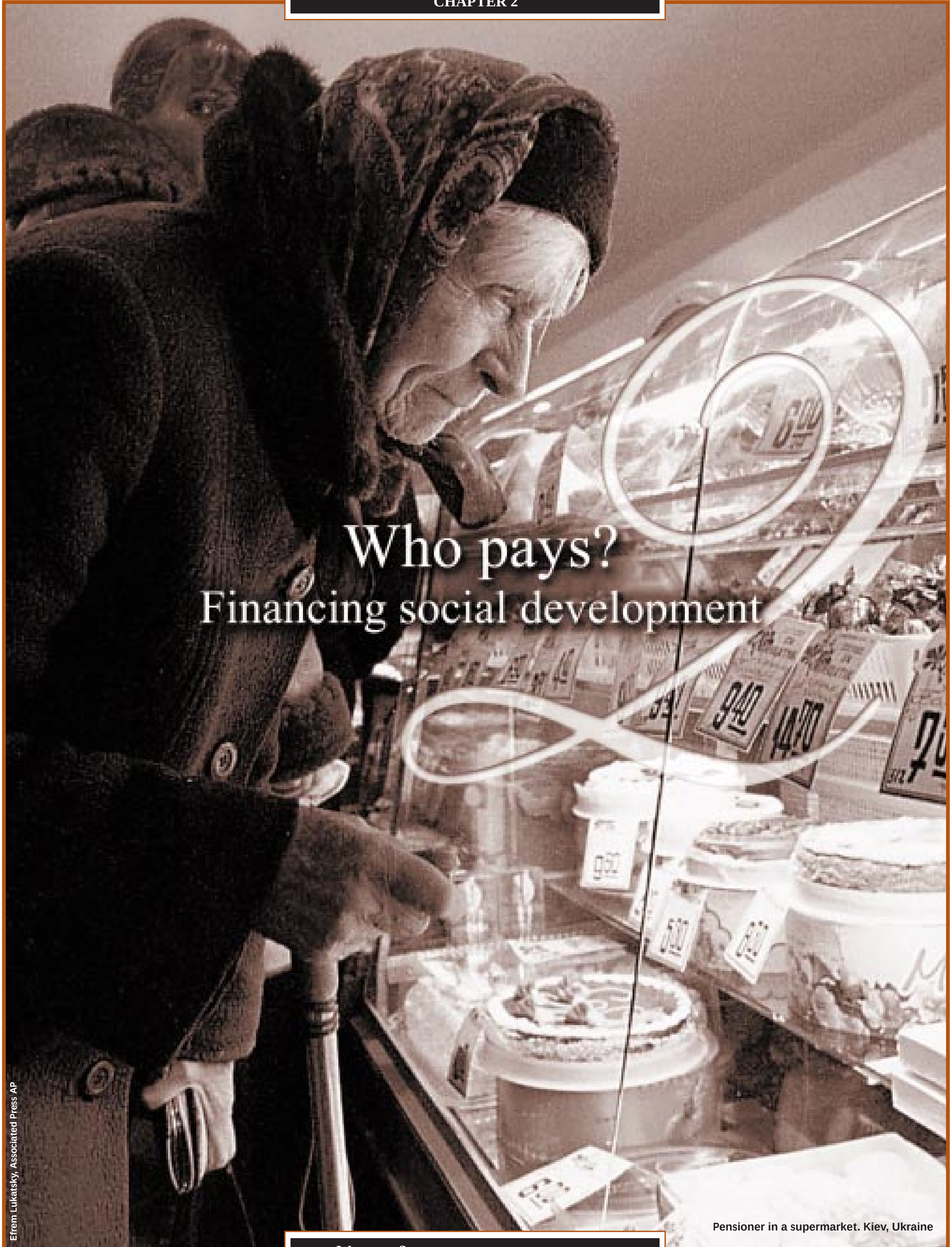


Who pays?
Financing social development

Efrem Lukatsky, Associated Press AP

Pensioner in a supermarket. Kiev, Ukraine

If governments are to achieve more equitable development, they will have to resolve the debt crisis and reorient development assistance. They will also need to adopt new approaches to taxation and pensions and find ways of generating more resources locally.

More wealth has been generated over thepast few decades than ever before. But the world does not yet have ways to channel enough of this into social development. Five years after Copenhagen, there is an even greater contrast between available resources and manifest need.

Most of the damage has been concentrated in developing and transition countries. There is less of a problem in the industrialized countries whose governments have generally sustained their social spending. The United States has been able to do this because its economy has been growing strongly. And the governments of Western Europe and Japan have given priority to social programmes. This contrast between resources available for social provision in industrial and developing countries threatens to widen disparities between rich and poor still further. An important goal for the years ahead must be to reverse this destructive trend.

Debt relief for the poorest countries

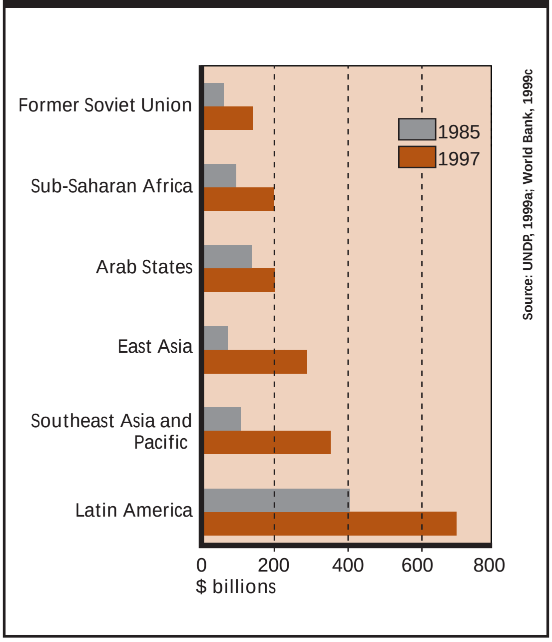
At the time of the Social Summit, the debt of the Third World and the former Soviet Union had reached $2.2 trillion and was climbing steadily, both through the inexorable magic of compound interest and the need to borrow yet more money to meet the most pressing demands for payment (figure 2.1). By 1994, annual debt service payments for a number of African countries were already equivalent to more than 40 per cent of their total exports of goods and services; and governments were often paying more in interest to foreign creditors than they were allocating to basic social services such as health and education, whose quality was declining markedly.

Many delegates at the Social Summit highlighted the seriousness of the problem and argued that it would be impossible to improve the living standards of millions of poor people when their governments were saddled with such an enormous burden of debt. This concern was reflected in the Copenhagen Declaration, which committed all signatories to “ensure the urgent implementation of existing debt relief agreements and negotiate further initiatives to alleviate the debts of the poorest and heavily indebted low-income countries at an early date”.

The HIPC initiative

The most elaborate response to these concerns emerged in 1996, when the IMF and the World Bank launched the Heavily Indebted Poor Country (HIPC) initiative. This was promising for a number of reasons. First, it raised the prospect of cancelling debt owed to the multilateral institutions; previous debt relief

Figure 2.1 – Evolution of debt, 1985–97



schemes had been concerned only with bilateral or private debt. Second, it established a different criterion for debt forgiveness—based not on the magnanimity of the creditor but on the debtor's real capacity to pay. The aim was to reduce the debts of the poorest countries to levels that were "sustainable"—repayable out of export revenues over a reasonable period. On this criterion, 41 countries were classified as HIPCs—whose debt was judged too high a multiple of their likely exports of goods and services—and who should thus be considered for debt relief.

In the event, the HIPC initiative has achieved little. It places such onerous conditions and requires so many different levels of certification that few of the 41 countries have so far qualified for relief. First, the country has needed to prove that, after all other avenues of debt relief have been exhausted, the net present value of public and publicly guaranteed debt would still be 200 to 250 per cent greater than the value of exports of goods and services. For most countries this is an unreasonably high threshold. Second, the country has to prove its commitment to neoliberal policy prescriptions. It must demonstrate a six-year track record of structural adjustment and submit to close inspection of its economic management. Finally, following a series of debt reductions by bilateral donors and commercial creditors, the multilateral agencies may step in to provide additional relief.

Unsurprisingly, only a few countries have survived the course. Within the first two years—1996–98—only Bolivia and Uganda managed to meet the criteria. Burkina Faso, Côte d'Ivoire, Guyana, Mali and Mozambique are scheduled to follow shortly. But the relief they can expect to receive is hardly generous. As a result of the HIPC initiative, Mozambique, for example, would see its annual debt service payments fall by only $13 million—from $113 million to $100 million. Uganda's experience, too, suggests that the HIPC initiative is unlikely to produce lasting benefits (box 2.1).

Pressure for alternatives

By 1998, criticisms of the HIPC initiative were mounting. Many people, particularly in the NGO community, were outraged at the lack of progress—especially during a period of booming global financial markets. Between 1996 and 1999 the rich countries saw their total stock market wealth increase by over $5 trillion, yet they seemed unwilling to deal with the HIPC debt of only $245 billion.

This groundswell of opinion took its most effective form in Jubilee 2000, which has proved one of the largest and most influential international NGO coalitions. With activists in over 40 countries, it called for "a debt-free start to the millennium for a billion people".

Responding to pressure from Jubilee 2000, and others, the Group of 7 industrialized countries announced that their June 1999 meeting in Cologne would include a comprehensive debt relief package. To concentrate their minds on this issue, thousands of activists also converged on Cologne for an alternative economic summit—bringing with them a petition signed by 17 million people.

At the end of their meeting, the G-7 members presented the Cologne Debt Initiative, which included limited debt write-offs: up to $90 billion for the poorest and most indebted countries. They also called on individual countries to cancel debts and requested the international financial institutions to provide faster, deeper relief. In addition, they changed existing HIPC rules, modifying the definition of debtors in distress to those with a ratio of debt to exports of 150 per cent or more.

But, overall, the response was disappointing. The G-7 countries avoided any large-scale debt cancellation and, if anything, they added to the conditions for debt relief. Administration of the initiative was placed in the hands of the

Box 2.1 – Uganda's debt

Between 1980 and 1996, Uganda's total debt rose from $0.7 billion to $3.6 billion. This was despite a sequence of debt-relief efforts, mostly arranged through the Paris Club—a group of bilateral creditors who have provided relief on increasingly concessional terms. By 1996, the country's debt was equivalent to 61 per cent of GNP. Sixty-two per cent of the total was owed to multilateral creditors.

Uganda could point to a long and satisfactory record of structural adjustment, dating from 1987. Therefore it was accepted as a candidate for HIPC relief in 1996, with a "completion point" set for 1998. In the interim, it underwent monitoring by the World Bank and the IMF, to ensure that it continued to implement structural reforms. The former included further reform of the financial sector, rapid advance in privatizing state enterprises, continuing civil service reform and strengthening the tax regime. The capital account was entirely liberalized in July 1997, and remaining non-tariff barriers to trade were lifted in April 1998. In the social field, the government adopted a Poverty Eradication Action Plan in June 1997.

Having satisfactorily completed these reforms, Uganda became the first country to be granted debt relief under the HIPC initiative, in April 1998. Through a series of negotiations, the total stock of debt (outstanding by end June 1997) was reduced by approximately 19 per cent.

Although this relief is welcome—amounting in the early years to $42 million annually—it is far from meeting Uganda's social development needs. President Museveni's Universal Primary Education initiative, for example, cost 120 million in 1997 alone. Such initiatives will remain dependent on external funding. Some of this will come in the form of grants, but the rest will be loans. As a result, the breathing space created by HIPC stands to be wiped out in a few years, as Uganda acquires more debts.

IMF, which was to demand not just proof of continued structural adjustment but also evidence of progress in poverty reduction. The annual cost to the G-7 countries of the Cologne reforms will be $2 billion to $3 billion—less than one third of the amount cut from aid budgets since 1992. Although international progress toward writing off all HIPC debt has been slow, individual countries have taken positive steps. Following earlier leads by the Nordic countries and the Netherlands, the governments of the United Kingdom, France and the United States announced plans in 1999 and 2000 to cancel all debts owed them by the poorest countries. But there is still a long bureaucratic and political road to travel before the infamous chapter of debt renegotiation can be closed. In the meantime, debt payments flow relentlessly out of poor countries toward creditors who have long since developed the financial means to write them off (box 2.2).

Debt relief for middle-income countries

Though the HIPCs are urgently in need of debt relief, they account for only around 10 per cent of total Third World debt. The remainder is owed by less-poor or middle-income developing countries whose development has also been shaped—and distorted—by decades of continuous restructuring under the discipline of debt.

The problems for these countries, typically in Latin America, originated in the 1970s. At that point, commercial banks were flush with capital from the oil exporting countries and lent fairly indiscriminately to many developing countries. This transformed financial flows to Latin America. In the period 1966–70, commercial banks had supplied only 8 per cent of the flow of resources from the United States to Latin America, but by 1978 they were responsible for 57 per cent.

The banks made minimal efforts to evaluate the risks associated with these loans. Many of the loans were used to finance investment in public and private enterprises, infrastructure and development programmes. But others were used to import consumer goods, to speculate on foreign exchange markets, or simply for private ends. The banks were sanguine about this. After all, much of their lending was going to governments, and "governments never default".

The debt crisis

Most of these loans were short-term, usually to be renewed annually, and the banks charged variable rates of interest. While interest rates remained low, repayment was less of a problem. But in 1979 the US Federal Reserve launched a historic assault on inflation. As a result, interest rates suddenly jumped to 20 per cent and, virtually overnight, projects whose business plans might have looked eminently reasonable—given their original assumptions—became unviable. A collapse in the prices of major Latin American commodity exports at this time further worsened the economic climate.

This was not just a crisis for the borrowers. It also threatened the stability of Northern commercial banks. In 1982, the Argentine debt alone represented 18 per cent of the capital of the nine biggest banks in the United States. Debtors and lenders thus found themselves locked into a classic debt trap: the banks had to continue lending to keep their debtors sufficiently above water to service earlier loans; and the debtor countries had to continue to accept additional loans at the new, high rates of interest.

The Third World debt crisis became headline news—a drama directed by the IMF that was to be played out in numerous acts. The plot was based on a series of threatened defaults that were followed by last-minute moratoria, most of which were conditional on debtors following the classic IMF prescriptions, devaluing their currencies to encourage exports and cutting public expenditure.

Over the course of the 1980s, the crisis eventually subsided—at least for the banks. They steadily set aside funds that would enable them to survive debt write-offs, while also exchanging some of the debt for stakes in state-owned enterprises. And by the early 1990s, the worst seemed to be over—particularly following agreement on the Brady Plan, which included an ingenious device that converted a considerable part of the remaining debt into bonds, backed by US government securities.

The banks were relieved at having outstanding loans transformed into bonds, which could be listed as an asset and traded in financial markets. But the debtor countries had less to celebrate. Their debt had not disappeared; it had merely changed form. Instead of paying interest to the banks, governments now had to pay it to holders of bonds. That meant continued sacrifices. People would need to tighten their belts still further. And governments would have to continue cutting public expenditure while stepping up exports, with the added pressure of keeping on the right side of the international investors, on whom they would depend for future funds.

The new bondage

Spurred by the unexpected success of the Brady bonds, for which there appeared to be a ready market, Latin American governments saw a way of relieving some of their problems by issuing

yet more bonds on their own account. This transformed the debt picture yet again. Between 1992 and 1996, for example, Argentina's total debt rose from $43 billion to $100 billion. Of this, 3 per cent was owed to banks and 15 per cent to financial institutions, but 60 per cent now took the form of bonds.

These bonds still must be serviced—both the guaranteed interest, or coupon, and ultimately the principal. The crisis for the indebted middle-income countries has therefore become more diffuse. Now they must not only satisfy the IMF, when they need its support, but also keep the international capital markets on their side.

Since the bond markets in most of these countries do not accept large issues, governments can only borrow a few billion dollars at a time. This ensures permanent vulnerability. If international bond rating agencies, such as Moody's or Standard & Poor's, take a pessimistic view of a country's prospects, investors will require that the latter's next bond issue offer higher interest. Debt service will become still more costly. And the proportion of the national budget that can be allocated to non-debt-related projects will shrink. Borrowers thus find themselves continually dependent on the rating agencies.

This not only ties the hands of governments, but also dampens democratic debate. Citizens or politicians who protest against the effects of mounting debt now find they risk retaliation from market forces. Even to mention publicly that the debt overhang is a constraint on social spending—or that social and economic policy must change—will flash warning signals to investors around the world. This induces an unhealthy form of self-censorship throughout the political systems of many indebted middle-income countries. Both the general public and their representatives avoid touching on questions of elemental social justice that could promote yet another round of capital flight, or contribute to yet another period of economic instability.

The new bondage also makes it more difficult to present a united front when negotiating with creditors. When governments owed money to a small number of banks, they could exert some pressure by threatening a concerted default. But bondholders are highly dispersed and mobile. To negotiate with them is a far more daunting task.

Desperation can still lead to default. A portent of things to come appeared in September 1999 when Ecuador, with a foreign debt of more than $13 billion, defaulted on the interest payments due on one class of its Brady bonds. The government attempted to negotiate with bondholders but only persuaded 8 per cent to support a plan that would give Ecuador more breathing space. Instead, 25 per cent of them voted to demand accelerated payments.

Box 2.2 – Missing targets, the price of debt

The current levels of debt in the HIPCs make it virtually impossible for them to achieve the goals set at the Social Summit. The Summit target for child mortality by 2015, for example, was 52 deaths per 1,000 live births. UNICEF estimates, however, that in the HIPCs the child mortality rate at that time will be 134 deaths per 1,000—equivalent to 2 million additional child deaths annually. The prospects are no better in education. UNESCO estimates that up to 40 million primary school-aged children in HIPCs will remain out of school in 2010—a figure likely to rise further by 2015. On the basis of primary education trends since 1990, Oxfam estimates that only seven of the HIPCs are likely to achieve their 2015 goals.

Ecuador decided to default and suffered the consequences—which included a collapse in its currency and little prospect of attracting new funds. Other indebted countries were quick to distance themselves from Ecuador's action. Indeed, both Mexico and the Philippines at the same time bought back some of their own Brady bonds.

Confronting the problem of debt bondage in middle-income market economies is difficult and complex. Yet a way will have to be found both to head off impending crises and to protect the millions of people who are suffering long-term declines in their standards of living and in social welfare.

Fresh departures for debt

Continuing poverty and the likelihood of further crises in both HIPCs and middle-income countries demand not just urgent attention to their immediate debt problems but also a fresh approach to future borrowing.

New institutions for dealing with debt

Past debt activities have largely been driven by crisis and have resulted in ad hoc rescue packages. This is not only inefficient, but has caused untold, and unnecessary, suffering for millions of people. What is needed to lessen the seriousness of future debt crises is a new institutional structure. For this to emerge, however, the industrialized countries have to mobilize behind one clear idea.

A number of governments and international bodies, including UNCTAD and the Economic Commission for Latin America and the Caribbean (ECLAC), support the development of procedures for the orderly workout of debt, including a temporary suspension of payments by beleaguered governments—a move to be given legitimacy by an independent arbitration panel—combined with encouragement for further lending during the period of debt restructuring. Going further still, others have proposed the establishment of a treaty-based international bankruptcy court. A crucial element of such proposals is that the burden of restructuring should be shared between borrowers and lenders.

Sovereign debt and bankruptcy

When it comes to debts owed by enterprises, most industrialized countries have effective bankruptcy laws. These ensure that bad decisions or bad luck do not condemn debtors to paying for their mistakes for the rest of their lives. Indeed, the dynamism of the US economy is often ascribed to the opportunities it offers risk-takers to wipe the slate clean and start again. Should there not be something equivalent for sovereign debt?

Jubilee 2000 and others have proposed that states should have recourse to an international bankruptcy court. Rather than having debt problems discussed in the secretive corridors of the Paris Club or the international financial institutions, they should be aired formally and publicly in a new institution. This would have many advantages, but establishing such a mechanism will not be easy. It is not clear, for example, how such a court could establish the necessary jurisdiction over both creditors and debtors. And debtors might be tempted to capricious default.

But it can be argued that the present system, or non-system, has its own forms of moral hazard. In fact, unclear arrangements for dealing with crisis encourage all creditors to protect their own interests at the expense of someone else. The strongest creditors win such contests. And it is often ordinary taxpayers—including relatively poor ones—who foot the bill. Moreover, in both borrowing and lending countries, government bailouts of failing financial institutions frequently have to be paid for by cutting social expenditures—robbing the poor to pay the rich.

Conditionality

Attempts to deal with international debt have always been associated with conditionality—though lately the conditions have been changing. In the 1980s, debt renegotiation generally required the borrowers to carry out neoliberal reforms; in the late 1990s, these stipulations have been supplemented with requirements that any relief be targeted toward reducing poverty.

This is understandable. Some of the original debts were incurred by corrupt or authoritarian regimes that used the funds to benefit elites. Donor governments and NGOs want to ensure that future funds do not disappear down the same drain. Thus members of the Jubilee 2000 coalition link their proposals for debt cancellation to requirements that funds freed for use by debt renegotiation be used to improve health, education and other social benefits. Creditor countries also insist that debt forgiveness carry similar social conditionality.

But this raises a number of difficulties. The most familiar is fungibility—governments receiving relief may claim to be using the freed-up funds on social expenditure they would have made anyway.

A second, equally familiar concern is that of excessive interference in local decision making. Those involved in debt relief efforts need to use caution in the ways they monitor and influence the use of resources. Apart from stifling local autonomy, too much conditionality can also exhaust time and money that might be better employed elsewhere.

A further, less obvious issue is that social conditionality may be over-simplistic. All governments nowadays find their room for manoeuvre constrained by international markets. They are under constant pressure to keep wages, taxes and public expenditure low—and interest rates high. This can seriously limit their ability to invest, to stimulate employment, to fund essential infrastructure, and generally to promote longer-term development. Therefore, if they do get debt relief, governments may have good reason to use these resources to overcome key restraints on growth, and not simply to increase direct social expenditure. Rather than defining a specific use for the funds, it might be better to insist that governments make their decisions openly and democratically.

Indeed, one of the most important benefits of effective debt relief may be to open up larger democratic spaces. High indebtedness fosters a crisis mentality that inhibits open debate on public affairs. This allows lenders to collude with debtors in seeking solutions behind closed doors. The population at large feels disempowered and nervous about rocking a boat that always seems in imminent danger of capsizing. People may therefore swing between cycles of apathy and protest, rather than engaging in reasoned debate about how the country can best move forward (box 2.3).

Citizens should also have the opportunity to consider debt relief in a much broader context—seeing how it fits into the global economic system. Even if their country's debts are cancelled, this will not protect them from future drops in commodity prices, or wild increases in interest rates, or a sudden shift in investor sentiment—any one of which could again wreak havoc in their fragile economies and plunge them back into debt. It is vital to find a way out of the current crisis, but it is just as important to foresee, and prevent, the next one.

Development assistance

The poorest countries urgently need debt relief, but this is not enough. To strengthen their economies, there must be an inflow of new resources; and a large proportion of these can only be obtained in the form of development assistance. Aid is needed not just to fund critical development projects, but also to attract foreign private capital, which is unlikely to arrive in the poorest countries unless backed by

guarantees from donor governments or multilateral agencies.

At the time of the Social Summit, prospects for development assistance were gloomy. Flows had already declined markedly, and only four donor countries—Denmark, the Netherlands, Norway and Sweden—were meeting or surpassing the agreed UN target of 0.7 per cent of their GNP. The Social Summit recognized the need to halt the slide, and delegates resolved to "strive for the fulfilment of the agreed target of 0.7 per cent of gross national product for official development assistance as soon as possible".

This resolve had little practical effect. Indeed, as indicated in table 2.1, official aid flows continued to dwindle. In 1995 the member countries of the Development Assistance Committee of the OECD gave $59 billion. But by 1997 the figure had dropped to $48.3 billion. In 1998 the figure improved—to $51.9 billion—but this is still considerably less than the 1995 level. The table sets this in the context of the military spending of DAC members.

Donor fatigue

The decline in ODA has commonly been attributed to "donor fatigue". One aid evaluation after another has pointed to wasted or misused funds, corruption in both public and private circles, and to the general institutional weakness in developing countries that makes it difficult for them to use aid effectively. As a result, donors have become increasingly dissatisfied. The World Bank, for example, in a widely read publication *Assessing Aid*, concluded: "Donors should be willing to cut back financing to countries with persistently low-quality public sectors".

But the problems with aid are not entirely due to the weakness of Third World institutions. In recent years, development assistance has had to operate in such a generally hostile global climate that its limited success is hardly surprising.

One of the most debilitating factors, as indicated in the previous section, has been debt. At the time of the Social Summit, around one quarter of bilateral aid was being used to repay multilateral lenders. And for World Bank aid the position was even worse. In 1993–94, out of every $3 that the World Bank offered as IDA loans and grants, it reclaimed $2 as debt repayment. Of the remaining dollar, the IMF pocketed part. Aid has also been diverted to cope with a string of humanitarian crises—some of

Table 2.1 – OECD aid compared with military spending

	1990	1991	1992	1993	1994	1995	1996	1997	1998
OECD official development assistance ($ billions)[a]	**52.9**	**56.7**	**60.9**	**56.5**	**59.2**	**59.0**	**55.4**	**48.3**	**51.9**
OECD military spending ($ billions)[b]	**657**	**612**	**620**	**595**	**572**	**548**	**553**	**550**	**539**
ODA as percentage of military spending	**8.0**	**9.3**	**9.8**	**9.5**	**9.7**	**9.3**	**10.0**	**8.8**	**9.6**
ODA as percentage of DAC members' GNP[c,d]	**0.33**	**0.33**	**0.33**	**0.30**	**0.30**	**0.27**	**0.25**	**0.22**	**0.23**
ODA average annual real percentage change, 1991-97[a]							**- 4.6**		

Sources and notes: [a] OECD/DAC, 1999b and 1999c; [b] SIPRI, 1999; [c] Randel et al., 1998 and 2000; [d] The target for overall official development assistance is 0.7 per cent of GNP (Commitment 9 (l) of the Copenhagen Declaration on Social Development).

them climatic, some of them man-made. The proportion of bilateral aid devoted to emergency relief rose from 1.5 to 8.4 per cent between 1991 and 1994.

Aid has also failed because of donor errors. An increasing proportion of aid has been used in co-ordination with the World Bank and the IMF to support policy reforms that ultimately have produced meagre results. Far too often, assistance has also been accompanied by such time-consuming demands for reporting that donor fatigue has probably been matched by "recipient fatigue". Each year, for example, Tanzania prepares as many as 2,400 progress reports per quarter for all its donor partners.

Reorienting development assistance

One way of reorienting development assistance is to require that a much larger proportion of aid be dedicated to social development. In the

Box 2.3 – Protests over social sector priorities

People in many poorer countries have become resigned to the cuts in public services they have had to endure. But as the press regularly reports, their anger frequently boils over into protests and strikes.

"Jamaica's capital, Kingston, was closed down as anti-government protesters blocked main roads across the island....The wave of protests was sparked by last week's budget, which increased the price of petrol by 30%. The government expects to spend 62% of tax revenue on debt service, and is struggling to protect spending on health, education and the police."—*The Economist,* 24 April 1999

"Since the fall of communism, academic freedom and government interest in higher education [in Russia] have mushroomed, although this has not been matched by increased resources. In response, student and industrial militancy have risen markedly. Besides strikes, demonstrations and pickets, students and lecturers have taken the state to court for unpaid salaries and begged outside Yeltsin's house. When in 1996 the government announced an indefinite delay in the payment of salaries and bursaries, 22 lecturers went on hunger strike. Within a week the government had given in. These are small victories against a background of defeat in a country where neoliberalism is running an education system into the ground."—*The Guardian,* 19 October 1999

"The strike [in Zimbabwe] began at the end of September when 400 junior doctors refused to go to work, demanding significant increases in their meagre monthly salaries and better hospital conditions. Nyasha Masuke, spokesman for the junior doctors, says: 'The hospitals are so badly equipped that we watch malaria patients die because there is no chloroquine. We see others die because there is no blood for transfusions.' Once the pride of Africa and a model for other developing countries, Zimbabwe's government health facilities have been starved of funds for nearly a decade.

A continuation of decline is likely as a result of Zimbabwe's new budget for 2000. The health ministry had requested Z$10bn ($250m) but was only allocated Z$6bn. In contrast, the defence ministry received a whopping Z$9bn. 'The government does not see any urgency in ending our strike,' says Dr Masuke. "The cabinet ministers and the rich can go to their private hospitals. It is the poor of Zimbabwe who suffer."—*The Guardian,* 1 November 1999

past, the bulk of non-military aid was used to stimulate economic development, through infrastructure projects, agricultural development, and various kinds of budgetary support. Social sector spending has lagged behind. Each country has had different priorities, but few have tried to ensure that large volumes of aid reach the poor. This was especially true while governments were preoccupied with adjustment. At that point, the best the poor could hope for were partial measures, such as social safety nets.

Moved by the desperate situation of large numbers of people deeply affected by crisis and adjustment, participants in the Social Summit focused a great deal of attention on the persistence of poverty. They committed themselves not only to reduce it, but also to eradicate it. And in consequence, all members of the international development community have now given poverty alleviation central importance in their programmes. But, given different traditions of social welfare and social policy in donor countries, it has not been easy for the aid establishment to develop an integrated approach to this goal. On one side are those who see poverty reduction in narrow terms—best achieved by targeting remedial action at the poor. On the other side are those of the welfare state tradition, who believe that poverty reduction should be a part of broader efforts by the state to improve social conditions and promote social justice. This division was clearly visible in the Social Summit's Declaration and Programme of Action and remains evident in the divergent policies of donors and their contrasting development assistance programmes.

The 20/20 initiative

The problems encountered in redirecting aid toward social development are well illustrated by experience with the 20/20 initiative. The final chapter of the Copenhagen Programme of Action includes a "mutual commitment between developed and developing country partners to allocate, on average, 20 per cent of ODA and 20 per cent of the national budget…to basic social programmes". Many people regard this mutual commitment as one of the most important achievements of the Social Summit. It has been taken up not just by bilateral donors and the major multilateral development agencies—including UNICEF, UNDP and the World Bank—but also by many NGOs in both North and South.

A great merit of the 20/20 approach is its apparent simplicity—which helps make it a sharp tool for advocacy. But the general unanimity starts to unravel when it comes to execution. There are problems right at the outset in agreeing on the definition of basic social services. While all donors agree that these include basic education, basic health, sanitation and clean water, not all of them see the need to deal with nutrition as a category separate from health. There are also different approaches to targeting. Some donors take 20 per cent as an overall target for their global development assistance programme, while others add the stipulation that it also has to be achieved in each recipient country. Then there is the question of conditionality. Some see 20/20 merely as a broad policy commitment—a long-term goal around which to organize collaboration. Other donors declare that if recipient governments to not achieve the 20/20 target they can expect to be penalized.

These disagreements make it difficult to coordinate donor activity or even to gauge progress. NGO monitoring projects, such as Social Watch and Reality of Aid, point to striking differences between reporting agencies. Not only do they employ different definitions, they also use incompatible accounting systems and statistical methods. This makes it almost impossible to determine the proportion of development assistance going to basic social services or to compare spending among donors.

The situation becomes even more complex when differences in reporting in Third World countries are taken into account.

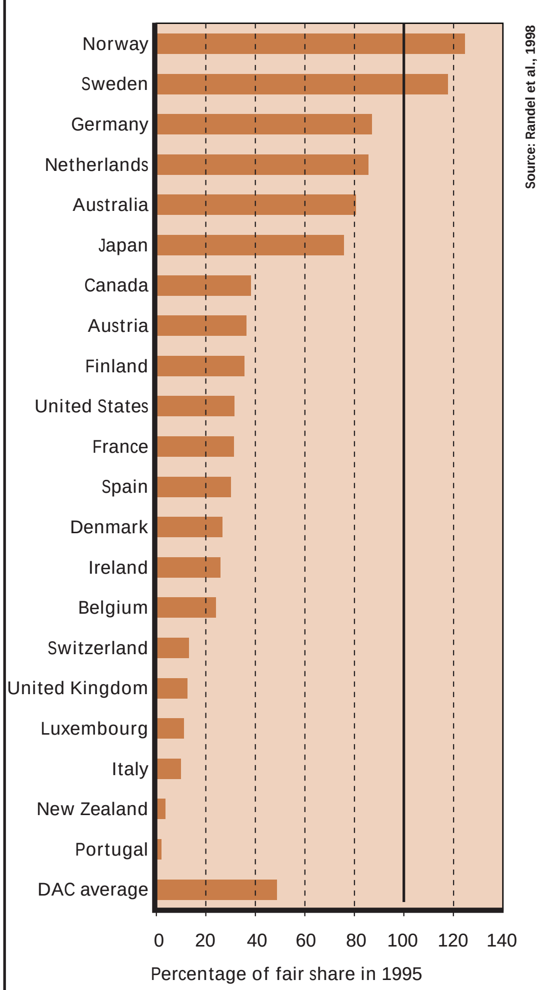
Nevertheless, the 1998/99 Reality of Aid report attempted to measure the performance of bilateral donors. The project estimated what contribution bilateral aid should make to financing basic social services and what each donor's share should be, based on each country's GNP. The conclusion is summarized in figure 2.2. This shows that in 1995 the DAC countries as a whole were giving only 49 per cent of what was needed. Sharing out the overall bilateral target by country on the basis of GNP, the project found that only Sweden and Norway were contributing more than their fair share. While most countries fall short of what they should be contributing, however, it does appear that the proportions going to basic social services are slowly increasing.

But an increase in aid flows is only a part of the story. Much depends on the response of recipient governments. Here again there are problems of fungibility: governments that receive funds earmarked for basic social services may simply seize the opportunity to shift their own funds elsewhere. A World Bank study of 14 countries found strong evidence for this, though there was considerable variation between countries. Thus when Sri Lanka received aid for education and health, it took the opportunity to withdraw an even greater amount from these sectors—so the net effect was to reduce basic social sector spending. Indonesia, on the other hand, received a similar amount but supplemented this from its own funds, producing a substantial increase.

Regardless of the level of expenditure, one also has to take into account how effectively the funds are used. Again there can be enormous variations. In Bolivia, for example, donor contributions, along with national funds, appear to have been channelled very effectively to local groups for social services. But this case seems to be exceptional. More typical perhaps is Côte d'Ivoire, where reports indicate that most public services are failing to reach the poor.

Even when funds are used well, there can still be doubts about focusing so rigidly on basic social services. One danger is that other important social services will be sacrificed in order to meet imposed targets. A number of Third World governments, anxious to prove to donors and

Figure 2.2 – Providing basic social services for all: Bilateral donors' fair share, 1995



Note: The Reality of Aid project estimated the total additional amount required to meet the target of providing basic social services for all. This amount was allocated among bilateral donors in proportion to their GNP, and the resulting "fair share" compared with actual contributions. As the chart indicates, the average achievement for all DAC countries was 49 per cent. Only Norway and Sweden exceeded the necessary contribution.

international creditors that they are spending more on primary education—at a time when budgetary resources are not increasing—have achieved the goals required of them by reducing the coverage and quality of other social services, like secondary or vocational education. Some have met international goals by budgeting for many new primary school buildings without having the capacity to provide additional teachers (especially if the secondary and tertiary systems are starved of funds). Ensuring universal access to primary education is obviously extremely important. But single-minded insistence on this, within an environment of very limited resources, can distort social policy.

There is also a significant political price to pay when governments give special attention to improving basic education and health services at the cost of existing programmes that benefit a wider cross-section of the population. Working-class and middle-class citizens who depend on public services have often seen their levels of living decline sharply over the past decade or more; and they are justly upset by deterioration in public schools, clinics and social security systems. International advice that all but the poorest turn to the private sector for these services presents them with a new financial burden and an affront to their sense of citizenship. Pro-poor conditionality in the context of scarce resources can thus be an explosive political issue.

Alternatives to rigid targeting

Rigid targeting clearly has fundamental weaknesses. The data are unreliable, funds fungible, and long-term effects unpredictable. In the end, what seems to matter more is not how the international development community targets its funds, but how they are actually used. They are likely to achieve more if each society is allowed to pursue realistic and appropriate options.

Some donors who have recognized this, and concede their inability to influence the precise use of their funds, are now considering a change of tactics. Instead of being selective within countries, they are being more selective between them. In future they will be concentrating their aid in countries that have the greatest potential for progress—typically those with a commitment to economic reform, along with a good record on human rights. After choosing countries with which they share a common vision of progress, donors then enter into partnerships in which both states and citizens' groups exert greater control over the use of funds. Countries that do not meet the minimum requirements for good governance and economic reform will no longer receive aid.

This new approach—which is progressively reducing the number of countries to which bilateral donors provide assistance—has practical advantages, but like all aspects of the current development assistance framework it also poses difficult moral and practical dilemmas. A large number of poor people live under regimes that do not fulfil these requirements for effective use of aid. Eliminating development assistance to these countries is difficult to square with a broad-ranging commitment to poverty eradication.

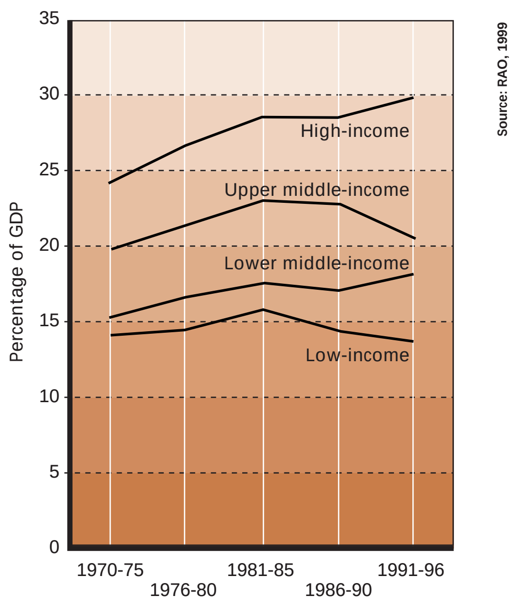
Alternatives to aid

One way to avoid the dilemmas associated with foreign aid is simply to replace it. For example, instead of the current system of discretionary giving there could be a mechanism for automatic transfers from rich countries to poor. Much of the new thinking in this area is rooted in the principles of human rights. International conventions on human rights have long recognized the right of every human being to a minimum standard of living, for example—and asserted that the duty to fulfil human rights transcends national borders. Now a number of groups are trying to work out how this broader view of rights and responsibilities can be put into practice.

One proposal is to establish a new international development fund. Each high-income country could contribute a fixed percentage of its GNP to such a fund, which could be governed by representatives from both better-off and worse-off nations. This council would decide on the transfers required to bring each country's average per capita income up to an agreed minimum. Even if contributions to the fund never exceeded half the current UN target of 0.7 per cent of the GNP of rich countries, it would raise far more money than is currently available in conventional aid programmes.

A variant of this would have three "windows". Poor countries would achieve a basic social safety net through the first window. Through a second window, they could receive extra payments for services that benefit the whole of the global community, such as protecting biodiversity or fighting narcotic drugs. The third window would enable the richer countries to offer compensation for damage that they might continue to inflict on poor countries by maintaining trade barriers, for example, or by refusing to accept immigrants.

Figure 2.3 – Tax revenue and GDP



Note: The figure shows how tax revenue as a proportion of GDP is higher in the richer countries—and the gap is getting wider.

Another approach is to establish new forms of global taxation. One of the most familiar proposals is the Tobin Tax on foreign exchange transactions, which globally now run at $1.5 trillion per day. Similar suggestions have been made for taxing air travel, Internet use or other services that have strong international dimensions. Such charges could be levied by national tax authorities and some of the revenue used by national governments. But a certain proportion—perhaps half—could be allocated to the UN for a range of activities, including social programmes, environmental protection or humanitarian interventions. A part might also be distributed among developing countries, so that countries with the lowest per capita income received the largest amount.

New proposals on global citizenship and international taxation are likely to be aired at the Geneva 2000 meeting of the UN General Assembly, as well as at the 2001 Financing for Development conference. Most industrialized countries will doubtless oppose any such moves. But the idea of an international development fund is gaining greater support, particularly from NGOs. The growing intersection between human rights and poverty eradication could become a significant force for change.

Tax reform

Even if international taxation transferred some funds to developing countries, they would still need to rely primarily on generating their own resources. Unfortunately, governments in many of the poorer countries have seen their revenues eroded. Much of this is due to economic decline. When business enterprises are producing less, and more people are out of work, there is less income to tax.

The poorer countries are also generally less

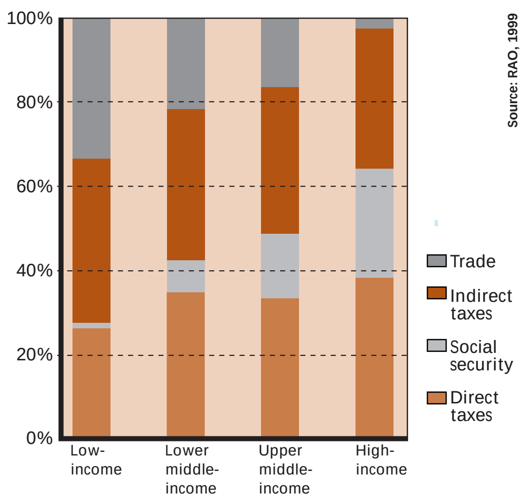
successful at tax collection. Not only do they collect less in absolute terms, but they also gather less as a proportion of GDP. This is illustrated in figure 2.3, which shows that high-income countries collect more than twice as much as a proportion of GDP—and that the gap seems to be widening.

A second difference between richer and poorer countries is in the source of tax revenues. This is illustrated in figure 2.4. The limited extent of formal employment in developing countries reduces the potential for collecting social security contributions or personal income tax. In Bangladesh, for example, only 0.5 per cent of the population was liable for personal income tax in 1991. Many developing countries have had to make up for the shortage of personal taxpayers by focusing direct taxation on larger enterprises, particularly those involved in mineral extraction.

THE ERODING TAX BASE

But the main difference between rich and poor countries is that the poor rely more on taxes on imports and exports. This is partly because customs duties are easier to collect. The World Bank has estimated that levying trade taxes costs 1 to 3 per cent of the expected revenue—compared with 5 per cent for value added taxes and up to 10 per cent for income taxes. On average, developing countries derive around one third of tax revenues from taxes on trade, though in some cases the proportion is far higher: for Lesotho and Madagascar, the proportion is around one half.

Figure 2.4 – Sources of tax revenue, 1991–96



Note: The poorer countries are more dependent on taxes from trade.

The drive toward globalization and trade liberalization is therefore likely to hit developing country revenues hardest. As tariff rates have been falling, so have their incomes. Between 1993 and 1998, for example, India reduced average tariffs from 71 to 35 per cent. In 1998, however, a new government had to raise the tariffs again, claiming that this was not to protect Indian businesses but to protect government revenue. Even as staunch a free-trade advocate as Chile has worried about the revenue implications of trade liberalization. In 1997 the government postponed a reduction in import tariffs because the parliament could not decide how the anticipated $420 million cost was to be met.

A second revenue-weakening effect of liberalization is tax competition. Global competitive pressures make governments wary of raising taxes—for fear that foreign, or even national, businesses will flee elsewhere. This has resulted in falling tax rates around the world, both for individuals and corporations. Some experts suggest that in future this race to the bottom could see corporate tax rates sink to zero.

The tax base is also being weakened by the increasing informalization of economies. Even in the European Union, it has been estimated that between 7 and 16 per cent of the labour force now operates in the black economy. In developing and transition economies, the proportion is much higher and seems to be rising. In Latin America between 1990 and 1996, the proportion of the non-agricultural workforce to be found in the informal economy rose in almost

every country: in Peru, for example, from 52 per cent to 58 per cent; and in Paraguay from 61 per cent to 68 per cent.

Taxing the consumer

Governments nervous about taxing businesses have set their sights elsewhere. Many have increased taxes on consumption, particularly through value added taxes—regressive taxes that hit hardest at the poor. One 1990 study of 39 countries undergoing structural adjustment found that almost all were shifting toward such indirect taxation. Pakistan is one of the latest countries to take this step. Here the ratio of tax to GDP is only 13 per cent—significantly below the 20 per cent ratio thought necessary to sustain public spending levels. Attempts in 1999 to introduce a sales tax faltered, however, after a general strike by small businesses. In Ghana, the imposition of a value added tax and subsequent price increases led to riots in May 1995 in which five people were killed.

A similar turn from taxing capital to taxing consumption is evident in transition countries. Hungary, for example, has been reducing taxation on corporations, particularly foreign ones: between 1988 and 1996, the contribution of taxes on business profits dropped from 30 to 10 per cent. Instead the government has increased personal taxation, which now accounts for 36 per cent of total revenue, and taxes on consumption, which now contribute one third of revenue. Payroll taxes are also high—the equivalent of more than half a worker's wage. Not surprisingly, Hungary also has a proliferating black economy—now estimated to account for around 30 per cent of GDP.

International avoidance

Another effect of liberalization is that individuals and businesses have increasingly sophisticated options for moving their funds internationally so as to elude, or at least minimize, taxation. The growth of electronic commerce will further expand opportunities for bypassing local and national tax systems.

Many of these funds are disappearing into tax-free offshore accounts. The IMF estimates that such accounts now contain around $8 trillion—equivalent to the GDP of the United States. If tax were to be paid on these funds, it could make an enormous contribution to social programmes. For example, if these deposits earned income of around 5 per cent per year and this were taxed at 40 per cent, around $160 billion annually would be raised—almost double what it would take for all countries to guarantee basic social services.

Recovering the resources lost through tax avoidance by the rich is thus essential to strengthening the resource base for social development. At the national level, one of the most important measures would be to improve the efficiency of tax collection. But the increasingly global nature of tax avoidance means that solutions must also be international.

One of the first steps in countering cross-border avoidance must be to ensure a better exchange of information among countries. In addition, states will have to consider harmonizing their tax systems to reduce the benefits of capital flight. They could, for example, agree on common ways to tax interest income, so that funds would not inevitably rush toward destinations where such taxes are either very low or non-existent. This has been a problem for Latin American governments, which find it difficult to tax interest and dividends while their citizens can earn tax-free interest on deposits in the United States.

States must also take concerted measures to eliminate tax havens. Major industrialized countries are working toward this goal. Since 1998, in fact, the OECD Forum on Harmful Tax Practices has been conducting a review of tax havens, defined as "tax poaching schemes… that impede the ability of home countries to enforce their own tax laws". Preliminary find-

ings were presented to the senior tax policy body of the OECD in January 2000, and might be followed by public banking legislation prohibiting receipt of funds from tax havens. A number of international NGOs are lobbying for such an outcome.

Growing awareness of the international dimensions of tax avoidance also stands behind the proposal to create a World Tax Organization. Like the World Trade Organization, this would provide a framework within which governments could work out a set of rules they would be willing to observe. Such an institution is unlikely to emerge any time soon—and will encounter fierce opposition from transnational corporations and speculators. But in the longer term, the needs of governments could drive the international community in this direction.

Pension reform

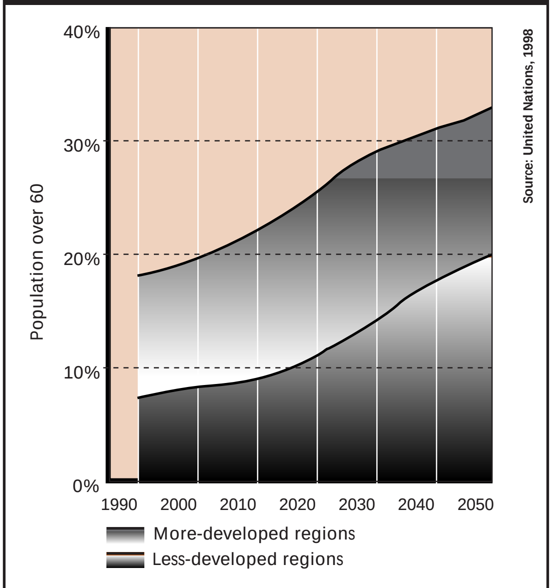
Many of the same factors that have weakened governments' capacity to tax have also affected pension schemes—particularly in middle-income developing countries and countries in transition. These programmes are essential elements of social protection, shielding recipients from hardship in old age. They are often the largest social transfer schemes and, along with health and education, absorb the largest amounts of social expenditure. But like taxation, they are vulnerable to economic crisis, rising unemployment in the formal sector and the growth of the informal sector.

Pension schemes are also affected by demographic changes. If the proportion of older to younger people in the population covered by any programme rises, the government needs to make appropriate adjustments to contributions and benefits. The industrialized countries' populations have aged markedly over the past few decades. But, as figure 2.5 shows, populations are also set to age rapidly in less developed regions in the first half of the twenty-first century.

During the past two decades, public pension schemes have been hit by a combination of shrinking resources and growing needs. Rather than undertaking wholesale restructuring, the advanced industrial democracies have responded with a number of innovative reforms. For the developing and transition countries, however, the international financial institutions have demanded far more radical change. And, as in the case of many prescriptions for institutional reform meted out during the 1980s and early 1990s, this advice has often proved misguided.

The central element in international prescriptions for pension fund reform in indebted middle-income and transition societies has been privatization. Encouraged by the Chilean experience during the 1980s, neoliberal reformers at both national and international levels have attempted to replace public social security systems with private retirement accounts. Their approach was supported by an influential 1994 World Bank report, *Averting the Old Age Crisis*. And it was backed up by the exercise of conditionality: discussions of structural adjustment loans gave a high priority to privatizing pension funds.

Figure 2.5 – Population over 60, 1990–2050



In Latin America, this pressure proved least effective in the more democratic countries. In Costa Rica, for example, citizens preferred to reform the public system—eliminating the last pockets of privilege for public sector workers and ensuring that new levels of contribution would be adequate to provide minimum benefits for the aged and infirm. In Uruguay, citizens forced a public referendum, through which they rejected a proposal for privatization. At a later stage, they did permit the introduction of private investment accounts, but not at the cost of eliminating the public programme. In Argentina and Peru, after the legislature refused to authorize partial privatization, it was eventually pushed through by presidential decree. Only in Chile and Mexico has there been a complete shift to private pension funds—but interestingly enough, in both cases influential sectors of the elite, including the military, have been allowed to keep their previous, publicly managed funds.

The struggle over pension reform reflects a broader debate about the meaning of solidarity and the nature of risk. First, should there be room in old-age protection schemes for some degree of redistribution between those who are better-off and those who are not? Almost all public pension systems have an element of redistribution, but privately managed individual accounts do not. Second, should pension programmes ensure some degree of security for all members, whatever the immediate circumstances surrounding their retirement? Public pension schemes establish a minimum benefit, based on the length and magnitude of contribution, and bear the risk for delivering that benefit. In fully private programmes, the amount of each pension depends entirely on the size of the individual's investment and the performance of the market.

There is, of course, no reason why the pension programmes developed in any country should be either entirely private or entirely public. Combinations of both abound. Indeed, some of the most creative attempts to deal with an aging population and falling tax revenue have involved innovative combinations of public and private spheres. Thus some industrial democracies have added individually funded accounts to basic public pension schemes; some private investment accounts are managed by business or trade union associations; and some public schemes invest in private markets. In addition, many countries have chosen not to dismantle their public system but have raised the pension age or introduced incentives for later retirement.

It is time to introduce a note of caution and realism into what has often been a highly ideological debate. This shift in thinking has already begun, as practical lessons are drawn from 20 years' experience with full privatization in Chile (box 2.4). In addition, a number of people are re-examining the technical arguments—economic and actuarial—for radical privatization. A recent paper from the Office of the Chief Economist of the World Bank insists that "the complexity of optimal pension policy should caution us against believing that a similar set of recommendations would be appropriate in countries ranging from Argentina to Azerbaijan, from China to Costa Rica, from Sierra Leone to Sweden". And it goes on to address "10 myths" that underlie past Bank support of mandatory private pension schemes.

Other issues in social protection

Public pension programmes are generally part of broader social protection schemes, including sickness, accident and unemployment insurance. Of the 172 countries included in the 1997 edition of *Social Security Programs throughout the World*, only six (Bangladesh, Botswana, Malawi, Myanmar, Sierra Leone and Somalia) lack any kind of public social insurance programme. But in the poorer countries, coverage is often restricted to a relatively

Box 2.4 – Salutary pension lessons from Chile

In the 1990s, Chile was in the forefront of pension reform—phasing out the public system and shifting all formal sector workers above a minimum poverty line from public to private pension schemes. Countries tempted to follow the same path should consider the discrepancies between claims originally made for this experiment and the reality after almost 20 years of experience. Discrepancies have emerged in the following areas.

• ***Efficiency***—Though it was claimed that privatization would improve efficiency, this is highly questionable. Private individual accounts have proved more expensive to manage than collective claims. In fact, according to the Inter-American Development Bank, administration of the Chilean system was, by the mid-1990s, the most expensive in Latin America.

• ***Yield***—Private pension funds were supposed to offer pensioners a good rate of return. But between 1982 and 1998—and after deducting administrative costs—privately held and administered pension funds in Chile showed an average annual real return of only 5.1 per cent. Since part of the fees and commissions are charged at a flat rate on all accounts, these charges have also proved highly regressive. When levied against a relatively modest retirement account, standard fees reduced the latter by approximately 18 per cent. When applied to the deposit of an individual investing 10 times more, the reduction was slightly less than 1 per cent.

• ***Competition***—Since the public pension system was a monopoly, it was assumed that privatization would promote efficiency by opening the way for sharp competition between pension providers. In the event, Chile's "pension industry" has become highly concentrated. The three largest pension fund administrators handle 70 per cent of the insured. And account holders have limited opportunities for transferring between them: to reduce spending on advertising, public regulators are limiting the number of transfers that any individual can make from one company to another.

• ***Coverage***—It was assumed that a private scheme would draw more people into the pension system by offering the prospect of profitable investments. This has not happened. Coverage and compliance rates have remained virtually constant.

• ***Stronger capital markets***—Another claim was that the conversion of the public pension system into privately held and administered accounts would strengthen capital markets, savings and investment. But a number of studies have recently concluded that, at best, this effect has been marginal.

• ***Gender equity***—Pension benefits in private, funded systems are determined strictly by the amount of money contributed. Since women typically earn less money and work fewer years than men, they receive considerably lower benefits. Public pension systems—as in Sweden, for example—can counter this disadvantage by providing credits for child care. Private pension systems cannot.

small group of formal sector workers and civil servants. And hundreds of millions of people—particularly in developing countries—have been affected by more generalized reductions in the coverage and quality of services.

As an alternative form of support for those in greatest need, some countries provide social assistance pensions. Governments, which finance these small payments not through contributions but through taxes, thus aim to support those whose income is too low to qualify for social security. But like other areas of social protection in the 1990s, the real value of such pensions in developing and transition countries has often plummeted; and the number of people receiving benefits has declined. The ILO estimates that about one third of all the world's people lack any type of formal social protection—whether contribution-based social insurance or tax-financed social assistance. In Africa, this applies to 90 per cent of the population of working age.

The social protection agenda in the years ahead must include efforts to deal with this problem. This could be achieved by extending existing social security programmes to cover informal sector workers. Or it could be done by supporting innovative voluntary initiatives. Many self-employed people in developing countries have devised schemes that provide some hedge against risk: co-operative insurance schemes, communal grain storage programmes, savings clubs and rotating credit societies. Many NGOs and donors are supporting these efforts.

In the last analysis, however, voluntary, community-based schemes will always be vulnerable to external shocks—sharp shifts in the economic environment, for example, or in the weather. And they can be fundamentally affected by changes in social relations among members as well. If they are to be more resilient they need to affiliate with large, professionally run institutions. Public social security systems are the obvious choice in this regard, though many now lack the financial or administrative capacity to incorporate a broad range of low-income, self-employed groups.

Mobilizing resources at the grassroots

Hit by rising debt repayments, declining development assistance and falling tax revenues, many Third World governments find it increasingly difficult to provide social services and social protection. They have therefore been trying to decentralize—to shift the burden of obtaining and managing resources from national to local authorities, often as part of structural adjustment programmes.

But there is a limit to what this can achieve. When governments decentralize, they may, of course, be strengthening democratic governance. But they may also be using this as a pretext for cutting financial support. And they may be demanding too much of local administrations whose institutions are ill prepared to take over. Decentralization is thus as likely to encourage inefficiency as efficiency, and can compound, rather than offset, the difficulties associated with declining social spending.

Another way of rationalizing the use of scarce resources for social development is through targeting. But this, too, has proved problematic. Most countries use targeting to some extent, and it does seem logical to direct scarce resources toward the neediest. In many situations, however, it is difficult to locate the individuals or households that have the best claim. Moreover, a growing number of studies have shown that in many areas of the developing world, targeting is not only haphazard but also expensive: often it would be cheaper to provide benefits to the population at large. And in towns or villages where the majority of the population obviously requires assistance, this form of rationing makes little sense.

A further option is to charge for social services. Donors and creditors have encouraged

cash-strapped governments to recuperate a part of the cost of social services by charging, or increasing, fees for public education and health services. Of all the measures proposed for raising revenue from local people, this is probably the most ill advised. One study of 39 developing countries found that the introduction of user fees had increased revenues only slightly, while significantly reducing the access of low-income people to basic social services. Other studies have shown that fees reinforce gender inequality, particularly in education. When forced to choose which child can go to school most families are likely to favour boys.

Many citizens' groups and NGOs made these points forcefully at Copenhagen, and their views are now broadly accepted the international development community. Yet, in fact, more governments are resorting to such charges than ever before.

Micro-finance

Governments can attempt to mobilize resources at the grassroots. But so can local people. And they are increasingly likely to do so, with the help of NGOs, donors and international financial institutions that are either investing in micro-credit or attempting more generally to strengthen grassroots financial systems.

Influenced by pioneering experiments like the Grameen Bank in Bangladesh, micro-credit organizations provide small loans at relatively low interest rates to poor people—most frequently women who use the loans for money-making projects. They organize borrowers into small groups and their loan officers monitor the clientele. Although no collateral is required, repayment is virtually guaranteed by peer pressure. Clients with good records are also eligible for better terms on future loans.

Thousands of small enterprises have been started with micro-credit; and by the time of the Social Summit, proponents of this approach were claiming that in the next few decades micro-credit could entirely eliminate poverty. At the Micro-Credit Summit of 1997, presidents and prime ministers, business and financial leaders, and representatives from 1,500 NGOs pledged to provide 100 million of the world's poorest families with small loans by the year 2005. Their programme was noted and approved by international bodies ranging from the Non-Aligned Movement and the Commonwealth Heads of Government to the G-7. In December 1997 the UN General Assembly adopted a resolution recognizing the importance of micro-credit in fighting Third World poverty.

Nevertheless, activists involved in the movement are becoming increasingly sceptical. Small loans may help many people live better in poverty, but they are generally not sufficient to provide an escape from poverty. Nor do they offer clear answers to poor women's deeper problems of disempowerment, since other members of the family frequently use loans made to women. One study of Grameen Bank villages in Bangladesh found that men used 60 per cent of loans granted to women, and that three quarters of the loans were not used in the ways that the Grameen Bank had sanctioned.

There are also doubts about long-term viability, since many micro-credit ventures are financially unsustainable and would collapse without continuing outside support. If these programmes did charge rates of interest sufficiently high to enable them be self-supporting, their loans would be too expensive for most poor borrowers.

Micro-credit is an important tool but, on its own, it is no solution to poverty. Communities do need access to affordable credit, but they also need a broader range of services, including facilities for saving small amounts, as well as institutions that can turn those savings into investments. Thus efforts to improve grassroots financial services in areas that are vastly underserved may provide more solid foundations for

social development than targeted micro-credit schemes can ever build.

Such institutions would be particularly useful for investing remittances—income sent back home by migrant workers in foreign countries. The amount of money pumped into the economies of developing countries by nationals working abroad has been growing rapidly. Between 1970 and 1995, global flows of remittances increased from \$2 billion to around \$70 billion—considerably greater than flows of development assistance. Remittances serve as vital lifelines for hundreds of millions of families. Yet they could have a much greater impact if they could be captured by local financial institutions operating along modern lines, rather than flowing into traditional money-lending circuits or leaking out into large corporations in distant cities.

To meet this need, local institutions would have to count on greater expertise and sufficient start-up capital. They would also need to see changes in national regulatory structures and banking laws. The growing micro-finance movement is attempting to deal with these issues, and it is receiving support from many international organizations. For example, the Asian Development Bank has recently announced that it intends to shift the emphasis in its lending from large infrastructure projects to micro-finance, rural electrification and farm-to-market roads. It will not give money directly to small banking organizations, but instead will promote regulatory reform so that local financial institutions can flourish.

Grassroots co-operative banks and mutual societies were motors of local progress in today's advanced industrial democracies. Can this experience be repeated at the turn of the twenty-first century, when electronic banking is erasing financial borders? Development organizations need to look more closely at the connection between micro-finance and the rapid evolution of the global financial industry.

A balance sheet

Individuals, households and communities have always taken the primary responsibility for financing social development. Their success depends, however, on broader economic and political trends. They will be in a much stronger position if their national economies are growing and if their social rights are being met. And they will advance more consistently and rapidly in a society that encourages solidarity and redistribution.

In many ways, the current environment is not encouraging. National debts are rising, aid is falling as a proportion of donors' GNP, and social protection and social services have weakened. Difficulties in taxing immense wealth have grown more severe, and—relatively speaking—those with less income are paying more.

But the picture is not entirely bleak. At least people in many parts of the world are more aware of the dangers of globalization and are mobilizing to confront them. Creditors and donors are offering debt relief in fits and starts. Governments are considering ways to make better use of the world's wealth by working together to curb tax abuses by individuals and transnational corporations. And even the international financial institutions are starting to doubt many of the hitherto unquestioned truths of neoliberal social policy—including privatization, user fees and targeting.

More generally, there seems to be a greater openness and a willingness to reassess some of the older and increasingly discredited preconceptions of development finance. This is certainly related to increasing pressure from those who have borne the burden of economic crisis and restructuring over the past few decades. They are often struggling to create or strengthen democratic governance under very difficult conditions—a subject to which we now turn.