



# Introductory briefings on the International Economy

Quaker Peace & Social Witness  
Economics Issues Programme

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Of course any omissions or inaccuracies remain the responsibility of QPSW.

The text of this document is available in large print. Please contact QPSW if you would like a copy.

## About these briefings

International economics is important. International trade can mean exotic foods available all year round or it can mean starvation. An expanding global economy has created levels of wealth unprecedented in human history, but has also left countries bankrupt and populations destitute. Industrial and technological progress continues at an ever-accelerating rate, and yet this progress is matched by the depletion of the Earth's resources and the destruction of the environment.

Quaker Peace & Social Witness aims to translate Friends' (Quakers') faith into action. An important aspect of this is the provision of information and support to people who care passionately about and are involved in campaigning for international economic justice. These briefings are part of that support. They set out to provide you with a basic grasp of the international economic system so that you may pursue your own concerns and interests with greater understanding, confidence and, we hope, success.

Included in the centre of the briefings is a pullout glossary that explains technical concepts and describes economic institutions. Where glossary terms are mentioned they are written in **bold** type.

### What is international economics?

'International economics' is a broad term. In the first place it refers to a reality of global movements of goods, services, people and **capital**. In the second, it refers to the theoretical approaches to studying and understanding this reality.

Theoretical approaches to economics are grounded in a set of judgements about what is most important in the field. The approaches that dominated the 19<sup>th</sup> and 20<sup>th</sup> centuries held the accumulation of wealth (economic growth) to be the main goal of economics. As such, the institutions and policies of this period were largely directed towards achieving growth.

As the 20<sup>th</sup> century drew to a close, however, people became increasingly aware of the inadequacy of this conception of the ends of economics. Sustained growth in the international economy has not led to the eradication of poverty. Growing disparities of wealth within and between countries have created numerous political and social problems, especially in light of an increasing emphasis on materialism; on what people have rather than who people are. Furthermore, environmental degradation continues at a furious pace, posing, according to UN Secretary General Ban Ki-Moon, 'at least

as big a threat to humanity as war.'

Presently then, international economics is a collection of contested descriptions of and prescriptions for human behaviour in dealing with the production, distribution and consumption of goods, services and, figuratively speaking, people.

### What is the international economic system?

If our definition of international economics is (necessarily) rather broad and clumsy, we may be more specific in outlining the structures and institutions that constitute the international economic system. This system is best described with reference to two themes: **capitalism** and **globalisation**.

The 19<sup>th</sup> and 20<sup>th</sup> century emphasis on growth as the end of economics has led to the creation of a broadly capitalist international economic order. Narrow government involvement in economic affairs, an emphasis on individual and corporate ownership of the **means of production** and an acceptance that inequality is the price paid for overall wealth growth: these are principles that have been accepted in much of the **developed world**.

Parts of the **developing world** have successfully integrated themselves into the global capitalist economy, though frequently through non-capitalist means. Other developing countries have had the capitalist model thrust upon them, sometimes with disastrous consequences.

International economic institutions such as the **World Trade Organisation (WTO)**, the **International Monetary Fund (IMF)** and the **World Bank Group** have traditionally been dominated by developed countries and have been instrumental in the proliferation of **capitalism**.

Judged by its own criteria the capitalist system has performed well. The post-war period has seen reasonably steady growth in global wealth. Some areas (such as east-Asia) that were very poor 60 years ago have seen impressive reductions in poverty levels. These 'successes', however, disguise or overlook deeper problems of equity and sustainability. While total global wealth has grown, the extent to which this extra wealth has benefited those

most in need is relatively trifling. More people became billionaires in 2006 than in any previous year; at the same time almost half of the world's population subsists on \$2 (about £1) or less a day. This cannot be the most useful distribution of the limited resources available to humanity.

In the long term this problem of equity becomes one of survival. The US, with 5% of the world's population, produces 25% of the world's pollution. If, other things being equal, development means the attainment of an American standard of living by the 95% of the world who live outside the US, then the environmental consequences of this would be devastating. Nevertheless, increased consumption by all is precisely what a capitalist system implies. New economic emphases on equity and environmentalism are urgently needed.

Broadly speaking, '**globalisation**' refers to a 'shrinking' world. Recent decades have seen the rise of individuals and companies whose power rivals that of countries, increased integration of national economies and massive shifts in industry types and locations. As a result, most countries (Britain included) have become heavily dependent on the rest of the world for their economic wellbeing. The increasing ease with which 'global movements of goods, services, people and **capital**' can take place has raised the importance of international cooperation and organisation (e.g. the European Union) as national bodies have floundered in the flux of global economics.

**Globalisation** can facilitate cooperation on issues that affect the whole of humanity (such as combating global warming); it can also facilitate the exploitation of people and the environment. Ultimately then, **globalisation** is what we make of it.

### Quakers and the international economy

As a freethinking group with no creed there is no rigid, homogenous 'Quaker' view of the 'right approach' to the international economy. This said, a commitment to Quaker Testimony inspires an aspiration to what can roughly be termed 'economic justice'; that truth, love and 'that of God in all things' be respected, nurtured and advanced in our economic dealings. Quakers have a long history of

working to promote economic justice, from challenging the established political and economic order of 17<sup>th</sup> century England, to campaigning against Slavery in the 18<sup>th</sup> and 19<sup>th</sup> centuries to the successful Quaker industrialist/philanthropists of the 19<sup>th</sup> and 20<sup>th</sup> centuries. This aspiration to economic justice is as relevant today as ever it was in the past.

This is a Quaker publication; as such the values that we give priority in evaluating the international economic system are Quaker values. Absolute neutrality is impossible to achieve when dealing with such controversial subject matter. To the extent that we have a bias we state it. Nevertheless, an effort has been made to provide a balanced account of the international economic system. We are critical, but we hope that we are not cynical.

This document is structured to present the international economy in a coherent and (fairly) logical manner. You will notice that there is some overlap in the content of the sections. This reflects the interconnectedness of the international economy itself. Divisions have been drawn for the sake of clarity and for ease of referencing.

For further information about any of the issues covered in this pack, or for a free subscription to *Better World Economics*, QPSW's newsletter on international economic justice issues contact:

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## International Trade

Trade has been central to international relations for centuries. Wars have been fought to control trade routes, empires have been built on the treasure amassed through trade and **tariffs** have been used to generate large chunks of government revenue. Today such activities occur less frequently (or at least less obviously). Nevertheless international trade remains a hugely important factor in determining relative national incomes and living standards.

Trading patterns are often a reflection of the political power of a nation abroad and of the structure of the international economy generally. The notion of free trade, for example, might not be so prominent were it not in the interests of powerful states that this be the case.

### Changing trade patterns

Partially as a result of political factors (such as **GATT** and the **WTO**) and partially as a result of technological improvements and an increase in the number of states, world trade has expanded exponentially since 1945. Between 1950 and 2000 the percentage of world **GDP** accounted for by goods exports grew from 5.5% to 18.8%. As World **GDP** has grown substantially over the same period the real increase in trade volume is even more impressive (at today's prices, the 1950 value of merchandise exports was \$62,000 million, compared with \$10,468,000 million in 2005 and \$12,062,000 million in 2006). Growth is clearly one of the major themes in the post-war history of trade.

Another significant theme is the success and failure of developing countries in catching up with the traditional major economies. Some developing countries have increased their economic power to the extent that they are able to compete with the **developed world** in the international marketplace. Singapore for example, between 1950 and 2005, increased the value of its exports from \$1005 million to \$229,649 million. The growth and global integration of larger developing economies such as Brazil, Russia, India and China (the so-called

**BRIC**) is a major development, the implications of which we are only beginning to discover.

Other countries have been far less successful; Malawi, with a population three times that of Singapore, had only achieved exports worth \$520 million by 2005. A peripheral position in the international trade markets tends to result in a lower material standard of living in the countries concerned. When the materials to which access is denied include antiretroviral drugs for the treatment of HIV/AIDS or even food, the necessity of resolving these iniquities becomes clear.

While the *status quo* economic and political thought is in favour of freer trade, there is increasing discontent with the current trade system, even at the highest tables of international economics. The traditional economic powers are increasingly worried about imports from industrialising countries such as China undermining their domestic industries. On the other hand, these rising powers have been frustrated with what they see as the **developed world's** hypocrisy in protecting its industries while demanding that developing countries open their economies to international competition. Meanwhile, the poorest countries remain largely excluded from and, arguably, exploited by the world trade system. That the **WTO's Doha round** of trade talks was suspended in July 2006 illustrates these fears and frustrations.

### Free trade and its discontents

It is important to understand why the doctrine of free trade has been placed at the centre of the current international trading system. There are two main reasons: the theories of **comparative advantage** and of economic competition.

Central to the theory of comparative advantage is the notion that economies should specialise in the production of the goods that they produce best, acquiring the other goods and services that they require through trade. According to the theory, specialisation results in increased efficiency, expanding the possibilities for consumption and raising world income. Every country will have a comparative advantage in producing something, even if

it produces it less efficiently than its trading partners. As such, it is in everyone's interest that trade is maximised and that barriers to trade are removed.

Economies that participate in the free trade regime are obviously more open to foreign competition than economies that pursue **protectionist** policies. It is argued that this competition is good for the world economy as it forces economic actors to produce efficiently or else risk losing custom to foreign competitors. Increased efficiency in a competitive market can facilitate lower prices for consumers and encourage developments in the range of goods and services offered.

These theories provide the logic within which pro-trade policies (such as those advanced by the **WTO**) are grounded. They are, however, criticised on a number of grounds.

In pursuing efficiency and income maximisation both theories tend to ignore the manner in which the benefits of increased efficiency and income are distributed. The post war period has seen global **GDP** increase substantially, but it has also seen huge increases in monetary inequality. In 2002 the Guardian newspaper reported that the top 1% of the world's population was earning as much as the bottom 57%. Inequality has only increased since then.

The theory of comparative advantage fails to consider the significance that specialising in the production of one trade good rather than another can have on a country's economic prospects. It has been argued that the comparative advantage of developing countries lies in the production of primary commodities (such as tea, cocoa or copper ore) and in basic manufacturing, sectors that are generally less profitable than more sophisticated industries. As such, countries specialising in the production of these primary goods need to produce more to achieve income levels comparable with countries specialising in financial services, for example.

The international economic competition facilitated by the free trade system has been criticised for being unfair on industries in less developed economies. These industries tend to be less efficient than

those in established economies and as such are often unable to compete in a free trade environment. This is simply competition doing its job of weeding out the weak; however, it means that these weaker industries never have the opportunity to become more efficient. This situation underpins the status quo distribution of areas of specialisation and, as it makes it more difficult for developing countries to develop, arguably contributes to global economic inequality.

### **The World Trade Organisation**

**Aims:** The World Trade Organisation aims to facilitate global trade through the negotiation and enforcement of trade rules that underpin a free trade agenda. Work carried out under the auspices of the WTO and the agreements that preceded it has led to a gradual reduction in **tariffs**, quotas and other trade barriers since the end of the Second World War.

**Mechanisms:** The WTO serves as a forum for multilateral negotiations on the reduction of trade barriers. In theory, members practice and benefit from **most-favoured-nation treatment**. The WTO also possesses a dispute resolution mechanism with the power to impose its decisions upon member states and to impose penalties for non-compliance with WTO rules.

**Governance:** WTO decision-making, nominally conducted through inclusive negotiations and consensus building, is not so equitable in practice. Developing countries, which represent the majority of the organisation's membership, traditionally have had little say in decision-making. Recent years have seen some developing countries gain strength through unity (e.g. the **G20**) and/or increasing economic power, however the very poorest countries continue to be marginalised from WTO activities.

**Tariff escalation** in the **WTO/GATT** system, makes it difficult for poor countries to serve developed markets. The only sure manner of achieving growth in export revenue for these economies is by producing more of the exported goods. In some cases this is not possible, or where it is possible it may have unwanted side effects (e.g. increasing the supply of timber will require more intensive clearing of forests). Primary products are also

relatively vulnerable to external shocks such as drought or technological innovation (e.g. the advent of fibre optics dealt a severe blow to the copper industry). Compare this situation with that of countries whose 'comparative advantage' lies in the services sector or in advanced manufacturing.

Almost all of today's powerful economies have built up strategic industries away from international competitive markets. It has been argued that developing economies need to be allowed to do the same, employing **protectionist** measures in building up their economies before fully exposing them to the forces of world trade. **WTO** agreements do give developing countries special treatment in complying with rules about opening themselves up to international competition; however, they usually do so only through minor exemptions or delayed deadlines for meeting obligations. The system is doubly unfair as the areas in which less developed countries can compete internationally tend to be those that are most heavily protected by the (supposedly pro-free trade) developed world; witness agricultural protectionism in the EU and US or the '**Bra Wars**' fiasco.

In spite of the obstacles, some formerly developing economies have industrialised successfully in the post war years through pursuing export-oriented trade policies. The 'East Asian Tigers', Hong Kong, Taiwan, Singapore and South Korea have, through strict internal regulation, become fully developed economies. Other Asian and Latin American countries have adopted similar policies in a bid to achieve similar results. While effective engagement with a free trade system has required, for these countries, an internal economic structure that is anything but 'free', their success demonstrates that development and '**convergence**' are possible in a free trade system.

Overall, it is not clear whether the attempts to institutionalise and apply free market trade policies have been successful or not. The world economy has continued to grow in the decades since 1945 indicating that trade liberalisation has been successful in helping to generate wealth. Further, some poor states have improved their economic

lot through trade in this period. On the other hand, it can be argued that free trade has contributed to increasing global inequality. There are states that appear to be condemned to poverty by the current international trading system. It should also be noted that the current international trade regime is not completely free and that **protectionism** in the developed world is an important factor restricting development in poorer countries.

The central issue with free trade is that in focusing on increasing world income it is not focussing on increasing the welfare of the world's population. The two objectives are not mutually exclusive; supporters of free trade argue that it is helping to lift millions from poverty as well as benefiting the rich. However, they are not identical either. More can be done to help the poorest in the world. Change in the international trade regime to this end is possible and necessary.

#### **The Doha Round**

The most recent set of **WTO** negotiations, **the Doha Round**, has been particularly controversial. These talks, dubbed 'the development round', aimed at reducing the protection provided by developed countries to their agricultural and primary commodity sectors as well as reducing the protection provided by developing countries to their manufacturing and services sectors; a classic example of a free-trade agenda. The talks stalled and were indefinitely suspended in July 2006 due to a failure to reach consensus on the mechanics of an agreement. Significantly, groups such as the **G20** enabled developing countries to stand their ground in the face of **developed world** deals that they considered inequitable.

The difficulties in the Doha Round combined with the fact that many **WTO** members are increasingly negotiating **bilateral and regional trade agreements** suggests that the **WTO** system is coming under increasing pressure. Given the vulnerability of poor countries in bilateral negotiations, this is an unwelcome development.

### The environmental costs of trade

It is argued that the environmental costs of trade are seldom taken fully into account, and that if they were then much of the trade that occurs today could not be justified socially, politically or economically. It is estimated that increased transportation of goods and people has resulted in a significant increase in pollution; particularly concerning is the increase in CO<sub>2</sub> levels which has been linked to climate change. Some environmental campaigners argue that a 'Polluter Pays Principle' should be implemented according to which transporters would face higher costs that would be passed on to consumers. Under this system goods would be more likely to be produced near to the point of consumption, thus limiting trade-related environmental damage.

### Changing the trading system

In the last decade there has been a significant increase in the numbers and types of civil society groups who consider the current international trading system to be inequitable and in need of reform. In the UK, The **Trade Justice Movement (TJM)** represents organisations (including QPSW) that are campaigning for trade rules 'weighted to benefit poor people and the environment'. Such campaigning has resulted in some changes to trade policies in the UK and abroad, however there is much more work to be done.

The Fair Trade movement seeks to provide consumers with an alternative choice of products that enable developing country farmers and producers to earn a higher income than would be possible through conventional means. By buying products that have been Fair Trade certified, consumers can ensure that producers are paid better prices and that workers enjoy better conditions than would otherwise be the case. The Fair Trade market is growing fast, but as yet remains relatively small. It is, however, an excellent way for consumers to make a difference within the current trading system.

Although the concepts are linked, Fair Trade is different from Trade Justice as advocated by the **Trade Justice Movement**. Fair trade offers an alternative way of trading, within the current

international trade system that directly helps producers, whilst those advocating Trade Justice are pushing for changes to the international trade system itself

### What you can do

Find out more: QPSW has a number of briefings and resources on the WTO's Doha trade round. See: [www.quaker.org.uk/qpsw](http://www.quaker.org.uk/qpsw)

The Quaker United Nations Office website and quarterly newsletter, the *Geneva Reporter*, feature information about Quaker work to promote a fairer negotiation process at the WTO. For a free subscription to the *Geneva Reporter* contact QUNO at: 13 Avenue du Mervelet, 1209 Geneva or Tel: +41 22 748 48 00 or see [www.quno.org](http://www.quno.org)

The International Centre for Trade and Sustainable Development (ICTSD) is a good source of independent and up to date (although slightly technical) information on WTO negotiations. See [www.ictsd.org](http://www.ictsd.org)

Campaigning: The **Trade Justice Movement** co-ordinates most UK campaigning to improve international trade rules. Specific campaigning actions change according to the specific trade negotiations going on at any particular time. For the most up to date information and resources see [www.tjm.org.uk](http://www.tjm.org.uk)

Buy Fair Trade: By buying Fair Trade certified products you can ensure that small-scale farmers get a fair share of the value of the things they produce or that workers producing goods in factories or larger farms do so in decent conditions.

For more information on Fair Trade products and how your Meeting, school or workplace can support Fair Trade see: [www.fairtrade.org.uk](http://www.fairtrade.org.uk)

## International Finance

International finance is concerned solely with the exchange of **capital** (money), not tangible goods and services. The international capital markets are widely regarded as the central component of the international economic system; most international economic transactions go through the capital markets and they have enormous influence over the 'real' economy (production, employment, wages etc). Since the 1960s the capital markets have expanded in size and importance.

**Capital** flows are vast, larger than any government could hope to control. They are varied, ranging from fairly stable **Official Development Assistance (ODA)** from the richer governments, to private '**hedge funds**' that are constantly moved to the locations where they will make the best return, to **Foreign Direct Investment (FDI)**, investment in one country by firms owned in another country. And they are largely unrestricted.

A distinction should be drawn between public and private finance. Public finance (such as **ODA**), provided by governments, is a relatively stable source of capital that can be used to achieve social goods. Private capital, on the other hand, tends to be more erratic and is directed to the location where it can make the most profit.

As the international capital markets have grown, they have arguably become less stable. The persistence of abject poverty in much of the developing world, financial crises in Latin America, Russia and Asia and huge surpluses and deficits in nations' **balances of payments** have led to scrutiny of the costs and benefits of the capital markets and of the assumptions that underpin the international financial system.

The most significant issues with the international financial system today are its potential for instability, the question of how the system may best be employed to assist the poorer parts of the world, and the issue of international debt. We discuss the first two issues below; debt will be covered in a separate section.

### The International Monetary Fund

**Aims:** A 2005 UN report states that 'the IMF recognizes that its main contribution to the **Millennium Development Goals** (including poverty reduction) is in promoting macroeconomic and financial stability [...] [t]hus, to the extent that poverty reduction conflicts with macroeconomic and financial stability, it is likely to have lower priority...' Given the prominent role of the IMF in managing financial crises in past decades, it is fair to say that 'promoting macroeconomic and financial stability' is the primary aim of the IMF and poverty reduction a subsidiary goal.

**Mechanisms:** The bulk of the IMF's work consists in assessing member states' economies and making economic policy recommendations to address perceived weaknesses. In financial crises, the IMF works to restore economic stability, most prominently through the provision of loans. In both cases, access to loans is conditional on the debtor countries undertaking reforms (ostensibly) designed to avert crises and promote economic stability. Countries in poverty or in crisis have little choice but to accept these conditions.

**Governance:** The IMF voting system is a compromise between the principle of state equality and the need to provide an incentive for states' financial support. Over the years, inflation and the growth of contributions have reduced the significance of states' 'basic' votes relative to those based on contributions. This development has increased the relative influence of rich countries. Restoring developing countries' influence in the decision making process is one of the objectives of the IMF's 2006 reform agenda, the Medium Term Strategy.

### Free flowing capital and IMF crisis management

Open **capital accounts** mean that **capital** is able to move freely to the location, where it will earn the highest returns. If governments restrict the mobility of **capital** by, for example, limiting its use to its country of origin, then where a more productive or profitable investment opportunity is to be found abroad, the restriction on **capital** movement prevents its 'most efficient' use. Theoretically, open

**capital accounts** overcome this problem, enabling more efficient economic activity and generating more wealth. This is the logic underpinning the frequent insistence of the **Bretton Woods Institutions** that a country's capital markets should be opened as a condition of receiving loans.

As restrictions on the movement of **capital** have been lifted the private sector has become a vastly more important source of finance for projects supporting economic growth. Private investment reached a record \$647 billion in 2006 and has been employed successfully in a number of areas around the world (for example in the **BRIC** economies). It is also playing an important role in those African countries deemed stable and profitable enough to attract investment. Private **capital**, however, has its disadvantages. While any investment is usually considered better than none by the poorest countries, the volatility of private **capital** in an open market makes it a far more dangerous source of investment than, for example, **ODA**. Without **capital** controls, **capital** can flow out of an economy just as easily and quickly as it can flow in.

The East Asian crisis of 1997 illustrates this point. In the latter part of the 20th century, parts of East Asia were widely considered to have undergone a miraculous economic transformation, displaying high levels of relatively equitable economic growth. The causes of the 1997 stockmarket crash remain unclear and controversial. What is clear is that the unregulated financial systems in the region meant that very many investors were able to pull their money out very quickly, at the first sign of economic weakness. The herd mentality of investors at that time heightened the crisis resulting in the failure of banks and businesses and in millions of unemployed. Entire communities slid into abject poverty.

The East-Asian economies have since recovered from the shock of 1997, however, the lesson that should be learned from their plight is that open markets do not regulate themselves; they can act against the public interest if left to their own devices. The **IMF**, working with ad hoc private institutions, was fairly successful in confining the Asian crisis to East Asia. It has been similarly successful in limiting

other crises where they have occurred. Success, however, is not guaranteed and the consequences of failure in an integrated world economy would be disastrous.

The manner in which the **IMF** and its partners have dealt with crises has been criticised. 'Bailout loans' given to countries experiencing problems have come with as many as 80 different conditions, designed to restructure the economy. In practice 'restructuring' has often meant cut backs on welfare provision, increases in taxation and other measures harmful to the people of the affected economies. These measures have halted the spread of crises to Western Europe and the US, but at a huge cost to the poor. Critics also argue that this action created an expectation that the **IMF** would bail out banks that made loans unwisely. The technical term for this situation is '**moral hazard**'.

### Does the international financial architecture help the poor?

While an open financial system permits forms of investment and growth that can help lift people from poverty, it does not actively facilitate these forms of investment and growth and, moreover, permits more exploitative financial activities too. The issue of debt is very relevant to this discussion and is dealt with separately below.

In 1999, under pressure from international **civil society**, the **IMF** announced a fresh approach to their management of the international economy, placing the reduction of poverty itself, as opposed to supposed means to that end such as the opening of markets, at the centre of their work. This new approach to assisting the poorest is grounded in documents called **Poverty Reduction Strategy Papers (PRSPs)**. These documents are ostensibly drawn up by poor countries in conjunction with staff from the **IMF** and the **World Bank** and domestic civil society. They describe in detail the policies through which debtor states intend to promote growth and reduce poverty. The **PRSP** approach is intended to tailor assistance to countries' specific needs and also to return ownership of (and therefore accountability for) financial policies to those countries. It

is also hoped that the setting of development targets will provide a more transparent model for effecting and assessing development.

The **IMF's** 2005 report on the progress of the **PRSP** approach essentially stated that the country-specific nature of the policy makes it difficult to draw general conclusions as to its success or failure, but that where the **PRSPs** had been implemented successfully they had demonstrated a degree of success in reducing poverty. The report went on to admit that there was much more work to be done in implementing and (especially) monitoring **PRSP** progress.

The UN Commission for Social Development is more critical, stating that the focus of the **PRSP** approach on growth is too narrow and that it is necessary to place **PRSPs** in a broad context in which all social factors can be addressed. Other groups in **civil society** have argued that **PRSPs** do not constitute a significant shift from the abandoned Structural Adjustment Policy (SAP) approach and that they are still largely enforced on developing countries. QPSW's experience shows that much more can be done in promoting civil society 'ownership' of **PRSPs**.

### Reform of the international financial architecture

Dramatic reform of the international financial architecture is unlikely in the short-term; however a number of initiatives have been set up in an attempt to avoid crises and to mitigate their effects if and when they occur.

Crises in the last two decades have seen the **IMF** shift slightly from its initial position of calling for virtually all restrictions on the movement of **capital** to be lifted. **Capital account liberalisation** is still promoted, however, far more attention is spent on the best process to do this (the 'sequencing' debate). The **IMF** is also keen to 'bail in' the private sector rather than be seen to constantly bail it out. This involves ensuring that investors continue to provide loans to struggling economies, helping them overcome **liquidity** problems, and also the promotion of types of **bonds** that facilitate the restructuring of debt.

Another initiative is the **Financial Stability Forum (FSF)**. Amongst other things the **FSF** is working on ways to increase transparency within financial institutions and improve corporate governance. The **FSF** suffers from a lack of participation from developing and emerging economies, a perennial problem with institutions of this type.

Another proposal is the Tobin Tax- a very small tax levied on all currency transactions to discourage destabilising speculative flows. Although advocated strongly by campaigning groups, doubts have been raised as to how effective such a small tax would be, given the gains that are possible from large currency devaluations, as in the East Asian crisis. There is a lack of political will to implement this type of measure. The United Nations Conference on Financing for Development in 2008 will provide an opportunity to assess the strength of the support for the Tobin Tax.

### What you can do

Find out more: The Bretton Woods Project is a good source of information on the impact of **IMF** policies on developing countries. See [www.brettonwoodsproject.org](http://www.brettonwoodsproject.org)

Support Quaker Work: QPSW's Global Economic Issues Programme is working to promote developing country concerns to policy makers at the **IMF** and **World Bank**. For more information contact 020 7663 1039 or e-mail [robinr@quaker.org.uk](mailto:robinr@quaker.org.uk)

Campaigning: QPSW is a member of the **Jubilee Debt Campaign (JDC)**. **JDC** campaigns for '100% cancellation of unpayable and unfair poor country debts' and for the **IMF** to drop the harmful conditions that it puts on debt relief. For more information on how you can support the campaign see [www.jubileedebtcampaign.org.uk](http://www.jubileedebtcampaign.org.uk)

## Glossary

**The balance of payments** measures the total transactions that a country makes with the rest of the world. It is the sum of the current account and the capital account.

**Bilateral and regional trade agreements** are deals made between small groups of countries intended to reduce barriers to trade. In this respect they further the liberal economic agenda of the World Trade Organisation (WTO). It has, however, been argued that such agreements undermine the spirit of multilateralism and that they can lead to hostility and inter-bloc competition. Furthermore, deals negotiated outside the WTO system can lead to weaker parties losing out. While this is arguably also the case in some WTO agreements, the larger number of developing countries at the WTO means that there is at least an opportunity to pool resources to resist inequitable demands. On a number of occasions developing countries have been pushed into accepting bilateral deals that had been resisted at the WTO.

**Bonds** are financial instruments used by governments and corporations to raise finance. A bond can be likened to an 'IOU' for a given amount of money - usually £100 in the UK. Bonds issued by companies or governments are bought by investors and are designed to be held for a fixed length of time. In return for holding the bond, the issuer

agrees to pay the investor a fixed rate of interest every year. At the end of the holding period, the face value of the bond is repaid. If the investor does not want to hold the bond until it matures it can be sold on the secondary market. UK government bonds are also known as gilt-edged securities or gilts.

**'Bra wars'** refers to the controversy in 2005 in which the EU imposed quotas on Chinese textile exporters in an attempt to protect European textile manufacturers. This action ran counter to the 'free trade' agenda supposedly advanced by the EU.

**Bretton Woods Institutions/system** is another name for the International Monetary Fund (IMF), the World Bank and the international financial regime that they embody and support. These institutions were conceived at the 1944 United Nations Monetary and Financial Conference at the Mount Washington Hotel in Bretton Woods, USA.

**The 'BRIC' economies** is a collective term for the perceived new economic powers, Brasil, Russia, India and China.

**Capital** is any form of wealth that can be employed in the generation of more wealth. 'Real capital' refers to material factors of production (not human labour). In finance capital generally describes money flows available for investment.

**The capital account** is the part of the balance of payments that measures capital flows, that is the sale of assets to foreign countries and the purchase of assets located abroad. Assets are any form in which wealth can be held, including currencies, shares, debt etc.

**Capital account liberalisation** is the process of dismantling capital controls (barriers to the free movement of capital in and out of an economy). Capital account liberalisation is generally advocated by the Bretton Woods institutions and has been implemented in many developed and developing economies. In theory capital account liberalisation brings efficiency gains, however, it also renders economies more vulnerable to speculation and to economic shocks happening elsewhere in the world.

**Capitalism** is an economic system that views growth as the ultimate objective of economic activity. Capitalist theory holds that competition between private firms and individuals, in a context largely free of government involvement, is the most efficient means to this end. Such a scenario is not however conducive to an equitable distribution of resources.

**Civil society** is a loose term referring to non-governmental groups and organisations that promote their common concerns to political decision makers.

**The Common Agricultural Policy (CAP)** is a system that offers support to European farmers through a complex system of subsidies, tariffs and other mechanisms. The CAP provides a measure of financial security to small-scale farmers; however, it tends to benefit large, rich farms to the greatest extent.

The CAP has been criticised for being costly and inefficient. It has resulted in overproduction and artificially high prices for consumers. It also constitutes a major obstacle for those developing countries seeking to export agricultural products to Europe.

**Comparative advantage**, in its simplest form, is the idea that countries should specialise in the production of those goods and services that they produce most efficiently and trade with other countries for the other goods and services that they need. The efficiency gains from specialisation should mean that all countries are able to produce and consume more goods than they could if they produced all of their goods and services domestically. There are many complex elaborations of this theory.

**Convergence** is the process of economic 'catching up' that can occur as less developed countries imitate the technological and managerial techniques that have been successful in the developed world.

**The current account** is the part of the total balance of payments that measures the difference in value of imports and exports of goods and services. A negative current account means that more goods are being imported than exported.

**The Department for International Development (DfID)** is the UK government department responsible for policy on developing countries. DfID co-ordinates the British aid budget.

**Derivatives** are financial instruments that derive their value from other financial products.

**The developed world** refers to a group of countries (most prominently

Western Europe, North America and Japan) that have traditionally had the most advanced industries and largest economies. This group has also been called 'the North' and 'the first world'.

**The developing world** refers to those countries that are poorer and industrially 'inferior' to the developed world, often substantially so. The division between the developed and the developing world is increasingly blurred as some countries have successfully industrialised. The growing assertiveness of the stronger developing countries is an important theme in international economics. The developing world is also known as 'the South' or 'the third world'.

**The Development Assistance Committee (DAC)** is a part of the Organisation for Economic Co-operation and Development (OECD). It is comprised of major aid donors. The DAC serves as a forum in which issues concerning international aid can be discussed. The DAC also collects and publishes statistics on bilateral aid.

**Doha Round** - See box on page 8.

**Economic growth** is an increase in the real (adjusted for inflation) value of an economy.

**Emerging economies** are those developing countries that are attaining levels of industrial and economic development comparable to those in the developed world.

**Export Credit Guarantees (ECGs)** are provided by an exporting country's government to exporters providing goods or services to another government (to encourage exports). If the purchasing government fails to live up to its contractual obligations, the guaranteeing government will make good the contract, but the value of that

payment is added to the national debt of the purchaser. The British export credit guarantee department has been heavily criticised for backing controversial projects such as giving export credits to arms manufacturers.

**Export Processing Zones (EPZs)** are areas within a country set up to attract investment and generally to set up factories assembling goods for exports. Often a government will apply favourable tax structure to goods produced in EPZs and will permit lower labour standards within an EPZ than elsewhere in the country.

**The Financial Stability Forum** is an initiative of the G7 that seeks to promote financial stability within the international capital markets.

**Fixed exchange rates** occur where governments set and fix the value of their currency relative to other currencies. A government maintains the value of its currency through manipulation of currency reserves. If, for example, market transactions result in the value of a currency rising above the fixed point, government will sell reserves of its own currency thus increasing supplies on the international market and lowering the value to the predetermined level. If the relative value of currency is falling, the home government (perhaps in conjunction with others) will buy its own currency and add them to reserves.

**Floating exchange rates** refers to a system where the relative values of currencies are determined solely by the relative market supply and demand for them. In a floating exchange rate system, governments do not intervene in currency markets to maintain currency values.

**Foreign Direct Investment (FDI)** is investment undertaken, generally by

transnational corporations, in countries other than that in which they are based. FDI includes entirely new 'greenfield' investments and joint ventures with local companies. It also includes takeovers of existing companies or the purchase of a significant share in them, so long as this is enough to exercise some degree of control over operations. (The degree of control is crucial to this definition: investment that does not give control is known as portfolio investment. Portfolio investment includes investments in other financial instruments such as bonds or derivatives.)

**The G7 (Group of Seven)** consists of the seven richest countries. Current membership of the G7 is Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. The finance ministers of the G7 meet periodically to discuss issues of international economic importance. This group is extremely powerful and its members in effect control the multilateral Bretton Woods Institutions.

**The G8 (Group of Eight)** is the G7 with the addition of Russia.

**The G20 (The Group of Twenty)** consists of a number of developing and 'transition' economies. It was formed in order to mobilise the collective strength of these countries in WTO negotiations and, given the inability of the developed world to get its own way in the Doha round, has to some extent demonstrated its effectiveness.

**The G77 (The Group of Seventy-Seven)** was formed in response to the view (propounded primarily by Argentinean economist Raul Prebisch) that the liberal international economic order disadvantaged the developing world. Operating largely within the structures of the United Nations, the G77 has campaigned for a

more equitable international economic order.

**GDP/ GNP** are different measures of national income. GDP or Gross Domestic Product measures the total value of production occurring within a country, regardless of the nationality of the agents undertaking production and whether or not income derived from it remains within the economy. GNP or Gross National Product takes account of the fact that money flows into an economy from assets owned by domestic residents but which are situated abroad, and also that money will flow out of the domestic economy by assets owned by foreign nationals. GDP and GNP per head are often taken as measurements of the state of economic development, however this can be misleading as these measurements do not take into account qualitative factors and non-monetary transactions, for example childcare provided on a non-payment basis. Other measurements may be more suitable for assessing levels of economic development in certain situations, for example by looking at the proportion of children enrolled in schools, the number of doctors per so many head of population etc.

**The General Agreement on Tariffs and Trade (GATT)** is an agreement promoting the liberalisation of trade in goods by committing signatories to lowering tariffs. GATT was incorporated into the structure of the World Trade Organisation in 1994 where it forms one of the three main WTO agreements (see also GATS and TRIPs).

**The General Agreement on Trade in Services (GATS)** is one of the three main WTO agreements. GATS deal with the liberalisation of trade in services (see also GATT and TRIPs).

**Globalisation** is an ambiguous and controversial term that cannot be fully described here. Essentially it refers to the changes in human society that are the result of rapid technological progress and increased international integration.

### **The Guidelines for Multinational Enterprises**

([www.oecd.org/daf/investment/guidelines](http://www.oecd.org/daf/investment/guidelines)) are recommendations addressed by countries' governments to multinational enterprises operating in or from those countries. They provide principles and standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation.

**Heavily Indebted Poor Countries (HIPC)** are countries with very high levels of poverty that have been granted debt relief provided they fulfil certain conditions set out initially by the IMF and World Bank.

**Hedge funds** are international investment funds bought into by wealthy individuals. Hedge funds make high-risk, speculative investments, often with borrowed money. Although hedge funds can achieve very high returns on investments they can also have a huge destabilising impact on financial markets.

**International Bank for Reconstruction and Development (IBRD)** is the main source of the World Bank Group's lending. It lends to relatively rich developing countries for projects (such as the improvement of infrastructure) or for 'adjustment programmes' designed to increase economic efficiency. IBRD loans incur interest slightly below market rates, have a grace period of around five

years and a repayment period of fifteen to twenty years.

**International capital markets** are the means through which capital is transferred from those who possess surplus capital to those who require capital investment.

### **International Development**

**Association (IDA)** is the arm of the World Bank which funds government projects in countries that are too poor to borrow at IBRD rates. IDA loans are known as credits and are interest free, although do incur a small administrative charge. Grace and repayment periods are about five and forty years respectively. The IDA cannot borrow from the commercial sector because of the concessionary nature of its loans. Its capital is thus considerably more limited than the IBRD and its lending is significantly less.

### **The International Finance**

**Corporation (IFC)** is the arm of the World Bank that provides financing at market rates, for private sector projects that would have difficulty in obtaining private sector credit. The role of the IFC has grown significantly as the Group has placed greater emphasis on growth driven by the private sector.

### **The international financial**

**architecture** is the name given to the set of institutions and agreements that govern, survey and regulate international capital flows.

**International Monetary Fund** – see box on page 10.

**The Jubilee Debt Campaign (JDC)** is a pressure group that campaigns for an end to poor country indebtedness to the developed world. It is the successor to the 'Jubilee 2000' and 'Drop the Debt' campaigns.

**Liberalisation** is the implementation of policies that aim to reduce regulatory interference with price levels and markets.

**Liquidity** refers to the state of having enough resources to satisfy present demands.

**The means of production** are those factors, including labour, capital and machinery, which can be used in the generation of wealth.

**The Millennium Development Goals** were formulated in the 1990s at a series of United Nations conferences. Amongst the aims are: the reduction of the number of people in poverty by one half, universal primary education in all countries, a reduction of two-thirds in the infant mortality rate by 2015 and the elimination of gender disparities in primary and secondary education by 2005.

**The Multilateral Investment Guarantee Agency (MIGA)** is the part of the World Bank that provides political risk insurance to companies investing in developing countries. This includes cover for eventualities such as expropriation of assets by the host country government.

**Moral hazard** occurs where investors are protected, for example by governments, to the extent that they no longer adequately consider the risks of investment decisions.

**Most Favoured Nation (MFN)** is one of the underpinning principles of the GATT and subsequently WTO agreements. MFN states that countries should not discriminate between their WTO/GATT trading partners. If for example, a tariff reduction of 50% is offered to one trading partner on good X then all other countries that export good X must be

allowed to benefit from the same tariff reduction.

**The neo-liberal paradigm of economic thought** is the prevailing school of economic thought at present, employed particularly by the major industrial powers and international financial institutions. Neo-liberalism focuses on the primacy of individual 'rational' economic decision making, leading to an optimal overall situation. Neo-liberal *laissez faire* policies advocate the rolling back of the state sector within the economy. Also called 'neo-classical'.

**Non-governmental organizations (NGOs)** are entities that are not directly supported by a government and that do not aspire to form a government themselves.

**Official Development Assistance (ODA)** is finance provided by governments to assist with foreign development. The OECD definition of ODA stipulates that this finance must have a grant element of at least 25% to be classified as ODA.

**The Organisation for Economic Co-operation and Development (OECD)** is an organisation consisting of developed countries that accept democratic and free-market principles. Its main activities are the gathering and distributing of information that facilitates the promotion of these principles.

**The Organisation of Petroleum Exporting Countries (OPEC)** is an international cartel, consisting of major oil exporting countries. Saudi Arabia is a particularly important member. OPEC can control oil prices through fixing production levels. The group was particularly powerful in the 1970s when it was responsible for multiple increases in the price of oil in 1973 and

1979. This action had huge economic implications for the rest of the world.

**The Paris Club** is an informal grouping of representatives of the export credit guarantee departments of governments that hold developing and middle-income country debt. The Paris Club meets occasionally to consider multilateral debt relief for countries that have been approved by the IMF.

**A Poverty Reduction Strategy Paper (PRSP)** is a document developed by the poorest countries in conjunction with the IMF and World Bank laying down a national strategy for the reduction of poverty. The PRSP forms the basis for IMF and World Bank lending and also is a precondition for receiving debt relief under the HIPC initiative. The PRSP process was formulated as a response to criticisms of the IMF and World Bank Group's previous non-consultative approach to country analysis. The PRSP process is designed to provide greater ownership by the country concerned, involving government and civil society to a greater extent.

**Protectionism** is the practice of using trade controls (such as tariffs) to 'protect' inefficient domestic industries from foreign competition. States pursuing such trade policies are called protectionist.

**'Race to the bottom'** describes the competitive reduction of regulatory, labour and environmental standards in an effort to attract foreign capital.

**Soft loans** are loans made on more favourable terms than would otherwise be available on the international money markets. The IMF, World Bank and regional development banks make soft loans. They are also often used as part of bilateral aid programmes.

**Speculation** is the practice of making large, short-term investments to profitable sectors, moving the money when a more profitable opportunity arises elsewhere.

**Tariffs** are taxes applied to imported goods and services.

**Tariff escalation** is an aspect of the WTO system in which raw materials have low tariff rates, which increase with the degree of processing undergone, discouraging developing countries from setting up their own advanced industries.

**Terms of trade** refers to the price that a country receives for its exports relative to that it pays for imports. If terms of trade are decreasing it means that the relative prices of exports are falling. In this case, importing a fixed quantity of goods and services will require an increased quantity of exports. Many developing countries are facing deteriorating terms of trade due to falling prices of primary commodities in the international markets. As such, these countries are struggling to maintain export earnings.

**The Trade Justice Movement (TJM)** campaigns for changes in the international economic system that would gear it towards assisting developing countries over maximising economic growth generally.

**(The Agreement on) Trade Related Aspects of Intellectual Property Rights (TRIPs)** is one of the three main World Trade Organisation agreements (see also GATT and GATS). It seeks to protect international property rights by extending Western style patenting to a range of things including copyrights, trademarks, circuit designs, trade secrets and pharmaceutical products.

Providing greater intellectual property protection should provide greater incentives for research and invention. In the short run however, while patents are valid higher prices can be charged for the use of the product of the research. In such cases it is likely that access to these products will be restricted.

**The Washington consensus** is the prevalent neo-classical school of economic thought and analysis developed and used particularly by the World Bank Group and IMF. This generally advocates the implementation of free-market policies (reduction of governmental role within an economy).

**The United Nations Conference on Trade and Development (UNCTAD)** is the most prominent policy discussion forum, research engine and 'academy' for those states and NGOs that seek to promote an international economic system that is geared primarily towards promoting development rather than growth.

**World Bank and World Bank Group** – see box on page 16.

**World Trade Organisation** – see box on page 7.

## International Debt

International debt is much like the debt incurred by individuals or firms in many respects. Countries wishing to spend beyond their current means may seek to borrow from a number of sources. The level of interest paid on this borrowing will vary depending on the lender and the perceived risk of lending, and the money thus raised can be spent wisely or foolishly. The key difference between the borrowing of individuals or firms and state borrowing is the immeasurably higher stakes in the latter case.

Where state debt is at a moderate level it can be useful for economic development. It can, for example, be used to invest in infrastructure or in the provision of essential services. Such investment can facilitate growth that enables the repaying of debts as well as raising living standards generally. Unfortunately, as with individuals and firms, the reality of indebtedness is often an unhappy one. Many developing countries have run up vast debts and yet remain in poverty. The **Jubilee Debt Campaign (JDC)** notes that 'the world's most impoverished countries are forced to pay over \$100 million EVERY DAY [their caps] to the rich world in debt repayments, while poverty kills millions of their people.'

### Commercial debt

Debt can be either commercial or official in nature. The commercial debt crisis had its origins in 1973 when the Organisation of Petroleum Exporting Countries (OPEC) engineered a rise in oil prices, boosting oil revenues in those countries. Oil producers then deposited their extra income with European, Japanese and North American banks that, in turn, were keen to lend the funds on profitably. Low but variable interest loans, usually of dollars, were quickly made to governments and government-backed corporations in countries such as Mexico and Brazil, which at the time had good economic prospects. Although debtors were encouraged to increase exports to service their debts, loans were sometimes used unproductively on prestige schemes or military spending. Some of the money

even found its way into private bank accounts. As interest rates rose, the debt burden became more severe until, in 1982, Mexico announced that it was unable to keep up repayments. A crisis of confidence in the international banking system followed; collapse was only avoided by bailout packages undertaken by the **IMF** in conjunction with creditors.

### Official debt

Many of the poorest countries, being seen as uncreditworthy, have not obtained commercial loans but are heavily affected by official debt. The **World Bank Group** has provided loans on a multilateral basis (mainly for long-term structural development projects, e.g. road-building) to developing countries almost since its formation in 1946, **IMF** development loans have increased more recently, since the 1982 crisis and regional development banks are an increasingly important source of loans. Bilateral official debt originates from straightforward loans from one government to another and also from the provision of **export credit guarantees (ECGs)**.

A reason given for past and present provision of debt is the potential that loans have for facilitating the expansion of exports. Increased exports should then provide money to pay back the debt while simultaneously allowing people to become better off. The reality of indebtedness rarely coincides with this ideal. Increased commodity exports from developing countries across the board (often advised by the **IMF**) have resulted in falling prices and deterioration in their terms of trade. Furthermore, trade barriers in developed countries make it even harder for debtors to gain substantially from trade. We have already noted the arguments in favour of an international trading system that offers more to the poorest countries.

### Criticisms of 'debt-led' growth

Some analysts question the whole idea of debt-led growth and argue that a different basis to the international monetary and economic system is required. It is, for instance, argued that poverty is better reduced through provision of effective health care, education and training or other micro-initiatives, rather than through

a reliance on large projects supported by borrowed foreign **capital**.

For some countries, repaying debts has proved impossible, even with the most stringent of 'adjustment' programmes. Furthermore, the human cost of maintaining repayments has often been devastating. Many Latin American and African countries have been forced to cut social spending in an effort to keep up with their repayments. As a result, real incomes and living standards in some places are lower today than they were in the 1970s. In spite of all of this, keeping up repayments, especially to the **IMF** and **World Bank**, is seen as imperative. The influence of these institutions is crucial as their continued provision of credit is effectively a vote of confidence in the economic management of a country. Without this countries find it almost impossible to attract private sector investment.

### Debt relief

The case for debt relief is strong, especially for those earmarked as **Heavily Indebted Poor Countries (HIPC)** whose debt levels are so high relative to their capacity to generate income that repayment is impossible. In many cases these countries have repaid more than the original sum of their loans, yet due to spiralling interest charges their burden of debt persists. Debt campaigners argue that this is morally wrong and also highlight the apparent double standard that richer countries such as the UK and Germany have gained from generous debt relief in the past.

Since the Latin-American debt crisis of 1982 various schemes have been presented to provide the most indebted countries with relief. Within the commercial sector the **IMF** and **World Bank** have provided money to help banks write off some debts.

Significant progress has been made on bilateral debt relief, particularly through the **Paris Club** meetings. The **G8** governments have committed to cancelling almost 100% of the debt owed to them by **HIPC** countries. The UK government has been one of the most progressive in pressing for debt relief.

As the levels of commercial debt have fallen, multilateral debt has in many cases risen. This has attracted much criticism, notably from the **JDC**. In response, and with the realisation that much of the debt could never be repaid, the **Bretton Woods Institutions** launched the **HIPC** and subsequently the enhanced **HIPC** initiatives, designed to reduce the debts of the poorest countries. Following the 2005 G8 summit in Gleneagles, the **World Bank** joined the **IMF** and the African Development Bank in implementing the Multilateral Debt Relief Initiative (MDRI). This initiative has resulted in 100 percent relief of the debt owed to these three institutions by all countries completing the **HIPC** Initiative. The MDRI will effectively double the volume of debt relief already expected from the enhanced **HIPC** Initiative.

While this progress should be welcomed, campaigners have been frustrated with the slow pace and limited application of debt relief. In particular they have criticised the 'sustainability thresholds' used to determine the extent to which countries are eligible for debt relief. These are said to be too strict and not based on the development needs of the debtor. Debtors only qualify for relief under the enhanced **HIPC** initiative if their debt to export ratio is greater than 150%. Further, countries are only permitted to apply for the **HIPC** initiative if they have first passed through the **IMF's Poverty Reduction Strategy Paper (PRSP)** process, with the extensive conditions and restrictions that this implies. This contrasts with the generous relief enjoyed by richer countries in the past and arguably does little to take account of the structural insolvency of many of the poorest countries.

### What can you do?

Campaigning: QPSW is a member of the **Jubilee Debt Campaign (JDC)**. **JDC** campaigns for '100% cancellation of unpayable and unfair poor country debts' and for the **IMF** to drop the harmful conditions that it puts on debt relief. For more information on how you can support the campaign see [www.jubileedebtcampaign.org.uk](http://www.jubileedebtcampaign.org.uk)

## International Aid

In 2006 the Secretary-General of the UN reported on the progress made since 1997 in eliminating poverty. The report stated that if current trends continued, the **Millennium Development Goal** of halving world poverty (defined as living on \$1 or less a day) by 2015 would be met. However, it also emphasised the regional disparities in success. While poverty rates were improving at an impressive rate in East Asia, progress in Latin America and the Caribbean was slow; progress in sub-Saharan Africa remained well off target and the number of people in poverty in Europe and central Asia actually increased. Clearly more must be done.

International aid is an obvious mechanism for the redistribution of wealth and an important means through which the international community can work to reduce poverty. Furthermore, the provision of aid has been conceived as a moral obligation on the rich to assist the poor. There is, however, considerable debate regarding the extent to which aid programmes are effective and the motives behind the provision of aid.

### What is international aid?

A broad definition of international aid is the 'concessional transfer of resources from one country to another'. Aid can be provided by the official sector, through governments or multilateral institutions such as the **World Bank Group**; it can also be provided by the non-official sector such as non-governmental organisations. The forms that aid can take range from outright grants of cash to be used to fund general programmes or specific projects, to 'soft' loans repayable with interest. Aid might also consist of direct provision of resources, such as food. Another common form of aid is 'technical assistance' or advice by donors. Although financing from the unofficial sector (e.g. charities) is by no means insignificant, this briefing focuses on aid from official sources.

Unsurprisingly international aid tends to originate in the developed world, although several middle-income and **OPEC** countries are also aid donors. Most donors give aid through multilateral channels as

well as their own bilateral programmes. A prominent mechanism for the multilateral provision of aid is the **Development Assistance Committee (DAC)** of the **Organisation for Economic Co-operation and Development (OECD)**. The **DAC** calls official aid for the poorest countries 'Official Development Assistance' (**ODA**) and for those developing countries that are slightly better off, 'Official Assistance' (**OA**). The **DAC** has a narrower definition of aid than that given above in that the main objective of a flow of resources must be the promotion of economic development (although this is sometimes questioned – see below). In addition the flow must have a grant element of at least 25%. This figure has been criticised by groups who feel that 'aid' should have a higher grant element.

Agencies such as the United Nations Development Programme, the UN Food and Agriculture Association and the European Union's European Development Fund also provide aid on a multilateral basis. Depending on the definition of aid used, the **World Bank Group** and regional development banks can also be considered sources, although only loans from the **International Development Association** arm of the **World Bank Group** might be considered to provide **ODA** with a large grant element.

### Is enough aid given?

In 1970 the United Nations General Assembly set a target that the rich countries should provide 0.7% of **GNP** as **ODA**. Although this figure is purely recommendatory, it is generally accepted by the international community and has been regularly reiterated since. Unfortunately, very few countries even come close to attaining this. In 2005 out of the 22 **DAC** members only five, Denmark, Luxembourg, the Netherlands, Norway and Sweden surpassed the 0.7% target. In 2006 a UK **Department for International Development** white paper on international development affirmed a commitment to reaching the target by 2013 and the UK has significantly increased its aid budget. Nevertheless, for the year 2005, Britain's aid contributions still only represented 0.47% of **GNP**. Total **ODA** from members

of the **DAC** fell by 5.1% in 2006 to \$103.9 billion. This represents 0.3% of members' combined GNP, well short of the 0.7% target.

### **The World Bank Group**

**Aims:** The **World Bank** was created to provide loans for the reconstruction of post-war Western Europe. With the recovery of Europe the Bank has focused on developing countries where it states that it exists to 'advance economic growth and reduce poverty'.

**Mechanisms:** These aims are pursued through the provision of finance for development projects at better rates than those developing countries would find in the marketplace. The **World Bank Group** consists of four bodies: the **International Bank for Reconstruction and Development (IBRD)**, the **International Development Association (IDA)**, the **International Finance Corporation (IFC)** and the **Multilateral Investment Guarantee Agency (MIGA)**. The term '**World Bank**' generally refers to the **IBRD** and **IDA**, whereas the **World Bank Group** is used to refer to the institutions collectively.

**Governance:** The decision-making procedures at the **World Bank Group** are similar to those at the IMF in that membership provides certain minimum voting rights with additional influence determined according to financial contributions. The US, with 16.4% of the votes (in November 2006) is able to block fundamental changes to the Bank's structure as these require an 85% supermajority. The US has traditionally appointed the President of the **World Bank Group**.

### **He who pays the piper calls the tune?**

Evidence of how official aid flows are distributed seems to bear out the theory that the motivations for the provision of aid are a mixture of altruism, guilt and self-interest. Aid programmes past and present have been used for political purposes. This was especially the case during the Cold War, however a glance to the top ten recipient countries of **DAC** aid (2005 data

in order: Iraq, Nigeria, China, Afghanistan, Indonesia, India, Ghana, Egypt, Vietnam, Sudan) demonstrates the very significant extent to which aid flows continue to reflect past or present political-economic relationships.

Bilateral aid is frequently 'tied' to other contracts that are economically beneficial to the donor. For example, aid might be given on the condition that it is used to purchase goods or engage a contractor from the donor country. Japan, France and Denmark in particular have large tied aid programmes. The **OECD** estimates that on average, tying aid reduces its efficacy by around 25%, as recipients are unable to shop around to find the cheapest source of goods. In addition, tying aid to donor goods or services may inhibit the growth of local capacity and ability of the recipient to become less dependent on assistance in future.

Despite the fact that untying of aid has been on the **DAC** agenda for several years, progress has been slow – although recent developments perhaps give cause for optimism. In previous negotiations several **DAC** members claimed that their industries would suffer and that it would be difficult to maintain domestic support for aid budgets if they untied aid. Provisional recommendations have since been made which have seen the untying of a good proportion of **ODA**. However, this recommendation does not extend to all types of aid or to the better off developing countries. Some governments, including the UK's, have made unilateral steps towards untying and have been instrumental in bringing about slow change at the multilateral level.

### **Making aid more effective**

There is considerable debate about the extent to which aid is effective. While there are many success stories, there are also failures. Most accounts acknowledge that aid programmes are generally 'a good thing', if only for the reason that their absence would have resulted in poverty levels even higher than they are today. It has been argued that existing aid programmes could be made more effective through greater emphasis on recipient rather than donor needs and by developing programmes that have a

greater impact on poverty. There have also been calls for better integration of aid programmes. The **Poverty Reduction Strategy Papers (PRSPs)** required by the **IMF** and **World Bank** are a means to this end. The provision of international aid and its efficacy in reaching the **Millennium Development Goals** is also likely to be a key topic at the United Nations Conference on Financing for Development to be held in 2008.

Controversially, it has been suggested that as developing countries become more open to private (non-aid) flows of **capital** from the international money markets, private financing will become more important for development and therefore maintaining and increasing levels of official aid will become less important. However, while private financial flows have risen to some developing countries, it is not realistic to assume that they can replace official assistance in the short to medium term. Private finance has tended to be concentrated in a few countries with better prospects. Private finance is also less likely to be stable than official aid. Past financial crashes warn us against the dangers that it can bring.

### What you can do

Find out More: For information on the forthcoming United Nations Conference on Financing for Development and what the UN is doing to promote more effective development assistance generally see: [www.un.org/esa/ffd](http://www.un.org/esa/ffd)

Current statistics on UK and other **OECD** country aid programmes can be found at [www.dfid.gov.uk](http://www.dfid.gov.uk) and [www.oecd.org/dac](http://www.oecd.org/dac)

Campaigning: Following **G8** commitments on aid in 2005, there are no current popular campaigns in the UK to encourage governments to increase aid levels. A number of **NGOs** will be working to monitor the implementation of those commitments and it is possible that some of them may organise campaigning on this issue in future.

## Transnational Corporations

Transnational Corporations (TNCs) are companies that own and controls assets in more than one country; they are one of the most visible faces of **globalisation**. Brand names such as Coca-Cola, McDonalds, Shell and Exxon are recognised in almost every country in the world and the activities of companies such as these dominate international production and trade. Most of the largest TNCs originate in developed countries and the largest 100 TNCs together employ over 6 million people.

Rich and poor country governments alike generally welcome **Foreign Direct Investment (FDI)** by TNCs. It is seen as a mechanism through which new jobs can be created, best practice imported and new technologies and skills introduced. This, it is hoped, will increase the economic capacity of individuals and of the economy as a whole. In poor countries TNCs bring with them expectations of faster development, the reduction of poverty and of **convergence** with the standards of living enjoyed in rich industrialised nations.

Others maintain that this view is at best overoptimistic. TNCs have the potential to do all the above. Certainly their presence is likely to be more stable and constructive than short-term **capital** flows (such as stocks or bank deposits). However, the evidence does not present a clear idea of the overall effects of **FDI**. In some areas such as South East Asia, the activities of TNCs have been an important vehicle for effective and relatively equitable economic development. However other sectors have seen TNC **FDI** associated with the perpetuation of economic inequalities, tensions between social groups and human rights abuses.

Between 1980 and 2004, **FDI** increased 16 fold, from \$132 to \$2,232.9 billions. While this investment has generally supported economic growth in recipient countries, the extent to which it has benefited poor people varies substantially. We mentioned that a number of East-Asian countries have seen relatively equitable growth in recent decades. This

growth is partially attributable to **FDI**. Other developing countries, particularly in sub-Saharan Africa, have not seen such a benign dispersion of the benefits of growth. In these countries investment has tended to be directed towards the exploitation of mineral and oil wealth as opposed to the development of more sophisticated sectors. This investment has had little impact on employment or per capita incomes and, arguably, has been harmful in some instances.

### Problems of governance

Many of the problems associated with TNCs stem from the fact that they are hugely powerful and yet, in many respects, unregulated. As the international economic regimes governing trade and investment flows have become liberalised, opportunities for TNCs have increased. Although there are numerous voluntary guidelines, there is no binding global legislation on issues such as environmental regulation, workers rights, competition policy and taxation. Because national laws (and enforcement of them) differ widely, TNCs are able to take advantage of these differences by, for example, shifting their activities to areas of lower regulation or lower labour costs.

This has led to fears of a '**race to the bottom**'. Many governments are so keen to attract TNCs that it can seem as though there is an active competition to offer them the most attractive environment. In some instances this has meant cutting bureaucratic procedures or the creation of 'one stop shops' to simplify licensing and the granting of permits etc; in others it has entailed tax cuts, subsidies, suppression of union activities or 'turning a blind eye' to labour conditions in order to attract investment.

Governments in a number of poorer countries have created '**Export Processing Zones**' filled with poorly regulated factories assembling goods for the export market; however, corporate power over government is not limited to poor countries and TNC influence over the structure of legislation is in evidence in the developed world too.

The **WTO** is accused of benefiting TNCs against the wider public interest. The

global extension of intellectual property rights embodied in **TRIPS**, for example, has acted as a restriction on the provision of the anti-retroviral drugs for the treatment of HIV/AIDS. Any restriction of this sort will cost lives.

### Corporate power

The financial power of TNCs can translate into political power. Industrial associations or individual companies often form powerful lobby groups to try and influence the decisions of actors in governmental bodies (e.g. the **WTO**). An example of this is the campaign to extend and protect intellectual property rights conducted in recent years by pharmaceutical companies.

Further, the global reach and huge markets of many TNCs means that they can exert great power over their supply chains. This is particularly evident in markets where a few large firms dominate the market (e.g. tea, cocoa or coffee). These firms can control supply price levels to the detriment of growers and labourers. Moreover, land that once enabled local people to be self-sufficient is now used for export 'cash' crops - often required as part of **IMF** poverty reduction strategies. As a result basic foodstuffs must be imported at a higher cost. The steadily deteriorating terms of trade for exporters of primary commodities are, to some extent, a testament to this fact.

Lastly, many consider global branding and mega-companies a threat to cultural variety and democracy. As cities across the world are becoming more and more alike, some lament the erosion of differences between national cultures.

### Moves towards greater corporate social responsibility

Recent decades have seen the increasing prominence of movements designed to check the power of TNCs. Notable methods of encouraging corporate social responsibility (CSR) include legislation to that end, voluntary codes of conduct and active investment. These are examined below.

There are increasing trends which indicate that in the future UK, US, Canadian and Australian courts may take more of an

active role in regulating TNCs that are based in their own countries for incidents occurring abroad. In the UK, the House of Lords ruled that South Africans who had worked in the former South African mines and mills of British firm Cape plc could sue the company in England for compensation for contracting asbestos-related diseases. This can be seen as setting an important precedent that British firms operating overseas can be held legally responsible in UK courts for their actions. However, cases that push the boundaries of existing legislation in this way are controversial and very rare, partly due to the expense and technical difficulty involved in pursuing them. Further, since November 2006, Directors of British companies have been required by law to consider the environmental and social implications of their actions. There is not, however, any legal obligation for them to act on their 'considerations' – and what this legislation actually means is yet to be tested in court.

Most other initiatives encouraging CSR are voluntary or made up of non-enforceable guidelines. A well-known example is the United Nations Global Compact. Another initiative, the **Guidelines for Multinational Enterprises** developed by the **Organisation for Economic Co-operation and Development (OECD)**, does have a facility for complaints to be made to governments about the conduct of TNCs based within their jurisdiction. Governments receiving such complaints are obliged to investigate any wrongdoings, however this process can be both lengthy and complicated. Initiatives like these have, in some cases, prompted TNCs to adopt their own ethical policy statements and guidelines. While these are sometimes quite comprehensive, civil society groups such as the members of the Corporate Responsibility (CORE) coalition frequently point out that codes of conduct are not always successfully implemented.

Lastly, the growing Socially Responsible Investment movement is another way in which some of the largest companies are being influenced. Many investors will include companies whose actions they consider less than perfect in their

portfolios, but will try to use their influence to modify corporate behaviour. This movement is still relatively small, however it is growing and may become an important tool in the future.

### What you can do

Find out More: There are a number of organisations that are critical of the activities of transactional corporations. These include Corporate Watch, a UK based research organisation providing information for campaigners opposing corporate activities. See: [www.corporatewatch.org.uk](http://www.corporatewatch.org.uk) or contact: Corporate Watch, 16B Cherwell St, Oxford, OX4 1BG Tel: +44 (0)1865 791 391

The World Business Council for Sustainable Development is a group of over 150 leading major global companies working on sustainability and corporate responsibility projects. Their website (<http://www.wbcasd.ch>) presents the alternative view of how business can make a contribution to sustainable development.

The Ethical Trading Initiative works with UK retail companies, trade unions and **NGOs** (including QPSW) to promote good conditions for workers who produce many of the goods that end up on our high street. For more information see [www.ethicaltrade.org.uk](http://www.ethicaltrade.org.uk)

Use your 'consumer power': The actions we take as consumers can have a significant impact on companies of all types – particularly if lots of people are taking similar actions and they take the time to inform companies about the motivation for their actions. *Ethical Consumer* magazine is a good source of information on companies, consumer campaigns and also publishes 'buyers guides' which rate a range of goods from an ethical perspective.

Using Investments: If you have investments, consider whether your money is invested in companies whose activities you support. Can you use your position as an investor to promote change within companies?

For more information on Ethical Investment and Shareholder Action contact the Economic Issues Programme

at 020 7663 1039 or e-mail [suzannei@quaker.org.uk](mailto:suzannei@quaker.org.uk). Organisations like the Ethical Investment Research Service ([www.eiris.org](http://www.eiris.org)) and the UK Social Investment Forum ([www.uksif.org](http://www.uksif.org)) also have useful information on their websites.

QPSW is a member of the Ecumenical Council for Corporate Responsibility; an organisation that encourages religious investors to use their influence as shareholders to promote corporate responsibility on the part of companies in which they invest. For more information on how you can get involved see [www.eccr.org.uk](http://www.eccr.org.uk) or contact the Economic Issues programme at 020 7663 1039 or e-mail [suzannei@quaker.org.uk](mailto:suzannei@quaker.org.uk)

Campaigns: The CORE coalition is campaigning for better regulation of Transnational Corporations. For information on the latest campaign developments and actions you can take see: [www.corporate-responsibility.org](http://www.corporate-responsibility.org)

## References and Further Reading

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Bretton Woods Project resources: The Bretton Woods Project provides independent information on the IMF and World Bank with a particular focus on environmental and

social concerns. The project produces in-depth briefings and a regular newsletter. See [www.brettonwoodsproject.org](http://www.brettonwoodsproject.org)

IMF Fact Sheets. Available at [www.imf.org/external/np/exr/facts/eng/list.aspx](http://www.imf.org/external/np/exr/facts/eng/list.aspx)

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## Notes

