CURRENT ISSUES IN DEVELOPMENT POLICY:

GROWTH, DEBT & THE ENVIRONMENT

Opening Address by Senator Gareth Evans, Minister for Foreign Affairs & Trade, to the Fourth World Development Debate, Canberra, 2 August 1989.

It has become something of a tradition that AIDAB's annual World Development Debate is timed to follow the release of the World Bank's annual World Development Report. The World Development Report always contains a wealth of valuable material which can be drawn upon by speakers during the Debate, and this year's is no exception. Certainly I have found it helpful in addressing the three issues that I would like to talk to you about this morning - the development implications of recent trends in the world economy, and the two basic themes of this year's symposium: international debt, and the link between development and the environment.

Recent International Economic Trends

Looking back at the 1980s, several main trends in the world economy stand out as having affected developing countries. In industrialised countries - the so-called 'North' - several major distortions have persisted for much of the decade. These major imbalances have done enormous harm to the growth prospects of many developing countries.

In the United States, a severe fiscal imbalance persists, putting pressure on world monetary and foreign exchange markets. The high real interest rates which have been a feature of the world economy for most of the 1980s are largely due to the continuing inability of the United States to exercise fiscal self-discipline. These high interest rates have, of course, been a major contributing factor to the persistence of the international debt crisis.

In Europe, the United States and Japan, policies of agricultural protection generating huge subsidies have distorted world agricultural markets in recent years. These policies rob developing countries of opportunities to develop sustainable markets for their commodity exports and thus exacerbate the difficulties that developing countries face in attempting to grow out of their present economic difficulties.

Despite these major economic distortions in the North, overall economic growth in industrialised countries has proceeded without interruption since the recession of 1982. But in Third World countries, the picture is far less satisfactory. Some parts of the developing world have done well, but many have not. Overall, the record of development during the 1980s has been disappointing. As the President of the World Bank, Barber Conable, said last year in his Presidential Address to the annual meeting of the Bank:

"...The stubborn fact of the Eighties is that growth has been inadequate...Poverty is still on the rise and the environment is poorly protected."

The developing countries that have done especially well are in Asia: the Newly Industrialising Economies, India and China (although conditions in China have, of course, deteriorated dramatically recently), and Thailand and Malaysia. In these countries, despite difficult international conditions, average growth rates of 7% per annum and more have been common. Indeed, the success of these countries has had a substantial effect on international thinking about development issues in recent years.

Developments in India and China during the 1980s have attracted less attention, but in some respects they are more important. When the world's two largest developing countries, with a combined population of almost two billion people, can find ways of significantly lifting the rate of economic growth, then an event of major historical importance has occurred.

In India, a series of supply side reforms which have promoted decentralisation and have been designed to encourage a greater reliance on market forces seem to be bearing fruit. The average rate of overall economic growth has risen from 3% per annum during the 1970s to over5% during the second half of 1980s. This may not sound a lot, but the impact of even this modest shift in the trend rate of growth on per capita income is very significant - the result has been that per capita income has been growing at around 3% per annum during the 1980s instead of 1% or less during the previous decade.

In China, the 1980s - at least until the dark pre-dawn hours of June 4 - have been marked by astonishing economic success. For close on 10 years, the Chinese economy grew at an annual rate of growth of about 10% per annum. This burst of high economic growth in the world's largest developing country must, without question, be counted as one of the most significant economic events of the 20th Century.

Unfortunately, for a large number of other developing countries the 1980s have been more difficult. In Indochina, Burma, Bangladesh and Sri Lanka the development process has been greatly retarded by internal strife, or by poor economic policies, or both. Growth slowed in Indonesia during the 1980s, and although there was a recovery in the Philippines in the post-Marcos era, the development challenges ahead in the Philippines remain daunting.

In Latin America, the debt crisis has led to a deepening crisis of development. During the

1960s and the 1970s, there was impressive and generally widespread economic progress in Latin America. During this period, per capita incomes grew on average by about 3% per annum. But during the 1980s there were setbacks in most, if not all, of the countries of the region. A combination of factors including productivity deficiencies, imprudent borrowing and lending activities, and adverse external circumstances let to a real income per capita fall in 20 out of 25 countries in the region between 1980 and 1987. In fact, in six countries, real per capita incomes in 1987 were actually lower than they were in 1970.

In Africa, as well, the 1980s has seen a deterioration in economic conditions across the continent. In most of the low-income countries in Africa there has been virtually no progress in per capita income during the past two decades, and in some cases there have even been declines. The main factors lying behind this disappointing performance include deep-seated structural problems inside these countries, serious policy deficiencies, and the difficult international economic conditions of the 1980s which have exacerbated the serious debt problems that many African countries face.

This, then, is a brief summary of the development record of the 1980s. What are the prospects for the 1990s? Crystal ball gazing is always a risky business, but it is at least possible to identify several of the main constraints to progress that developing countries must cope with at present. Different developing countries face, of course, many different types of constraints on development, but, there are two particular constraints - one external, and one internal - which are retarding growth in a large number of developing countries around the world. Both of these factors seem likely to continue to affect overall trends in the developing world during the early 1990s.

The external constraint is a particularly acute shortage of foreign exchange. In this respect, the international economic environment that developing countries find themselves in at present is a very difficult one.

Although the latest World Development Report does not dwell on the shortage in excessive detail, the phenomenon underpins much of the discussion in this year's report. There are various reasons for it, but one of the most important is the virtual collapse of private banking flows to developing countries in recent years. Indeed this collapse, which is both a cause and an effect of the international debt crisis, is one of the major international economic changes of the 1980s. Between 1981 and 1988 private commercial bank flows fell by over 90%, from over $US 50 billion to under $US 5 billion.

Unfortunately, the prospects for a resumption of private commercial flows to the Third World are not good. The World Bank's own conclusion, as summarised in this latest World Development Report, is that:

"All the evidence points to continued low capital flows to the developing countries in the coming decade."

The bleak prospects for an increase in private sector flows to developing countries has very substantial implications for the growth strategies that these countries need to adopt during the 1990s. If relatively little external finance is going to be available in the foreseeable future, then the implication is - not to put too fine a point on it - that developing countries are largely on their own. Although the World Bank is too tactful to say so in so many words, one of the underlying messages in the latest report is that industrialised countries are increasingly turning their backs on developing countries.

What, then, can developing countries do to promote growth in this difficult environment? One thing that they might do, of course, is hope for more overseas aid. But this is like farmers praying for rain. It is no way out because there is simply not enough aid available. As the World Development Report points out, official flows from industrial countries are insufficient to fully offset the sharp reduction in private flows. The most practical thing for most developing countries to do is tackle the internal constraint to growth that I referred to earlier, which is an insufficient supply of domestic savings. As the World Bank correctly puts it, in view of the decline in foreign capital inflows,

"Developing countries will have to rely to a greater extent than in the past on their own saving to finance investment."

It is timely that the World Bank has chosen to focus on this topic because it now seems increasingly clear that unless developing countries can do more to mobilise their own resources to promote growth, the prospects for the 1990s are not encouraging. On this subject, the current World Development Report does not give much ground for optimism. Each year, the World Bank prepares two views of the next decade. One is a so-called 'adjustment- with-growth'scenario; the other is a 'low growth' scenario. The latest 'adjustment-with-growth' scenario - that is, the more hopeful view - puts per capita income growth in all low and middle income countries combined (but leaving aside China and India) at only 1.5% per annum. Since this remains significantly below the long-term trend of the last 20 years, which is 2.4% per annum, even this relatively hopeful view can hardly be regarded as satisfactory.

International Debt

There is one particular aspect of the international economy which retarded growth in many developing countries for most of the 1980s: the international debt crisis. And unfortunately, as the decade comes to a close, it is a crisis which shows few signs of abating.

The total external debt burden on developing countries has now grown to quite massive proportions. At the end of 1988, the total level of debt was over $US1,300 billion, compared to $US830 billion at the end of 1982. These figures, baldly stated, almost defy sensible interpretation, so perhaps I might outline some of the main implications of the debt problem as I see them.

At the outset, I should emphasise that anybody who thinks that the developing countries' debt crisis is not important for Australia is mistaken. In fact, the debt crisis affects Australian foreign affairs and aid policies in a number of ways. And the prospects are that during the next few years, these influences will become more, rather than less, evident.

For one thing, the debt crisis has retarded economic development and has increased the likelihood of political instability in dozens of developing countries, including in Asia. I specifically mention Asia because of the widespread perception in Europe and North America that the international debt crisis is mainly a Latin American problem which happens to have some significant side-effects for certain low income countries in Africa. In this matter - as in a number of other areas of international economic policy - too many people in Northern Hemisphere countries suffer from a form of myopia.

I only need to draw your attention to the countries chosen for inclusion in the so-called "Baker 17" list of heavily-indebted nations. These are the countries which United States' Secretary of State James Baker identified in 1985 as being particularly affected by the international debt crisis. Of the seventeen countries, twelve are in Southern or Central America. Only one - the Philippines - is in Asia!

Now I can well understand that governments in Asia are not exactly keen to qualify for inclusion in the Baker list of debtor nations. However the virtual absence of Asian countries from the Baker list has had the unexpected and undesirable effect of encouraging policy-makers in Europe and North America to overlook debt problems in Asia.

In fact, a number of developing countries in Asia apart from the Philippines have been significantly affected by debt problems in recent years. Bangladesh, Pakistan, Sri Lanka and, to a lesser extent, India have all had to cope with rising debt burdens during the 1980s, while closer to home both Indonesia and Papua New Guinea have had to tailor their domestic economic policies with an eye on their external debt.

Now it is true that in some respects, the debt problems of these countries are less urgent than those of Mexico, Brazil and Argentina. But to no small degree that is precisely because the debtor countries in the Asian-Pacific region have behaved with more budgetary restraint, and have adopted more appropriate economic policies, than countries like Mexico and Brazil.

Indonesia is a good example. Fiscal policy in Indonesia has been applied with tight restraint throughout most of the 1980s, especially since the dramatic collapse in oil prices in 1986. As a result of the Indonesian Government's decision to swallow whatever bitter economic medicine was needed, Indonesia has remained credit worthy. On numerous occasions in the last few years, the Indonesian Government has confirmed that despite sharp increases in the debt service ratio, any suggestion of default by Indonesia on international obligations is out of the question.

As a result of this general approach, Indonesia is not regarded as being a problem debtor nation in international circles. In contrast, Brazil, Argentina, and Mexico - to name just a few - are widely said to be in a state of economic crisis and therefore deserving of special international support. But if governments in debtor nations in Latin America had been prepared to bite the economic bullet the way Indonesia has, they would not be in such difficulties today. The danger now is that governments in Latin America which have followed lax economic policies will - in effect - be rewarded for their recalcitrance, while countries in Asia which have implemented appropriately firm policies will - in effect - be penalised for the self-discipline that they have shown.

The present international approach to the debt crisis is discriminating against countries in the Asian-Pacific region in another way as well. Nearly all of the countries in this region that are burdened with high debts are relatively low income countries. Per capita income in Indonesia in 1987, for example, was $US450, while the level in Papua New Guinea was $US700. In contrast, nearly all heavily-indebted countries in Latin and Central America are middle-income countries. Per capita income in Mexico in 1987 was over $US1,800, while in Argentina, Brazil, Venezuela and Uruguay, income per capita was over $US2,000 - more than four times the level in Indonesia. Why, one wonders, should middle income countries in Latin America be favoured with programs of assistance through organisations such as the World Bank and the International Monetary Fund, while low income countries in Asia which have done much to tackle their own debt problems receive relatively little assistance?

Apart from the direct impact of international debt policies on our region, there are other reasons for us to take an interest in discussions about international debt. Australia's international reputation is inevitably affected to some degree by the stand we take on a major international economic issue such as debt. Consistent with Australia's general approach of strengthening our foreign and trade links with countries in our region, it is sensible for us to join with our neighbours to ensure that the interests of nations in Asia and the Pacific are not overlooked.

Yet another reason why we should take an interest in discussions about international debt is that rising debt burdens reduce the effectiveness of international aid. Indeed, unless aid programs are adjusted to allow for the effect of the debt crisis, there is a danger that they may become pro-cyclical in their effects rather than counter-cyclical: that is, there is a danger that aid programs might reinforce the contractionary economic effects of the debt crisis in developing countries rather than counteract them.

The reason that this danger exists is that traditionally, donor countries such as Australia have provided foreign funding for aid activities in developing countries on the condition that recipient countries were prepared to supply a reasonable share of local costs. The philosophy underlying this traditional approach is that the provision

of some local costs is an indication of genuine commitment to the activity on the part of the recipient country. The problem that has arisen recently is that as more and more developing countries introduce austerity programs, more and more aid programs are being delayed because of a shortage of local costs. Thus a vicious circle sets in: rising debt burdens lead to cuts in local spending, which in turn delay aid programs, which retards economic growth and reduces the capacity of developing countries to pay off their international debts.

Obviously, wherever possible, such vicious circles need to be avoided. In recognition of this, there is now a tendency in the international donor community to be more generous in the provision of local cost financing. For the time being, until more progress is made towards solving the international debt crisis, this is sensible. But this is really an ad hoc approach to a problem which has been caused, essentially, by the international debt crisis. It would be better for the international community to look for a proper solution to the debt crisis rather than adopt partial responses which do not address the fundamental cause of the problem.

These comments about the implications of the debt crisis for Australian foreign and aid policies really only touch on a few aspects of this major international economic problem. I am pleased to see that both the Department of the Treasury and AIDAB have prepared detailed papers on the implications of the international debt crisis for Australia. Both papers were submitted to the Joint Committee on Foreign Affairs, Defence and Trade of the Australian Parliament earlier this year. With the permission of the Joint Committee, these papers were published in the International Development Issues series just a few days ago. I urge those of you especially interested in this topic to read this useful publication.

Environment

I have dwelt at some length on the international debt problem because this is one of the two main topics that the World Development Debate conference is discussing this year. The other main topic is, appropriately, the link between development and the environment.

During the past year or so, environmental issues have moved up towards the top of the political agenda across the world, in both developed and developing countries alike.

Understandably, debate in Western countries has tended to focus on issues that we in the industrial countries see as important. Discussions about environmental problems in industrial countries have often emphasised, first, certain global issues such as the greenhouse effect, and secondly, a wide range of specific environmental problems within our own countries such as soil degradation, air pollution caused by motor vehicle emissions, the need for better waste disposal systems to avoid the sort of sewerage problems seen at Bondi Beach recently, and so on.

We need to remember, however, that developing countries have certain specific concerns too, and that their priorities will not always be the same as those of the industrial countries. It is important that we conduct a dialogue about the environment with developing countries in a sensible way for several reasons. First, they have legitimate concerns which we should listen to. Secondly, to be quite pragmatic, we simply cannot expect to achieve much success on various important issues - the protection of tropical rainforests, for example - without the full cooperation of developing countries. And thirdly, the likelihood of substantial North-South disagreement during the 1990s is high unless industrial countries and developing countries deal with mutual concerns in a constructive way.

What, then, are the particular concerns of developing countries which we should - in our own interests - pay attention to? First is the link between poverty and the environment. In the view of developing countries, many of their most urgent environmental problems are largely a consequence of poverty. Deforestation, for example, is widespread in the Third World partly because poor people need firewood and need forage for their animals. Even when they well understand the long term damage that their fuelwood and forage gathering activities cause, their short term needs are so urgent that they are prepared to risk the long term consequences. After all, as Maynard Keynes so succinctly put it, "in the long-run, we are all dead". Nobody understands the harsh trade-offs between short term needs and long term conservation better than poor people in developing countries.

Secondly, the acute awareness of the consequences of poverty leads policy-makers in many developing countries to give very high priority to the promotion of economic growth and development as policy goals. In industrial countries, discussions about the desirability of sustained development tend to emphasise the need for sustainability. In contrast, the emphasis in poorer countries tends to be on the need for development. Thus there is general support in the Third World for a highly growth-oriented approach to economic policy. There is relatively little sympathy for notions which question the value of a high economic growth rate as conventionally measured by increases in gross output.

This "growth-first" philosophy has been especially evident in developing countries in East and Southeast Asia in recent decades. I am, of course, aware of the fact that many people in Western countries have doubts about the wisdom of single-mindedly pursuing economic goals at the cost of other objectives, such as social welfare and the environment.

But what those of us from wealthier countries need to bear in mind is that in this matter, there are genuine differences in views between many commentators in Western countries on one hand, and governments in many developing countries on the other. The simple fact is that whether we like it or not, in many developing countries, policy-makers have carefully weighed up the pros and cons of giving high priority to economic growth, and have decided to do so.

In any case, commentators from Western countries are hardly in a good position to lecture developing countries on the disadvantages of economic growth. After all, it is only because of sustained economic growth over a period of several centuries that we have relatively high living standards today. We cannot expect to be taken very seriously if we tell developing countries that they should be content with less.

A third special concern for many developing countries is the perceived need to promote industrialisation. Obviously, in most cases, this stems directly from the desire to stimulate economic growth that I have just referred to. In many developing countries, the majority of the population still lives in rural areas. Industrialisation is seen as a way - indeed, it is seen as the way - of breaking through the barriers to progress that the existence of a large agricultural sector imposes. Industrialisation is seen has having another important advantage as well: the generation of a new and hopefully rapidly growing class of exports which will allow developing countries to escape from their present precarious dependence on the uncertainties of international commodity markets.

Clearly, a drive for rapid industrialisation - including the development of a range of heavy industries - is likely to exacerbate problems of industrial pollution. Indeed, any visitor to Japan, or South Korea, or - more recently - China can testify to the environmental costs of rapid industrial growth. Nevertheless, most developing countries have decided that the benefits of industrialisation outweigh the costs. It is safe to predict that for the remainder of this century and well into the next, governments across the Third World will be doing what they can to promote rapid industrial growth.

Yet another area of difference between industrial and developing countries concerns the question of who should pay the costs of protecting the environment. As far as global issues such the greenhouse effect and preservation of the ozone layer are concerned, representatives from developing countries are quick to point out that most of the energy consumption in the world takes place in rich countries, not in poor ones. And they are quite correct. According to data in the latest World Development Report, commercial energy consumption (measured as kilograms of oil equivalent per capita) was almost 6,600 units in OECD countries in 1987. In contrast, consumption in low income countries - at around 300 units per capita - was less than one-twentieth of the level in the OECD. Thus developing countries argue that if there is a worldwide problem of excessive energy consumption, the solutions to the problem should be found in rich countries, not in poor ones. On this topic, they see much merit in the application of the 'user pays' principle.

Neither do developing countries accept that they should slow down the rate of exploitation of resources such as tropical forests just because there is international pressure on them to do so. Many developing countries, especially those which are coping with heavy debt burdens, are facing severe balance of payments pressures. They argue that rich nations can hardly expect them to meet their debt service obligations and, at the same time, reduce their exports of tropical timbers. Moreover, they say, if people in industrialised countries want to protect rainforests, let them put up the money to do so. Many governments of developing countries have said that they will do more to protect their forests provided industrialised countries help with higher levels of overseas aid or through support for schemes such as debt-for-nature swops.

These, then, are some of the special concerns that developing countries have in the area of environmental policies. How should we respond to them? As a result of the measures announced in the Prime Minister's recent environment statement, Australia's approach to environmental problems in developing countries is now quite clear. The Prime Minister announced that a new four-year Environment Assistance Program (EAP) costing $20 million will be established within the Australian aid program. The main goal of the program will be to promote sustainable development with environmental sensitivity in developing countries. We expect to spend over $4 million on appropriate activities during the current fiscal year.

The broad policy guidelines for this new Environment Assistance Program, as well the details of the implementation, have already been issued as a public document. There are five general principles that AIDAB will follow in undertaking the Program.

First, there will be an increased commitment to ensuring that environmental issues are taken into account across all areas of the aid program. That is, all aid activities - and not just the parts of the aid program which are specifically funded within the EAP - will be expected to meet acceptable environmental standards.

Secondly, specific steps will be taken to ensure that words are translated into action. For example, procedures will be developed which guarantee that all Australian aid activities will be subject to environmental screening procedures.

Thirdly, Australia will cooperate with developing countries themselves to strengthen their capacity to deal with the enormous environmental problems that they face. This will be done in recognition of the fact that in many developing countries the political will to tackle environmental problems already exists, but the ability to do so is weak.

Fourthly, Australia will support international measures to tackle global environmental problems through multilateral agencies such as the World Bank, the United Nations, and so on.

Finally, we will cooperate with other countries on a bilateral basis through organisations such as the Development Assistance Committee of the OECD.

Further details are contained in the briefing documents prepared by AIDAB for today's meeting.

Conclusion

I hope it is clear that on a global level, the three themes that I have discussed today - the world economy, the international debt crisis, and the environment - are closely interrelated. It is unrealistic to hope that solutions can be found to global problems in any one of these areas in isolation. We need to move on all three fronts at once.

Developing countries are well aware of the interrelationships as well. In numerous international meetings in recent years, representatives from developing countries have emphasised the close link that they see existing between problems of world trade, debt, and the environment.

They have pointed, for example, to the highly protectionist agricultural policies in the United States, and in Europe and in Japan, and have correctly emphasised that there is no prospect that they can meet their debt obligations when there are so many artificial barriers which restrict trade. They have warned, too, that any increases in protectionism in the United States in the manufacturing sector will only exacerbate international debt problems. And they have frequently drawn attention to the fact that as long as hundreds of millions of people in developing countries remain poor, the environmental pressures on our planet will remain immense. That is why there really is no sensible approach other than to continue the search for solutions to all three of the immensely complex problems that I have discussed today.

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