Putting Financing for Development in Perspective: The South Finances the North

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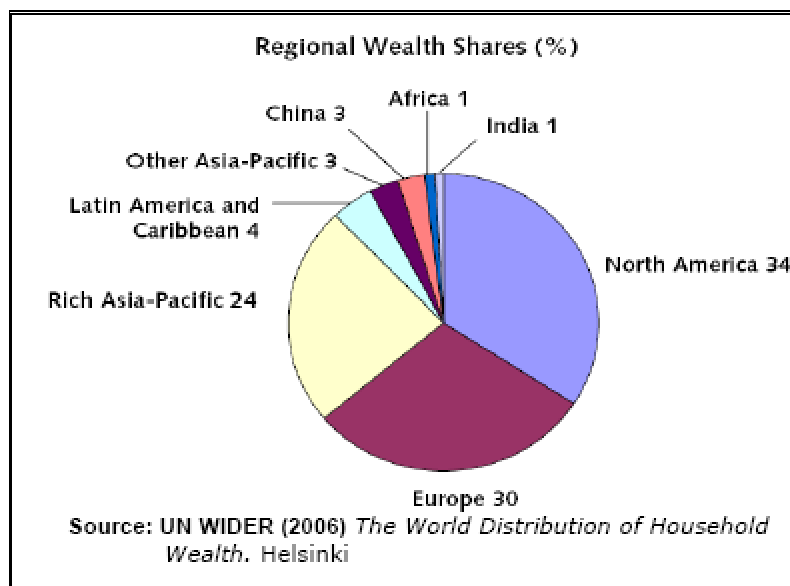
The gross asymmetries in the distribution of wealth justify North-South transfers, through increased and improved ODA. However, net global financial flows show a different picture: the reality is that Southern countries transfer resources to the North. This article reviews the issues and calls for multilateral action.

World Distribution Asymmetries: The Need for International Redistribution

The extreme inequality in the world distribution of income and assets seriously undermines governments' capacity to finance development processes. In 2000, the richest 10 per cent accounted for 85 per cent of total world income and assets; in contrast, the bottom half of the world adult population owned barely 1 per cent of global wealth [1]. While the economic benefits of globalization go to a few countries, companies and individuals, the cost of development must be dealt with at the national and local levels, with fewer resources, within a diminishing policy space.



Source: UN WIDER (2006) The World Distribution of Household Wealth. Helsinki

The justification for international redistribution cannot be stronger. For globalization to be accepted, it will have to be a globalization that benefits the majority, a globalization for all, instead of a few. The magnitude of the concentration of income in Northern

countries is so gross, that authors like Samir Amin have claimed that is apartheid at a global scale. North America, the European Union, and the high income countries of Asia and the Pacific hold 84 per cent of the world's wealth, or 79 per cent of world's GDP; redistributing a significant part of it to Southern regions is legitimate.
North-South Transfers: Official Development Aid (ODA)

The official channel for international redistribution is ODA. ODA has existed since colonial times, but in its current form, it can be traced to the post-war period, when the Bretton Woods institutions were created. The good experience of the Marshall Plan in Europe, which mobilized 2 per cent to 3 per cent of US GDP per annum from 1948 to 1953 to only 16 European beneficiary countries (an interesting comparison to the limited percentage that rich countries spend in ODA for more than 180 developing countries), led to the idea of a 'Marshall Plan for the South', which finally won official support from Northern governments. In 1970, the UN General Assembly endorsed that 0.7 per cent of the GNP of rich countries should be devoted to aiding the South. Since then, Northern governments have repeatedly committed to contribute 0.7 per cent of GNP to ODA. However, aid never reached this target, it remains at only 0.3 per cent. Exceptionally, in aid rose to 0.33 per cent due to extra donations sent for relief efforts for the Asian Tsunami and Iraq war, but ODA fell back in 2006 (Figure 2). The U.S. contribution in was 0.17 per cent, Japan 0.25 per cent, the European Union 0.54 per cent. Only Denmark, Luxemburg, the Netherlands, Norway and Sweden have met the 0.7 per cent commitment. Rich countries are becoming richer -- and meaner. In real terms, their contributions have decreased (relative to their income) over the past decade; in the early 1990s, contributions were 0.32 percent of OECD's GNP on average. Several governments have claimed that the 0.7 per cent commitment is outside their budget envelope; however, comparing expenditures on military defense and aid, for instance, shows that it is really a question of priorities. [2]

Figure 2: Official Development Aid (ODA), 1990-2010

Source: OECD Development Assistance Committee (OECD DAC) www.oecd.org/dac/stats

Donors argue that this reduction in ODA comes from a fatigue of the limited effectiveness of development aid. Partly, this is a self-fulfilling prophecy: Northern countries never invested on a Marshall Plan for the South but instead gave tiny resources so the world's 180 developing countries never fully developed. Additionally, since all commitments to ODA are voluntary, donors choose their own preferences, in terms of countries and areas of investment. Main aid recipient countries are Iraq, Nigeria, China, Afghanistan, Indonesia, India, D.R. Congo, Egypt, tightly inked to economic and political interests of the world's main powers. This concentration of ODA makes international redistribution unfair, given that most developing countries receive very little. Besides problems of size and concentration, ODA also suffers from high transaction costs, lack of predictability, macroeconomic impacts, tied aid, lack of policy coherence, and issues related to fungibility and conditionality, explained in detail elsewhere. What is important, however, is not to loose perspective; often debates over an aspect of ODA create much ado, distracting attention from critical issues. The reality is that the gross inequities in the distribution of global wealth are an obstacle for development, and international redistribution is necessary. The current ODA system is imperfect, but its drawbacks can be corrected, and better options put in place.

Given the failure of donors to meet their commitment to provide 0.7 per cent of GNI as aid, new international sources of development finance have been proposed, mainly taxing luxury activities or activities with negative social or environmental externalities, such as air ticket solidarity levies, global environmental taxes, tax on speculative short-term currency flows (the so-called ‘Tobin tax') and others. Additionally a variety of private public-private partnerships and foundations, mostly in the area of health, have flourished since the 1990s, such as the Gates Foundation, the Global TB Vaccine Foundation, among others. These new sources of development finance are good initiatives but they should complement —never replace— ODA.

Some argue that private sector flows and worker remittances make ODA irrelevant. Net private debt and equity flows to developing countries have risen from a little less that $170 billion in 2002 to close to $647 billion in 2006. While private sector flows to developing countries are certainly much larger than ODA, it should be noted that 70 per cent of them only benefit a few sectors in a few middle income economies, such as Argentina, Brazil, China, India, Malaysia, Mexico, Singapore, South Korea, Taiwan Province of China and Thailand; private flows are insignificant in the least developed countries of Africa and elsewhere. [3] Workers remittances are another important transfer to developing countries, reaching $193 billion in 2006 (compare to $106 billion ODA the same year). These are, however, informal flows of finance; they are fundamental to sustain migrant families' private consumption, and a good source of foreign exchange for governments, but not a good financing mechanism to support public policies for long-term sustainable economic and social development in a country. Main recipients are India, Mexico and the Philippines; remittances are unevenly spread between developing countries, and they rarely benefit the poorest population groups.

Ultimately, what is needed is an enforceable and progressive multilateral system to transfer resources from richer to poorer governments, sharing responsibility for

development. Proposals for an International Tax Organization (ITO) have been suggested, among others, by IMF's former Director Vito Tanzi, and by the United Nations Panel on Financing for Development. ITO terms of reference included efforts to avoid tax competition and its pressures to make tax systems less progressive and equitable, to coordinate efforts to fight tax evasion and tax heavens, and to study a global formula to levy taxes on multinational enterprises. But the idea of an ITO was not received with enthusiasm by the US and other Northern countries in the later Monterrey Conference on Financing for Development (2002), despite it would involve a high degree of distributional justice and —in technical terms— would not be difficult to implement as multinational corporations are already taxed. In 2004, with the votes of 115 countries, the UN General Assembly adopted a resolution calling for an examination of international taxes as an instrument of development financing, but again no agreement on an ITO. However, ITO is ultimately a correct step to improve global governance and redress the erosion of the nation-state's tax base and policy space.

Avoiding South-North Transfers

The analysis of net financial flows shows a different reality: Not only North-South transfers are scarce, actually Southern countries transfer resources to the North. Looking at the bigger picture, debt interest payments, profit remittances, and investments in capital markets in developed economies, offset net financial inflows to developing countries. According to UN DESA's latest World Economic Situation and Prospects 2007, the net financial flows in developing economies have gone from a positive net inflow of US$40 billion in 1995 to a negative net outflow of US$657 billion in 2006 (table I). Net transfers to sub-Saharan Africa have also become negative in 2006, having been the only region with positive net transfers in previous years. If we add the accumulation of foreign-exchange reserves in developing countries, the figure goes up to US$3 trillion. Most of this goes to the US economy, which monopolizes two-thirds of world savings, followed by countries like Spain, the UK and Australia. This is, poor countries are transferring resources to rich countries.

Table I: Net Financial Transfers to Developing Countries, 1995-2006

(Selected years, in Billion Dollars)

	1995	**1998**	**2000**	**2002**	**2004**	**2006**
Africa	5.9	15.6	-27.7	-6.7	-35.0	-95.3
Sub-Saha ran*	7.5	12.1	2.8	5.3	4.5	-10.1
Eastern Asia	21.8	-128.4	-119.1	-146	-162.1	-244.7
Western Asia	20.1	34.8	-29.7	-18.4	-69.8	-194.7
Latin America	-1.7	44.3	-1.6	-31.6	-80.0	-123.1

Transition Economies	-2.7	3.6	-49.4	-26.1	-54.6	-125.1
Memorandum						
- HIPCs	6.7	8.5	7.8	10.3	10.2	9.8
- Least Developed Countries	11.8	12.5	5.7	7.1	5.4	-4.3

Source: UN DESA (2007) *World Economic Situation and Prospects 2007,* page 58, based on IMF data. See: http://www.un.org/esa/policy/wess/wesp2007files/wesp2007.pdf * Sub Saharan Africa excluding Nigeria and South Africa.

Global savings are flowing in the wrong direction, overwhelmingly to the richest country in the world, while poor countries are crowded out of global resource transfers. The US borrows $2 billion a day from poorer countries. Thus the global distribution of net savings is very inequitable. Beyond this, this situation questions the whole logic of the current international financial system: poor countries should not be financing rich countries.

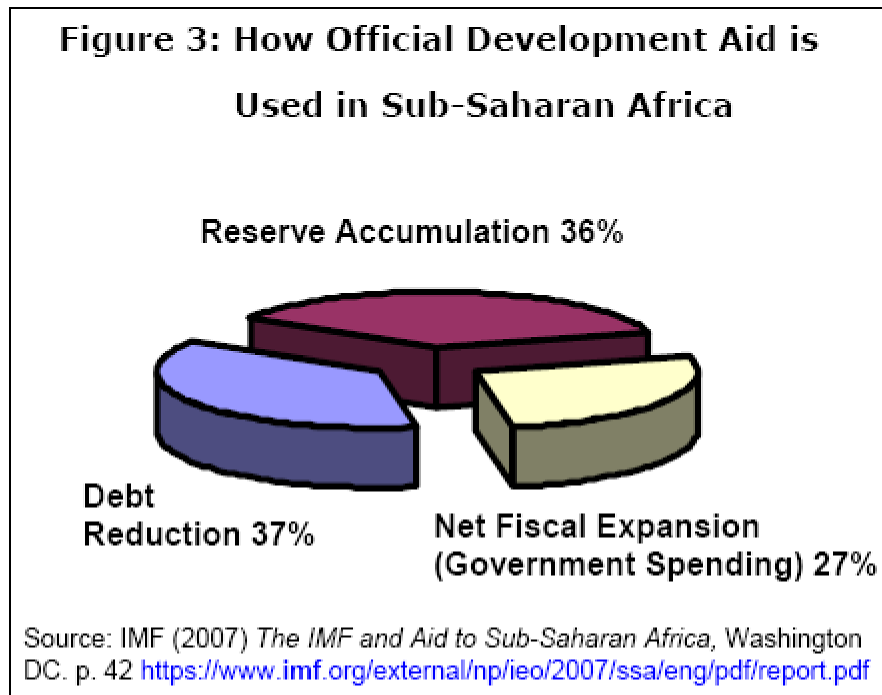


Figure 3: How Official Development Aid is Used in Sub-Saharan Africa

Source: IMF (2007) *The IMF and Aid to Sub-Saharan Africa*, Washington DC. p. 42 https://www.imf.org/external/np/ieo/2007/ssa/eng/pdf/report.pdf

As McKinley and Izurieta point: "Based, in effect, on borrowing money from other countries, US households have monopolized goods and services that could have a greater impact on global human welfare if they were consumed in poorer countries… the US economy is enjoying a gargantuan inflow of financial resources that could be invested at a higher social rate of return by low-income and middle-income countries in their own

development". Even the IMF Evaluation Office warns that since 1999, nearly three-quarters of aid to the poor countries of Sub-Saharan Africa are not being spent (Figure 3); rather, at the IMF request, it is used to pay off debt and accumulate reserves, instead of being used for much necessary economic and social investments to eradicate the overwhelming poverty and human deprivation of the region.[4]

Options to curtail South-North transfers:

1. Reducing outflows below the level of inflows (e.g. significantly expanded debt relief, or increased taxation of investment profit remittances)

2. Increasing substantially non-liable inflows above the level of outflows (e.g. ODA grants)

3. Diversifying central banks reserves away from liabilities in the US like Treasury bills (e.g. building reserves in regional local currency bonds, or bonds of development banks that invest at national level, or issuing new SDRs under a new global reserve system).

Any of these options has drawbacks, best solutions would require international coordination. Indeed there is a need for a new global financial architecture. Recent trends in financial liberalization, opening up capital accounts when incentives are distorted and domestic regulation/supervision is inadequate, have increased financial flows to the North, as well as the frequency and severity of currency and financial crises. A new financial architecture should also address an increase in the availability and provision of ODA, as is presented earlier in this paper, not only in terms of quantity but also in terms of the areas and approaches, this is, promoting expansionary, growth-oriented and equitable macroeconomic and sector policies geared towards employment, human development and the expansion of national markets.

With respect to debt reduction/forgiveness, there are many arguments to support further action. The HIPC initiative (1996) has been generally positive but too slow to deliver results. In 2006, only 22 countries have reached completion point at which debt relief is delivered. Many object to the fact that HIPC targets only highly indebted low income countries; there are strong arguments to condone debt in a larger group of countries, shifting away the responsibility from debtor governments to rich creditors who should also share liability for the irresponsible lending they incurred in earlier decades. Many question the legitimacy of this debt as it was often created by former (often non-democratic) governments who spent loans in military/defence and grandiose infrastructure projects with no social returns. However, current democratic governments need to service debt, consuming fiscal space to achieve social and economic development. Additionally, critics argue that the neoliberal conditionalities attached to HIPC impede national development, such as deepening financial liberalization, privatization of strategic economic sectors, increases in regressive VAT taxes, among others. Faster and wider efforts for debt relief are necessary.

Regarding the highly inequitable global reserve system, as pointed earlier, developing countries finance the U.S. current account deficit by accumulating US dollar-denominated international reserves as a "self-insurance" to protect themselves against potential future financial crisis, and as a way to keep currencies away from appreciation. For the US is beneficial as its deficit is sustained, and the country expands its consumption and imports based on debt. The US promotes economic growth based on domestic consumption, and developing countries (particularly Asian) based on exports. The situation provides [asymmetric] benefits for all. But how long can these imbalances be maintained? And to what extend are they an obstacle to achieve social and economic development goals?

For developing countries, there are major arguments to use resources to expand domestic consumption instead of financing consumption in the US and other rich countries. Expanding domestics markets could be an effective means of reducing poverty and achieving national development. There have been moves towards using Central Bank reserves for national development in developing countries. Mostly, by launching regional bonds, such as the regional Asian Bond Funds or the proposed ALBA bond [5]. In early 2005, China announced that it is no longer committed to holding reserves in dollars, and used them to recapitalize its public banking system. Singapore, South Korea and the Arab Emirates have created investment funds to support national and regional companies. In Latin America, the proposed Banks of the South and ALBA intend to use reserves to finance development in the region.

Additionally, there are better means to protect against future financial crisis than "self-insurance", accumulating foreign reserves at national level. Precisely, the IMF was created as a "collective insurance", pooling funds against financial risks. "Collective insurance" is a reinforced objective of the proposed Asian Monetary Fund [6] and Bank of the South/ALBA together with FLAR [7], supported by developing countries dissatisfied with IMF's current lending decisions and conditionalities. There are also more ambitious proposals –from Soros to Stiglitz- for a new global reserve system to issue a pool of reserves each year (such as Special Drawing Rights) that could be distributed disproportionately to poor countries to help to correct global imbalances and better use resources for social and economic development.

Given the magnitude of South-North transfers and the very limited North-South transfers, developing countries are trying alternative South-South integration experiences and South-South banks. However, as shown at the beginning of this article, South-South resources are lesser, developing countries only hold 16 per cent of the world's wealth, or 21 per cent of world's GDP. South-South cooperation must continue in view of the lack of agreement on a global agenda, a second best option, but fighting apartheid at the international level remains an urgent imperative. The extreme inequality in the distribution of world's wealth requires multilateral action to avoid savings leaving developing countries, and increased/improved ODA to ensure redistribution at a global scale.

[1] UN WIDER (2006) The World Distribution of Household Wealth. Helsinki; UN DESA (2005) The Inequality Predicament: Report on the World Social Situation, New York; Jomo and Baudot (2007) Flat World, Big Gaps: Economic Liberalization, Globalization and Inequality. London.

[2] Sir Richard Jolly (2004) Disarmament and Development, UN DESA, estimates that US military expenditures were 6 per cent of GNP in 2003, compare to 0.1 per cent expenditure on (tied) ODA the same year.

[3] Chandrasekhar (2007) Global Finance Today: Deja Vu? IDEAs, New Delhi.

[4] McKinley and Izurrieta (2007) The Gross Inequities of Global Imbalances, UNDP International Poverty Centre Brasilia; McKinley (2007) Use Aid for Investing in the MDGs, in Poverty in Focus, UNDP International Poverty Centre Brasilia.

[5] Asian Bond Funds are being developed by East Asia's central banks after the 1997-98 Asian Crisis, with the support of the Bank for International Settlements and Asian Development Bank. ALBA (Bolivarian Alternative for the Americas) is a regional association that includes Bolivia, Cuba, Ecuador, Nicaragua and Venezuela

[6] The Chiang Mai Initiative, which includes all ASEAN countries (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) plus China, Japan and Korea, was launched in the aftermath of the Asian Crisis, and holds about 80 billion dollars, however only 10 per cent is usable without IMF approval. In May 2006 Asian ministers decided to study the idea of an Asian Currency Unit (ACU, similar to the former European ECU) based on a basket of currencies.

[7] The Bank of the South has been proposed as an alternative development bank to the IFIs, together with a Bank of ALBA; FLAR is the Latin American Reserves Fund (created in 1978), a regional monetary fund for Latin America.