection of the wishes of the participants with traditional power capabilities – is fulfilled both positively and negatively. On the one hand, the speed and complexity of global problems are such that few governments have the capacity to make decisions without seeking professional input, political participation, and legitimacy from the involvement of external actors. More importantly, while governments (like other powerful groups) certainly continue to have enormous power to block decisions – and while government personnel can still siphon public resources for private uses – their ability to pursue and realise the public interest has become increasingly dependent on popular acceptance and legitimacy. The difference between 'democratic' and authoritarian governance is no longer restricted to the form of the government but extends also to its substance, effectiveness, and reach.

In other words, not only do governments voluntarily seek external advice, they find it difficult to accomplish anything without such involvement. James Rosenau has argued that the key difference between governance and government is that the former functions only if it is accepted by the majority, whereas the latter can function even in the face of widespread opposition (Rosenau, 1992). True, but there is a large distance between being able merely to function and being able to accomplish anything of consequence. Rosenau's test is largely inconsequential. A more relevant test would be to ask whether there is a difference between government and governance in terms of the capacity for accomplishment. The answer by and large is no.

The upshot of this discussion is that in the age of globalisation, it makes sense to project the world as a single country, and to ask questions regarding the agenda of sustainable development as well as its financial needs, not from the perspective of a value-free and irresponsible inter-state system. Rather, the approach suggested here, and which has been implicit in many arguments for foreign aid as well as responsible investment, is that of a single country.

The question then is how should the global community express its commitment to social equity and environmental conservation? This casts the entire debate in a different light, and indeed challenges conventional wisdom – which appears to have strong roots in the instrumentalism of the colonial period. A brief historical comment on the historical continuity from the 19th to the 21st centuries may be in order here.

9.3 Globalisation redux

A recent authoritative study demonstrates that the forcible incorporation of smallholder production into commodity and financial circuits controlled from overseas undermines food security, confiscates local fiscal autonomy, and integrates millions of tropical cultivators into the world market at the cost of 'a dramatic deterioration in their terms of trade'. This is not a description of contemporary conditions. It is the account of the historian Mike Davis of the world under the British Empire in the 19th century (Davis, 2001). The historical continuity of what made, and keeps, a huge part of the world poor is astonishing.

Since the 1960s every attempt by developing countries to engage with the global economy on terms that would help them develop, such as managing investment, regulating foreign multinationals, and stabilising commodity prices, has been resisted and opposed. According to Joseph Stiglitz, Nobel prize-winner and former chief economist at the World Bank 'Countries find themselves in situations where they are having policies imposed on them. It is not unlike the 19th century opium wars when countries were told to open up their markets and this threat was backed up by military force. Now it is an all or nothing deal. Either you do it the Washington consensus way or we will exclude you'. (in Elliott, 2001b). This is another echo from the 19th century when, according to Davis, 'From about 1780 or 1800 onward, every serious attempt by a non-Western society to move over into a fast lane of development or to regulate its terms of trade was met by a military as well as an economic response from London or a competing Imperial capital.'

Globalisation in the 19th century was on the terms of the then dominant power, Britain, which claimed it as the discharge of the white man's burden. Britain argued for example that it had rescued India from 'timeless hunger'. It is the sort of rescue that India could have done without. The structural adjustment of India by the British Raj and its knock-on effect in China wrecked indigenous coping strategies. Thirty-one serious famines occurred in the 120 years of British rule in India, almost twice the total number of seventeen recorded in the previous 2000 years.

9.3.1 What have we learnt from conventional development?

The age of globalisation is in the last instance the age of global development, and as such it has much to learn from the experience of national development. The idea of economic (or social) development as a key component of the goal and purpose of governments is a recent one. Even more recent (and apparently still controversial) is inclusion of sustainable development in the goals and purposes of the global community of policy-makers. Yet until now, this goal has been viewed in a rather arms-length manner.

However, there is much that is negative in the experience of development. Development was always and everywhere preoccupied with industrialisation, and rarely with poverty eradication or social equity. The African thinker Abdul Rahman Babu argues that Africa would do well to imitate not the prescription but the experience of the West. The Western experience of modernisation, he argues, was built on three pillars – agriculture, textiles and construction – namely the activities needed to feed, clothe and house people. In the West the three key sectors still underpin all other economic activity, and are still heavily protected. In developing countries, IMF policies undermine these very sectors. They encourage African states to export raw materials, undermine subsistence agriculture and local businesses, and turn societies into markets for imported food and irrelevant consumer goods.

Babu argues that Africa should protect these three essential sectors, and not embark on further development until it has increased the capacity to save. Others, who have provided innovative leadership in the creation of sustainable livelihoods, do not go as far as Babu, but they too argue that for a community to grow, it needs to create a sustainable basis for its growth. This requires an investment in the social capital of the community, as well as the development of a robust base of savings (Khan 1992).

There are those who argue that poor communities in general and the African poor in particular have no savings capacity, but there is considerable empirical evidence to the contrary. Community development programmes, micro-credit programmes, and rural support programmes in South Asia invariably result in creating a savings tradition as well as supportive financial institutions. In Africa, as Jacques B. Gelinas shows in *Freedom from Debt* (Gelinas, 1998), the failure is that of the big state and international banks, which have placed Africans in bondage to foreign creditors. The result is a vacuum in the domestic financial savings sector. 'Finance, like nature, abhors a vacuum', says Gelinas, and so micro finance institutions have stepped in. Grameen Bank in Bangladesh, the Tontines in Cameroon, or the Naam groups in Burkina Faso have done more than mobilise finance: they have mobilised women, the outcasts of the banking world.

It is important to recognise also that the savings tradition requires time and effort. On the eve of the industrial revolution (1760-80), British investment constituted little more than 5 per cent, but certainly less than 10 per cent of GDP. In other words, after roughly 5,000 years of city civilisation, it was still necessary for the (then) most advanced economy to devote 90 per cent of its economy to immediate consumption. Only after an initial breakthrough was achieved were higher shares of income devoted to investment. Developing countries will have to do the same.

There is also the argument that developing countries have to 'catch up'. But with whom and with what? Japan 'caught up' 150 years after Britain; Sweden 50 years after the rest of Europe. Needs are always relative. The first priority is to escape from debt bondage, feed, clothe and house people. Only then can development be considered as a genuine priority.

9.4 Concluding comments

This chapter has argued that we should approach the world as if it were a single country. This approach places at the centre the responsibilities of various institutions and individuals. It provides a new window to interpret income transfers, implementation, and development. The existing inter-state system is not only not oriented towards such problems, its very instrumentalism creates problems for implementation as well as envisioning.

The change in approach also provides a new way of apprehending both the importance and potential of development finance. Rather than view it as a form of charity from one nation to another, the perception of the world as a single country invokes the idea of mutual commitment and responsibility. Thus, instead of focusing on how to mobilise cheap resources, it asks how to create a broad-based societal legitimacy for development finance. From this, it is a short step towards the notion of mutual responsibility and institutional transparency. This can provide the basis for a consensus both over finance and development.

This chapter (except for 9.3) was prepared by **Tariq Banuri**. 9.3 was contributed by **Ann Pettifor** and **Andrew Simms**.

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REGIONAL & INTERNATIONAL NETWORK GROUP

The Ring is the only network of its kind involved in a structured programme of collaborative research and policy advocacy. A common approach to sustainable development issues has been achieved through close co-operation, knowledge exchange, and the sharing of ideas and experiences. Following an initial focus on strategic development, capacity strengthening and planning within the individual organisations, the Ring network moved on to consolidate its regional bi-lateral exchanges and 'pooled research', and developed a collaborative research programme around common priority themes.

These included:

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- Multilateral Environmental Agreements
- Trade and Environment
- Climate Change
- Financing for Development.

The Ring is now an established network in the field, and has developed an international reputation for excellence. On occasion, the Ring has also worked with associate organisations and individuals. For example, for several years the Ring has worked closely with the IUCN Commission on Environment, Economics and Social Policy (CEESP), contributing substantially to its quarterly journal, Policy Matters. In addition, several Ring initiatives over the last few years have been steered by Adil Najam, Assistant Professor at the Department of International Relations, Boston University.

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The **vision** of the Ring is to promote and develop collaborative working in support of sustainable development through:

- Linking grassroots communities and policy makers.
- Linking civil society and research agendas.
- Sharing and disseminating knowledge and experience between the North and South, and between regions.

The **added value** of the Ring is gained from joint research and information sharing and lesson learning between Ring partners. This gives the Ring a unique inter-regional and regional perspective on major sustainable development issues.

The **objective** of the Ring is to ensure that international sustainable development policy making and institutions are informed and influenced by local realities, and hence are supportive and enabling of local action.

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