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MAKING GLOBALISATION A POSITIVE FORCE FOR SUSTAINABLE DEVELOPMENT

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EXECUTIVE SUMMARY

The Issue

The world economy is undergoing profound change. It is becoming increasingly globalised. Globalisation is an economic, social and environmental process characterised by:

- The extension of economic markets beyond the local and national to international and global levels, as illustrated by the increased 'openness' of economies.
- The global diffusion of new technology, and particularly
- The global expansion of communications networks.
- The increasing multi-cultural nature of national societies, and the inter-mixing of different value systems.
- The rise of collective environmental problems such as global warming and biodiversity loss on a global scale.
- The globalisation of life risks, as with AIDS and other transmissible diseases.

2. A major question is whether globalisation is consistent with the now widely accepted goal of *sustainable development*, a goal that requires all nations to invest significantly more in economic, social and environmental assets and especially the assets available to the poor and vulnerable. Critics suggest globalisation might produce only a temporary raising of living standards at the expense of generations to come, and that the whole process may by-pass the poor.

3. This paper addresses this question by suggesting (a) **a framework** for thinking about globalisation, sustainable development and poverty, and (b) posing **a set of actions** that Commonwealth governments can discuss.

The Framework

4. The framework for analysis involves focusing on the **assets** that current and future generations need for human development. These assets are **human-made capital** (machines, roads, factories); **human capital** (the skills and education embodied in human beings); **natural capital** (the stock of natural resources and the waste handling capacity of natural environments); and **social capital** (the 'glue' that binds communities together and the destruction of which shows up in increased crime, wars, social breakdown, etc.). Only by raising the per capita levels of these capital assets, and by improving the efficiency with which they are used (**technological change**) can the poor and future generations be better off.

5. If globalisation is associated with increases in all these assets then globalisation is potentially good for the poor and good for the future. But if globalisation places any of these assets at risk, then globalisation must become a managed process, one that has to be the subject of some national and global action to mitigate its negative effects whilst maximising its positive effects.

The Effects of Globalisation

6. A review of the substantial and growing literature suggests the following:
- Globalisation is increasing the flow of foreign direct investment to developing countries, increasing the human-made capital base of these economies. However, these increases are associated with (a) a static picture for official foreign aid and (b) a strong bias to the 'top 12' developing economies, and negligible flows to Africa and the Former Soviet Union.
 - Globalisation is, on balance, beneficial to the poor in terms of real incomes. However, there are short-term effects that result in income loss and unemployment, especially in industries that were previously protected. There are concerns that in some cases these short-term effects can persist for prolonged periods, especially in new labour is attracted and if social 'cushioning' policies are not in place.
 - Globalisation raises average per capita income and there is evidence that, in the longer term, rising incomes result in improved natural environments. The evidence is not compelling, however. The process may work well for local environmental problems, but not for increasing global problems such as climate change, biodiversity loss, over-fishing and marine pollution. In any event, attention should not be diverted from the need to invest early in forms of pollution control and resource conservation that benefit the poor and improve human capital. Pollution control is a 'public good' and as such does not attract private investment. The environment could suffer if official aid is not better targeted at these public goods.
 - Globalisation in the absence of control measures will increase greenhouse gas emissions which generate global warming the effects of which damage the developing world more than the rich world.
 - Through rising income, globalisation raises the demand for health and education, producing a potential 'virtuous' circle. But this process can easily by-pass the poor and women.
 - Higher incomes tend to be associated with improved social capital but, again, it is unwise to allow globalisation to determine the pace of social capital formation.
7. The evidence suggests that while human and human-made capital are enhanced by globalisation, there are real risks to natural and social capital. These risks must be managed.

The Actions

8. The table below lists these impacts of globalisation and suggests actions that could be the basis for further discussion.

Asset or feature of sustainable development which raises human wellbeing	Ways in which globalisation affects assets, or associated problem	Mitigating actions by world governments
Increasing human-made capital	<p><u>Foreign investment</u> More foreign private investment but bias against poorest developing nations and Former Soviet Union. Increasing marginalisation of the poorest.</p> <p>Static official aid.</p> <p><u>Domestic investment</u> Low domestic savings/investment ratios</p>	<p>The political climate for private investment must be improved through reduced corruption, improved democracy, more participation, adherence to human rights, good governance.</p> <p>Urge the 0.7% GNP target for DAC is met by all rich nations. Substantially improve the debt relief programmes of multilateral and bilateral institutions.</p> <p>Reduce protection by rich countries which disadvantages developing world.</p> <p>Reduce high discounting of the future by the poor by credit reform, property rights, collective security.</p>
Increased natural capital	<p>Environmental standards may be improved through need to compete on world markets, and via technology transfer, but -</p> <p>Risk that market forces will neglect the environment as a public good with apparently low rates of return</p> <p>Economic growth may bring long term environmental improvement but it is not guaranteed.</p> <p>Developed country greenhouse gas emissions will do more harm to poor countries than to rich countries.</p>	<p>Steadily increasing environmental standards and instruments for internalising externalities. Encourage creation of markets in environmental assets.</p> <p>Invest <u>early</u> in pollution control and resource conservation and demonstrate that there are high social returns to such investment.</p> <p>Work towards early ratification of the Kyoto Protocol and begin a rapid process of investing in impact-mitigation in vulnerable economies.</p>
Increasing human capital	<p>Potential 'virtuous' circle: globalisation encourages growth which encourages demand for health and education which further encourages growth, but -</p> <p>Process can by-pass women,</p>	<p>Invest in human capital generally, but correct gender bias through equal access to education and health, emancipation, gender mainstreaming, and listening to the voices of women.</p>

	<p>Human health can be impaired by lack of investment in environmental capital for the poor,</p> <p>Health can be damaged if globalisation leads to short run unemployment,</p> <p>Social expenditures to cushion short run impacts of globalisation may by-pass the poor</p>	<p>Recognise investment in natural capital as complementary to investing in human health.</p> <p>Cushioning institutions and resources need to compensate for short run impacts.</p> <p>Re-target social expenditures to where they are most needed. Tackle corruption and rent seeking.</p>
Increase social capital	<p>Possible virtuous circle: globalisation encourages growth which appears to encourage less social disruption, greater equality and more respect for human rights, but:</p> <p>Short run employment impacts can destroy social capital</p> <p>Potential worsening of 'household' social capital if men and women react differently to new opportunities.</p> <p>Not always the case that the growth process benefits the poor; sometimes it may lead to loss of community and social identity</p> <p>Potential conflicts between indigenous and imported cultures due to foreign investment and imported labour.</p>	<p>Gender-sensitive social cushioning policies needed - see above.</p> <p>Gender-based policies</p> <p>Encourage local community formation, NGO activity, compliance with human rights, reduced corruption in government. Encourage common property.</p> <p>Encourage 'corporate social responsibility' in FDI and in all official aid. Invest in niche markets utilising indigenous skills and knowledge.</p>

Financing the Actions

9. All the suggested actions require some form of finance. Available finance can be generated from a number of sources:

- (i) Reducing protection in the developed world that damages the export potential of the developing world. The World Bank estimates losses to the developing world in this respect of \$100 billion p.a.
- (ii) Generally removing or reducing subsidies to production and consumption in rich and poor countries. In addition to (1) above, this might release at least another \$100 billion p.a.
- (iii) Honouring the UN target of 0.7% of GNP for foreign aid. This would release yet another \$100 billion p.a.

- (iv) Increasing the use of economic instruments, such as environmental taxes, carbon trading, and improving the efficiency with which existing environmental markets are managed. Privatisation in one form or another can release scarce funds from government-run activities. Markets in environmental goods, e.g. payment to forest owners to conserve forests that regulate watersheds and help protect downstream water supplies and soils.
- (v) Substantially increasing the provision of micro-credit to small borrowers.

PART I

A FRAMEWORK FOR EXAMINING THE RELATIONSHIP BETWEEN GLOBALISATION AND SUSTAINABLE DEVELOPMENT

I. INTRODUCTION

A. *The Issue*

1. The world economy is undergoing profound change. It is becoming increasingly globalised. Definitions of globalisation abound, but it is generally accepted that it is an *economic, social and environmental process* characterised by:

- The extension of economic markets beyond the local and national to international and global levels, as illustrated by the increased 'openness' of economies¹;
- The global diffusion of new technology, and particularly
- The global expansion of communications networks (OECD, 1997).
- The increasing multi-cultural nature of national societies, and the inter-mixing of different value systems.
- The rise of collective environmental problems such as global warming and biodiversity loss on a global scale.
- The globalisation of life risks, as with AIDS and other transmissible diseases.

2. The essential feature of globalisation is that distance is no longer a limiting factor in economic and social change. The latest developments in technology are potentially as available anywhere in the world. What is produced in any one country can be marketed in all, resulting in increasing specialisation in production to serve the expanding market. More countries will participate in the global market. Firms will be less tied to a given geographical area, being able to 'migrate' to areas of maximum economic opportunity. Increasingly, the Internet links far distant communities, making news and information a globally available good. Information, perhaps the most valuable economic resource, is increasingly available to all who can connect to the Internet. Capital resources also move more freely in a globalised world, and the pressure for similar movements in human labour through international migration increases. Trade is increasingly free of protectionist elements, so that national boundaries become less significant in economic terms. Finally, in a globalised world the economic fate of any one country is increasingly dependent on the economic fortunes of all other countries. Experience with recent economic crises and, most tragically, with the events of September 11th, shows how interdependent the world has become. No one country can isolate the wellbeing of its inhabitants from the wellbeing of the rest of the world.

3. Opinions differ about the extent to which globalisation is *controllable*, and even if it is controllable whether it should be controlled. Two dominant questions emerge:

- Is globalisation consistent with the increasingly major goal of public policy worldwide to reduce, and eventually eliminate, *poverty*? Or is globalisation

¹ Openness can be measured in various ways. Typical indicators would be the share of internationally traded commodities and services in GNP, the growth of international capital flows and international human migration. See World Bank (2001).

inherently structured so as to by-pass the poor, or even make their condition worse?

- Is globalisation consistent with the now widely accepted goal of *sustainable development*, a goal that requires all nations to invest significantly more in economic, social and environmental assets? Or might it produce only a temporary raising of living standards at the expense of generations to come?

4. As it happens, these two questions are closely connected. Sustainable development is not just about ensuring that the basis for the well-being of future generations improves, but about ensuring the well-being of the current poor is also improved. This was emphatically underlined in the Brundtland Commission's report on sustainable development. Unsustainable paths of economic development threaten the poor disproportionately because they have fewer assets to cushion them against impacts such as natural disasters, climate change, the volatility of commodity prices and economic cycles. They have a lower stock of health and education with which to combat disease and unemployment. They also have limited power to defend what they do have against others, and less political voice to challenge authority or to drive policy reforms to benefit them. If violence erupts, they are the most likely to suffer either as the direct victims of violence or because they become dispossessed as refugees. Economies may be able to survive for some time with large fractions of their population in poverty, but this surviving is not the same as being sustainable, and poverty creates conditions where social disintegration accelerates. Sustainability has to be about raising the income and capabilities of the poor. The evidence so far is that globalisation can benefit the poor, but the risks are there that it will not. For this reason, among others, governments need to manage the globalisation process.

5. A briefer way to pose these questions is to ask to what extent the goals of sustainable development can be fully integrated into a globalised world. In turn, this means taking the 'three pillars' of sustainable development - the economic, the social and the environmental - and making the goal one of enhancing all of them against the backdrop of globalisation. Economic goals relate to improving the average state of human wellbeing² on a sustained basis. Dominant social goals are (a) reducing and eventually eliminating poverty, and (b) substantially reversing the losses of social cohesion at national and international level, losses illustrated by increasing violence and terrorism. Environmental goals relate to improvements of local and global pollution, reductions in the rates of loss of biodiverse ecosystems, and conservation of scarce natural resources.

6. These goals are firmly embedded in Agenda 21 - which, for example, links the goal of poverty reduction to sustained economic growth in developing countries (UN, 1992, para 3.1). Poverty reduction is also a major theme in bilateral assistance (making globalisation benefit the poor defines the theme of the UK's 2000 White Paper on International Development), the UN agencies (e.g. as expressed in the UN Millennium Declaration goals), and, within the Commonwealth, it is a recurrent theme of the Commonwealth Heads of Government, and was a major sustainable development concern highlighted by Commonwealth Environment Ministers at their meeting in Nairobi, February 2001.

² The term 'wellbeing' is intended to capture the pluralistic nature of an individual's standard of living: wellbeing rises with rising per capita incomes, but also with personal freedoms, health, skills, knowledge and self-fulfilment. See Dasgupta (2001). It might also be equated with 'human development'.

7. If globalisation is an inevitable and unavoidable process, and if it does have negative effects on poverty and sustainability, then policy must seek to *mitigate* the negative impacts of globalisation. If, however, globalisation can be *managed* by the international community, then the issue for policy is how best to guide the globalisation process so as to *avoid* the negative impacts. It is clear that globalisation has many features that can be managed, but that the basic process of globalisation is potentially beneficial to the world and to the world's poor.

8. Management therefore needs targeting at:

- *investment* in the assets and institutions that have the potential for generating sustainable development
- *financing* of that investment
- *mitigating* any adverse consequences of globalisation, particularly as they affect the poor.

9. This document sets out a framework for answering the questions and highlights the fundamental issues that must be addressed in order to translate debate into action.

II. A FRAMEWORK

10. The widely disseminated definition of sustainable development by the World Commission on Environment and Development (WCED, or the 'Brundtland Commission') is worth restating:

'Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts:

- the concept of 'needs', in particular the essential needs of the world's poor, to which overriding priority should be given, and
- the idea of limitations imposed by the state of technology and social organization on the environment's ability to meet present and future needs' (WCED, 1987, p.43).

11. Typically, only the first sentence of this definition is quoted, giving the impression that sustainable development is about relationships between generations at different points in time. But the rest of the definition makes it clear that the WCED was just as concerned, if not more so, about addressing the needs of the current poor. Sustainable development is about providing the right conditions for sustained increases in per capita wellbeing over time, and about raising the per capita wellbeing of the poor today.

12. The capacity to improve human wellbeing can be seen as a function of the *capital assets* that are available to a population. All capital assets yield flows of services through time, and, potentially, all capital assets decay and can be renewed by the act of *investment*. The traditional concept of capital as machinery, factories and roads - *human-made capital* - needs to be broadened to include other types of asset to include:

- *human capital* - the stock of knowledge and skills embodied in humans, together with the *health quality* of human assets, most notably the health status of the population;
- *environmental* or *natural capital* - the stock of natural resources and environmental receiving capacity³, and;
- *social capital* - the positive relationships between individuals and between individuals and institutions, relationships which generate social cohesion and reduce discord and distrust.

13. Together, these stocks of assets comprise the foundation of sustainable development⁴. In all cases, a secure asset base provides the context for investment to generate sustainable development. For example, investment risks are very much higher in a context where there is political instability and social discord, crucial features of the breakdown of social capital. For future generations to have a higher level of wellbeing than current generations, the asset stock per capita must rise through time. The obligation of any one generation is to provide that capital base for the following generation. As far as current poverty reduction is concerned, the obligation is to raise the asset base of the current poor. Thus, sustainability requires the focus of asset creation on the poor today, as well as on ensuring that the assets of future generations are not depreciated or debased by today's actions.

14. Rapid *population change* could threaten sustainable development by making it more difficult to increase *per capita* stocks of assets. *Technological change* holds out the hope that the efficiency or productivity of these assets can be increased through time. The challenge for global policy is how to enhance the quantity and quality of all the assets needed for sustainable development.

III. GLOBALISATION AND SUSTAINABLE DEVELOPMENT

15. Some of the opposition to globalisation arises precisely because of fears that globalisation will reduce the stocks of some of the assets in the overall asset base needed for sustainable development. In particular, there are fears that globalisation will increase human-made capital and human capital, but at the expense of social and environmental capital (e.g. Daly, 2001). Some would argue that this process, if it occurs, is a beneficial 'trade-off' of assets because wellbeing responds more sensitively to investment in human and human-made capital, i.e. there is a higher rate of social return to human-made and human capital than to social and environmental capital investments. But there are strong reasons for seeking policies that try to make the whole asset base increase without any one asset declining. These reasons become all the more powerful when the focus is on poverty reduction. The reasoning can be illustrated by looking at some of the central linkages between capital assets and globalisation.

³ *Natural capital*, which yields a flow of services through time, should be distinguished from *natural inventories*, which do not. Thus, an ecosystem is capital, but a barrel of oil is not. The sum of inventories and capital can still be thought of as wealth, however. See Kopp (1992).

⁴ This 'capital theory' of sustainable development is developed in Pearce et al. (1989) and more recently in Dasgupta (2001). It is also the foundation of modified national accounts and other sustainability indicators - see Pearce et al. (1996).

A. *Globalisation and human-made capital*

16. Globalisation has been instrumental in improving the flows of financial capital to developing countries, and hence in enhancing the human-made capital base of those economies. Since 1970, total net capital flows have increased in real terms by one order of magnitude from \$30 billion to over \$300 billion (Schmukler and Zoido-Lobaton, 2001). In turn, these investment flows have helped to generate manufacturing industry in the developing countries so that the share of manufactures in total developing countries' exports has increased dramatically. They have also raised the productivity of capital, i.e. its rate of return, because recent technology is embodied in the new investments. On this basis alone, globalisation has greatly expanded the human-made capital basis of the poorer countries. Nonetheless, there are still major causes for concern.

17. First, the rise in investment is due to private capital flows. Official flows of development assistance have not increased since 1990. Private net flows outweigh official flows by a factor of ten. Private flows are less likely to be directed at public goods such as social and environmental capital, much of the private flows being directed at merger and acquisition. The bias in total net flows may therefore be at the expense of social and environmental capital.

18. Second, private investment has generally avoided Africa and some of the Former Soviet Union countries. Low-income countries⁵ receive only a minor fraction of the total flows. This reflects the higher risks and the relative unattractiveness of investment in low income economies. Even within middle and high-income recipients, net flows are around four times higher to the 'top 12' economies than to all other non-low income countries⁶. These biases reinforce the view that official aid still has a central role to play in this respect. Those economies that have become marginalised by the globalisation process need to be brought within the 'envelope' of benefits that globalisation is bringing, as emphasised by the Commonwealth Heads of Government in their 1999 Fancourt Declaration on Globalisation and People-centred Development.

B. *Globalisation, environmental capital and poverty*

19. Free markets are fundamental to globalisation, but it is well known that free markets need to be regulated to avoid monopoly power aimed at securing dominant market share, and to avoid the potential disregard for environmental damages that firms may have in their efforts to minimise the costs of production and gain a competitive advantage. Both effects could militate against the poor due to their relative lack of empowerment, and to their comparative over-reliance on 'free' natural resources, such as forest products and river and groundwater, to supplement meagre money incomes. Firms may also migrate to the lowest cost locations, exploiting low cost labour, i.e. labour in the poorest countries, but also potentially increasing unemployment of labour in rich countries if it cannot compete. These fears are partly unfounded and partly founded, but controllable. Despite many, careful studies there is hardly any evidence of significant migration of 'dirty industries' (Smarzynska and Wei, 2001). Just as markets have become globalised, so have many environmental standards. Firms cannot afford to exploit low-income labour of their environments if they are to have credibility in the market-place. The new but increasing trend towards corporate self-

⁵ As defined by the World Bank, low income countries are those with less than \$755 p.a. per capita income.

⁶ China, Brazil, Mexico, Argentina, Republic of Korea, Malaysia, Russian Federation, Thailand, Chile, Indonesia, Turkey and India.

regulation and social responsibility intensifies this effect, as does the fact that foreign-owned firms may adopt more modern, and hence cleaner, technology. Even if economic activity shifts to low income countries, that should push real wages in the host economies upwards. Nonetheless, the process is not without risks. It becomes critical for the international community to intensify its demands for the prices of traded goods everywhere to reflect the true social costs of production - not just those of labour and capital, but of 'free' natural resources and the social fabric. This process of 'internalisation' of environmental costs has advanced in OECD countries and is increasingly the subject of legislation and market-based incentives⁷ in the developing world (OECD, 1999; Panayotou, 1998). While efforts continue to improve working conditions, less attention has been paid to innovative ways of making economic producers sensitive to the costs of social damage in the form of displaced communities, loss of social cohesion (social capital) and human health and education.

20. The early stages of traditional economic development appear to be associated with a general reduction in the quality of natural and built environments. Raising real incomes and securing basic needs such as health and education take precedence over environmental quality and resource conservation. It has been widely suggested that, after a point, income changes to reach levels where both the affordability of, and demand for, environmental improvement increases⁸. To some extent, then, economic growth secures environmental improvement - the two are mutually compatible. However, relying on this evolutionary process, even if it exists, to resolve environmental problems is unwise. The process may well work for local environmental problems, but not for increasing global problems such as global warming, biodiversity loss, over-fishing and marine pollution. While the poor may, often unavoidably, generate local environmental problems, the rich bear primary responsibility for global damage. In turn, those global damages will tend to have a disproportionate influence on the wellbeing of the developing world and especially the poor within those countries. Global warming damage, for example, will constitute a higher percentage of developing countries' GNP than GNP in the developed world (Eyre et al., 1997).

21. The available evidence also suggests that those nations adopting positive environmental policies can achieve the same economic growth patterns but without major environmental damage. The growth and development process can be managed through the wise adoption of policies aimed at energy, water and soil conservation, biodiversity protection and pollution control. The links to sustainable economic development arise because natural resources and environmental capacity are parts of the productive process, just like labour and capital. Raising their efficiency in use is therefore important and this requires targeted policy measures. More indirect linkages also exist. Pollution is a major factor in disease and early mortality in developing countries, accounting for perhaps 20 per cent of the global burden of disease in the developing world, a figure comparable to that for malnutrition (Lvovsky, 2000)⁹. Air pollution alone may account for 3.5 million premature deaths per

⁷ Market-based incentives refer to policy instruments that focus on facing resource users and polluters with market signals, especially prices, that reflect the damage done to the environment.

⁸ This is the process known as the 'environmental Kuznets curve' (EKC), an inverted 'U' shaped graph of environmental damage against real income per capita. See, for example, Panayotou (1997). The status of the EKC should not be exaggerated, however. It may hold for cross country comparisons but not always for single economies over time. Nor is the evidence consistent across individual natural resources or pollutants. See de Bruyn et al. (1998) and Perrings and Ansuategi (2000).

⁹ Lvovsky's figures are based on the major study by Murray and Lopez (1996) and other sources. The range is 4.5% for the established market economies to 6.5% for the Former Soviet Union and up to 26.5% for Sub-Saharan Africa. These percentages are directly correlated with income per capita: the poorer the nation the higher the incidence of environmental factors in the total burden of disease.

annum in the world as a whole, nearly all of them in the developing world (Lvovsky et al, 2000). Environmental improvement therefore contributes directly to the quality of life through impacts on human health and longevity, but it also affects economic performance indirectly via effects on labour productivity (Hansen and Selte, 2000). There are additional reasons for supposing that environmental improvements improve the lot of the poor. Many of the world's poor still rely on untreated water supplies from rivers and wells: 32% still have no access to treated supplies, very largely in poor, rural areas (WRI, 2000). Water pollution therefore directly affects human health in the poorest communities. The poor still make use of open-access forest and wetland areas for fuelwood, building materials, drugs and wildmeat. Such 'free' goods may add from 40 per cent to over 100 per cent to conventional incomes (Pearce and Pearce, 2001). The poor are directly affected by forest loss since it increases the distances walked by women and children to fetch fuelwood, with consequent effects on health, on schooling and on productive time lost.

22. It follows that environmental quality is not a luxury to be afforded when economic growth permits. It is a vital ingredient of the sustainable development process. Development generally depends in part on resource and environmental conservation. But the links to poverty alleviation are even stronger because of their high dependency on environments in their original state. Investment flows in environmental capital need to increase. There is a stronger role here for official development assistance since environmental capital frequently takes the form of a 'public good' for which the private incentive to invest is low¹⁰. Internalising environmental damage through regulation and market-based incentives would also generate a market in pollution control and resource conservation in the poor world.

C. Globalisation, human capital and poverty

23. Globalisation spreads public knowledge more widely and can dramatically change the level of knowledge per individual. The most notable example is through the use of the Internet. Knowledge creation, as proxied by years of schooling, is known to have significant effects on economic growth (Barro, 1998). In general, economic growth is good for raising both average real income levels but also for raising the income levels of the poorest (Dollar, 2000; World Bank, 2001). Globalisation becomes an integral part of the development process. As incomes grow so the demand for schooling rises significantly in poor countries, and especially so where women have control of household decisions (Ranis et al., 2000). However, while the initial level of education is significant as an explanatory factor in growth, it is less clear that changes in education result in changes in growth. There is some agreement that the 'quality' of education matters, i.e. investments in higher education may matter more than changes in earlier schooling. Education of females is very effective in limiting family size, releasing resources and enabling children to receive more benefit in terms of nutrition and education. But women can also be seen as human capital with special features - the ability to direct available income more efficiently than men, to nurture their children better, and to make better savings and investment decisions (Interagency Meeting on Women and Gender Equality, 2001). Women tend to respond better than men to economic dislocation (Narayan et al., 2000). Maximising female human capital thus requires fairer treatment for women and their involvement in all decision-making contexts.

¹⁰ A public good is one that, when provided to one individual tends to be supplied to everyone, and where there are limited means for excluding individuals from the benefits through pricing or rationing. Clean air is an example.

24. Individuals' health is a function of their surrounding natural and built environments, the availability of preventive and palliative medical care, and nutrition. The quality of human capital is thus improved by environmental policies aimed at reducing air and water pollution and exposure to waste, by investing in medical infrastructure and by improving food intake and calorie consumption. Globalisation raises per capita incomes and increases in low-level incomes are known to be linked to increases in food intake. Healthier individuals also have higher labour productivity (Ranis et al. 2000). Health thus contributes to economic development generally (Commonwealth Secretariat, 2001). How far social expenditures on health contribute to *poverty* reduction is more open to doubt. Dollar (2000) reports that such expenditures are usually more directed at the rich and the middle class, suggesting difficult policies of reform aimed at re-directing such expenditures. Globalisation thus has the potential to benefit health through income increases and through the consequent increases in government revenues that could be directed towards health care. If, in addition, forms of debt relief accompany globalisation so as to overcome the short-run disruptive costs associated with the opening of markets, the consequent release of funds could also be targeted at health care (Commonwealth Health Ministers, 2001). The political difficulty is one of ensuring that such specific targeting of funds is pursued.

25. Health and education are in turn positively related to real income growth. Thus, 'virtuous' circles are feasible, whereby investing in human capital raises growth which in turn raises the demand for human capital. Globalisation directly affects the stock of knowledge and indirectly affects it via increased demand for education via positive effects on income. Globalisation may not directly affect health, but it does so indirectly via the income effect.

26. One reason why the beneficial effects of globalisation may not be readily perceived is that they may well be longer term. In the short-run, exposure to international markets may well mean the unemployment of previously protected resources such as labour. Globalisation may therefore appear to be linked to unemployment, but the evidence is that strong adjustment policies yield eventual significant benefits (World Bank, 2001).

D. Social capital and globalisation

27. Finding the links between globalisation and social capital is complex, partly due to the difficulty of finding proxy measures for social capital and partly due to the difficulties of defining social capital itself. Nonetheless, the origins of the term suggest that it has to do with trust between individuals and norms of civic co-operation. As such, the density of co-operative institutions, such as clubs, co-operatives and communal societies, could act as one indicator of social capital. Efforts to relate such indicators to economic growth suggest that social capital positively affects economic growth (e.g. Putnam, 1993). Knack and Keefer (1997) find strong evidence that trust stimulates growth in poorer countries. What is not clear from the current state of research is whether there is a reverse linkage, from economic growth to more social capital. Some indicators suggest that high-income countries, such as the USA, are characterised by reductions in co-operative behaviour (see Knack and Keefer, 1995). To cast further light on this, one constructive approach is to look at the relationships between economic growth and indicators of social 'disintegration', the negative of social capital, as revealed in indicators such as crime and corruption, lack of a free press, political prisoners etc. The initial indications are that more wealth is associated with less social disruption: the faster is economic growth, the less social disintegration there is, as measured by civil liberties, inequality, corruption, ethnic separatism, political rights and sudden political change (Klitgaard and Fedderke, 1995). In a wide-ranging review, Bardhan (1997) found that

corruption in government and business, 'rent seeking'¹¹ and lack of democracy are all associated with reduced economic growth¹².

28. Efforts have also been made to link *inequality* with economic growth. A recent study by Gylfason (2002) shows that high growth economies have less inequality than low growth economies, with the suggested line of causality being from inequality to low growth. Social exclusion and inequality have frequently been linked to conflicts and war (e.g. Colletta and Cullen, 2002). But it is not just inequality of incomes that is harmful to development. *Gender inequality* matters too. It is now well established that failure to consult women or to involve them in decision-making is harmful to the potential success of development projects. Ironically, women may be the greater short-term losers under globalisation as hitherto protected markets, in which they often work, face new competition. Thus, independently of the moral force of gender equality, the place of women in development can be seen as reflecting vastly under-utilised human capital.

29. Opponents of unmanaged globalisation point to the potential for globalisation to harm social capital. The greater is the foreign-owned element of the human-made capital stock, the more likely it is that the cultural identity of the host nation will be exposed to the investing nation's culture. There may therefore be a loss of cultural identity, giving rise to new social conflicts that were not there before. World Bank (2001) considers that cultural diversity tends to be very resilient to imported cultures and that cultural diversity may actually expand in a positive fashion. But far more needs to be learned about the impacts of resilience to the import of foreign culture.

30. Another dimension of concern is the effect on workers in economies where openness is pursued. As noted above, there may be short-term disruption from globalisation. Indeed, it has been argued that what globalisation does is to shift the government-worker compact away from 'more wages for less industrial unrest' towards 'more long term wages for short-term disruption and unemployment' (Grunberg, 1998). But if labour is increasingly mobile in a globalised world, it may be that it becomes permanently substitutable by non-indigenous labour. The labour force may then be unemployed on a longer term basis, and the country may move to a 'knife edge' situation where small changes in costs result in significant changes in comparative advantage (Bhagwati, 1997). The prospect of social capital losses through unemployment or cyclical employment should not be discounted and remains a major source of concern to the critics of globalisation.

31. There are also complex links between social, human and environmental capital. For example, environmental improvement may only be sustained if institutions and attitudes reinforce the policy measures aimed at environmental improvement. In this respect, social capital might be measured by attitudes towards the environment and towards other members of society, and by the formation of communal approaches to the control of natural resources. Such 'common property' solutions to resource degradation are widespread and can be encouraged by participatory and empowerment approaches to communal involvement¹³.

¹¹ Rent-seeking refers to the activities of competing interest groups to secure a share of gains arising from such things as monopoly profits, subsidies, favourable contracts etc.

¹² Amartya Sen speaks of the 'protective power of democracy' and notes that no famine has ever occurred in a democratic country (Sen, 2000).

¹³ Common property involves communal management of natural resources, with rules of access and use. It needs to be contrasted with 'open access' which defines common use of a resource but without rules governing access and use.

Notable developments are communal bargains between downstream beneficiaries of upstream watershed conservation. It remains the case that still not enough is known about why some common property regimes succeed and why some break down, a continuing challenge to the international aid community (Dasgupta, 2001; Baland and Platteau, 1996).

32. Similarly, communal identity may encourage school attendance and hence human capital. Communal lending agencies can limit risks, improving social and economic resilience in times of crisis. Efficient exploitation of environmental infrastructure, such as sanitation, can be facilitated by strong linkages between the supplied community and the relevant authorities¹⁴.

IV. CONCLUSION

33. Sustainable development as rising per capita well-being through time requires that (a) all the relevant capital assets required to generate well-being themselves increase faster than population growth, or (b) that rates of technological progress, which increase the productivity of capital assets, proceed more rapidly than population growth. The more growth in capital assets can be combined with technological progress, the greater the margin of security for obtaining sustainable development. In terms of the additional, but fundamental, goal of reducing poverty, significant increases in the asset base of the poor are required, and urgently. While there may have to be trade-offs, the initial focus of policy should be on raising the quantity and quality of all capital assets through the process of investment. Crucially, investment must not be confined to increases in human-made capital, or even just human-made and human capital. It must be extended to natural environments and natural resources, and it must embrace the complex issue of how to reconstruct and build social capital. Whereas globalisation has unquestionably been associated with investment in human-made capital, and whereas it has improved human capital via increased knowledge and indirectly via the income-induced demand for more education and health, it is less obvious that globalisation can be relied upon to safeguard social and environmental capital. Hence policy needs to be especially directed at those assets.

¹⁴ These examples are taken from the numerous studies reported in Isham et al., 2002.

PART II

MANAGING GLOBALISATION FOR SUSTAINABLE DEVELOPMENT

I. A SUMMARY OF ACTIONS

34. Part I of this paper showed that, while globalisation may appear as an inevitable process, the reality is that it is, at least to an important extent, manageable. This section raises issues designed to stimulate discussion by Ministers about the ways in which the Commonwealth can help to design positive actions that can be taken forward by the World Summit on Sustainable Development (WSSD).

35. Table 1 sets out the issues according to the framework developed in Part I. First, each of the assets necessary for sustainable development and identified in Part I is listed, along with the ways in which globalisation affects the process of asset formation in developing countries. The potential solutions to any adverse consequences of globalisation are then set out. The actions are expressed in terms of investment in the different assets and in the conditions necessary for investment to be successful. Those conditions have to be thought of as the necessary requirement for any investment to succeed. Even the most well thought out policies and projects will fail if the structure of incentives in society and in the economy is not consistent with the project or policy. Indeed, this is the single most important reason as to why initiatives fail.

36. The actions in the Table are then discussed separately. There is no suggestion that these actions are comprehensive, but they emerge from the framework discussed in Part I and they are generally consistent with suggestions being made elsewhere. All investment requires finance. The paper concludes with a discussion of possible innovative and improved financing mechanisms that Ministers may wish to discuss.

Table 1. Globalisation impacts, problem areas and potential solutions

Asset or feature of sustainable development which raises human wellbeing	Ways in which globalisation affects assets, or associated problem	Mitigating actions by world governments
Increasing human-made capital	<i>Foreign investment</i> More foreign private investment but bias against poorest developing nations and the Former Soviet Union. Increasing marginalisation of the poorest. Static official aid.	1. The political climate for private investment must be improved through reduced corruption, improved democracy, more participation, adherence to human rights, good governance. 2. Urge the 0.7% GNP target for DAC is met by all rich

	<p><u>Domestic investment</u> Low domestic savings/investment ratios</p>	<p>nations. Substantially improve the debt relief programmes of multilateral and bilateral institutions.</p> <p>3. Reduce protection by rich countries which disadvantages developing world.</p> <p>4. Reduce high discounting of the future by the poor by credit reform, property rights, collective security.</p>
Increased natural capital	<p>Environmental standards may be improved through need to compete on world markets, and via technology transfer, but -</p> <p>Risk that market forces will neglect the environment as a public good with apparently low rates of return</p> <p>Economic growth may bring long-term environmental improvement but it is not guaranteed.</p> <p>Developed country greenhouse gas emissions will do more harm to poor countries than rich countries.</p>	<p>5. Steadily increasing environmental standards and instruments for internalising externalities. Encourage creation of markets in environmental assets.</p> <p>6. Invest <u>early</u> in pollution control and resource conservation and demonstrate that there are high social returns to such investment.</p> <p>7. Work towards early ratification of the Kyoto Protocol and begin a rapid process of investing in impact-mitigation in vulnerable economies.</p>
Increasing human capital	<p>Potential 'virtuous' circle: globalisation encourages growth which encourages demand for health and education which further encourages growth, but -</p>	

	<p>Process can by-pass women,</p> <p>Human health can be impaired by lack of investment in environmental capital for the poor,</p> <p>Health can be damaged if globalisation leads to short run unemployment,</p> <p>Social expenditures to cushion short run impacts of globalisation may by-pass the poor</p>	<p>8. Invest in human capital generally, but correct gender bias through equal access to education and health, emancipation, gender mainstreaming, and listening to the voices of women.</p> <p>9. Recognise investment in natural capital as complementary to investing in human health.</p> <p>10. Cushioning institutions and resources need to compensate for short run impacts.</p> <p>11 Re-target social expenditures to where they are most needed. Tackle corruption and rent seeking.</p>
<p>Increase social capital</p>	<p>Possible virtuous circle: globalisation encourages growth which appears to encourage less social disruption, greater equality and more respect for human rights, but:</p> <p>Short run employment impacts can destroy social capital. Potential worsening of 'household' social capital if men and women react differently to new opportunities.</p> <p>Not always the case that the growth process benefits the poor, leading to loss of community and social identity</p> <p>Potential conflicts between indigenous and imported</p>	<p>12. Gender-based policies and gender sensitive social cushioning policies needed - see above.</p> <p>13. Encourage local community formation, NGO activity, compliance with human rights, reduced corruption in government. Encourage common property.</p> <p>14. Encourage 'corporate social responsibility' in FDI</p>

	cultures due to foreign investment and imported labour.	and in all official aid. Invest in niche markets utilising indigenous skills and knowledge.
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II. THE ACTIONS

A. *The political climate for private investment must be improved through reduced corruption, improved democracy, more participation, adherence to human rights, good governance.*

37. Good governance is not a luxury, but a basic requirement for development. Human rights, peace and security are needed to provide the conditions for the well functioning markets that globalisation should induce as protective barriers fall. The ability of the poor to participate in markets requires their access to property rights, education and health services. Good governance in economic management will help to create an attractive investment climate and enable countries to take advantage fully of the benefits of globalisation. Democratic systems and good governance underpin effective policy monitoring and implementation. The poor in particular attach great importance to security from violence, and for their property, and yet are often distrustful of the police and the criminal justice system and suffer more than other sectors of the population from corruption (UK Government, 2000). Participation of all relevant groups, including the poor, in policy-making provides legitimacy, effective policies and an opportunity for mutual learning. This is as true for the smallest communities, to the global architecture, where small states and least developed countries, whose resources are severely constrained, are particularly disadvantaged. This issue was discussed by Commonwealth Environment Ministers in Nairobi in February 2001 (CCGE, 2001).

38. Policy reforms towards greater transparency and a minimisation of administrative discretion will reduce rent-seeking and eliminate incentives that generate corrupt practices. The task of good governance and fighting corruption rests not only with governments, but with the business community and multilateral institutions too, who must also be accountable for their actions and advice.

39. Overall, the 'investment climate' includes the tackling of corruption, protection of property rights, institutional reform and reduced bureaucracy and the enforcement of contract law. Again, such measures underline the inadequacy of partial reforms and policies. Environmental and social improvement are not likely to succeed through more and better investment unless the context in which that investment takes place itself improves. But the pervasiveness of the reforms needed is itself a massive challenge to the development community.

40. The Commonwealth can help by:

- promoting a culture and awareness of human rights;
- supporting the empowerment of women through implementation of the Commonwealth Plan of Action on Gender and Development;

- reinforcing and implementing the Commonwealth Principles on Promoting Good Governance and the Elimination of Corruption;
- advocating the negotiation of a UN compact on good governance and the elimination of corruption;
- reinforcing and implementing the Principles for Corporate Governance in the Commonwealth (Commonwealth Association for Corporate Governance)

41. In terms of processes, we have made great strides in tools to support sustainable development (such as environmental assessment and economic approaches to environmental policy) and institutional arrangements (Agenda 21 processes, co-ordinating committees in government, national environmental action plans), but there is still a need to bring about a deeper integration of the three pillars of sustainable development. One way to achieve this might be through fully multi-sectoral, interdisciplinary and participatory approaches in key areas that can provide effective intervention points in delivering sustainable development.

42. These might include:

- future scenario-planning, focusing on different climate change scenarios and human capital development requirements;
- risk management, to ensure that inherent risks in development are identified and reduced or mitigated. This issue was recently examined by a UN Expert Group on 'Environmental Management and the Mitigation of Natural Disasters: a Gender Perspective' (UNDAW 2001);
- trade and sustainable development;
- human settlements issues; and
- broad-based policy approaches to health, as advocated by Commonwealth Environment Ministers at their meeting in Christchurch in November 2001, to address social and economic determinants of equity in health, not just health care.

43. The World Bank's environment strategy focuses on three similar areas of intervention: health; livelihoods; and vulnerability to natural disasters. Important elements in these processes are a focus on sustainable development and poverty reduction; gender sensitive analysis; good feedback mechanisms; and two-way information flows between different levels of decision making. .

B. Urge the 0.7% GNP target for DAC is met by all rich nations. Substantially improve the debt relief programmes of multilateral and bilateral institutions.

44. The World Bank (2001) recommends targeted and increased foreign aid and better debt relief. The dramatic changes in the status of official aid relative to private investment flows have been noted. Official aid needs to increase in line with previous promises, but it also needs to be better targeted towards the marginalised economies that have not been embraced in the globalisation process. In order to be effective, a clearer understanding of why some economies have been by-passed by globalisation needs to be established. Accepting, for the time being, that risk factors are too high for private investors, carefully managed official aid can partly fill the financing gap.

45. Official DAC¹⁵ aid amounted to \$56 billion in gross terms in 1999, or some 0.24 per cent of DAC Members' GNP. This fraction has declined from 0.34 per cent in 1990, and in per capita terms from \$77 per DAC person to \$66. Achievement of the UN target of 0.7% would, applied to current GNP, generate in the region of \$100 billion p.a. in additional aid flows, and more if growth of GNP in the developed world is allowed for. The ancillary target of 0.15-0.20% of GNP for the least developed countries would also help to alleviate the 'bypass' effect that globalisation is having on these poorest countries. At the same time, there have been widespread discussions about the extent to which existing ODA is 'efficient'. For example, much of it is being used to finance debt repayment rather than new development initiatives, a significant proportion appears to go on transactions and administrative costs, and serious doubts have been expressed about the success rate of those funds that have been development-oriented. These are long standing debates but they serve to underline the fact that increasing total aid on its own is not enough.

46. In addition to increased and more efficient official aid, debt relief in those countries with unsustainable debt repayments can be combined with domestic policy reform and poverty alleviation policies. The IMF and World Bank have already initiated a programme for heavily indebted poor countries (HIPC) in return for sound economic management policies. Nonetheless, relief to date has been modest and the 'conditionality' attached to debt relief has itself been criticised. There is an uneasy tension in debt relief policies. Attaching no conditions invites the risk of misuse of the released funds. Attaching conditions raises traditional criticisms of interference and relies heavily on the assumption that those imposing the conditions know best.

47. The relief of high levels of international debt self-evidently releases funds that would have been targeted at interest payments and capital repayment. It is important that any such release is not wasted and that it is directed at investments to improve the chances of sustainable development, i.e. investment in the four forms of capital identified earlier. Debt service (the payment of interest and capital charges) currently absorbs sums equal to around 17% of the exports of goods and services in low and middle-income countries. Clearly, debt relief is a complex matter: relief will be counterproductive if policies are not in place to prevent new indebtedness arising.

C. Reduce protection by rich countries which disadvantages developing world.

48. The World Bank (2001) recommended a 'development round' in international trade negotiations aimed at substantial reductions in industrial and agricultural protection by developed countries and which harms developing country exports. It is estimated that such protection costs the developing world at least \$100 billion p.a., twice the flow of gross official aid. The World Trade Organisation has already pledged to integrate the interests of the poorest countries into future trade negotiations: 'we are committed to addressing the marginalisation of least developed countries in international trade and to improving their effective participation in the multilateral trading system' (WTO, 2001, para 3). Such policies have the attraction of being potentially immediate in their implementation and in not requiring investment in institution-building: they require the effort to be made in the rich world, and now. But removing protection will not happen with a stroke of the pen, as the GATT/WTO negotiations have shown over the years. There are strong vested interests to be

¹⁵ Development Assistance Committee of the OECD.

overcome. But tackling them will not just benefit the developing world, it will also show that the rich nations are willing to suffer costs of adjustment to benefit the developing world.

D. Reduce high discounting of the future by the poor by credit reform, property rights, collective security.

49. What evidence we have is that the poor 'discount' the future heavily, attaching low importance to it relative to the present. This militates against investment in soil conservation practices, tree growing, agro-forestry and other environmentally beneficial activities that are essential for a sustainable livelihood. Bringing those discount levels down requires (a) affirmation of existing property rights so that the risk of dispossession is minimised, (b) creation of property rights through land reform, (c) adequate legal institutions for settling resource and property rights disputes, and (d) adequate enforcement mechanisms. Additionally, (e) investment in credit institutions targeted at the poor, (e.g. the Grameen bank), is required.

E. Steadily increase environmental standards and instruments for internalising externalities. Encourage creation of markets in environmental assets.

50. Environmental standards unrelated to human health need to be increased at a modest rate and as finances allow. Current institutions may not be adequate for the experimentation with new environmental policy measures such as tradable quotas, but the evidence suggests there is more scope for such things as environmental taxes which have the potential to raise public revenues as well as correct environmental problems. Environmental standards related to human health demand much earlier attention, as countries like China have fully recognised.

F. Invest early in pollution control and resource conservation and demonstrate that there are high social returns to such investment.

51. Better epidemiological information has now shown that water and air pollution are major health risks in developing countries. Investing in pollution control, clean water and sanitation has large social returns. Methodologies to estimate these return do, however, need further improvement and a campaign of persuasion to the effect that early pollution control is an essential condition for human capital development, and hence sustainability, is required.

G. Investing in climate change reduction, and impact-mitigation in vulnerable economies.

52. Because the climate change impacts in developed countries will be among the most significant, reduced global warming will have a proportionately greater benefit in the developing world. Some measures whereby mutually beneficial emission reductions can be obtained are enabled in the Kyoto Protocol through the 'Clean Development Mechanism' (CDM)¹⁶. Such 'emission trading or offset' schemes can provide finance for emission reductions in the developing world. One of many ways in which sustainability could be supported through the CDM is to focus on those greenhouse gas emission reductions that generate 'ancillary benefits' (OECD, 2000). Reducing power station or industrial emissions,

¹⁶ The CDM allows for developed economies to invest in emission reduction in the developing world, jointly or exclusively financing such investments, and claiming credit for the emission reduction against their own Kyoto target.

for example, also reduces the emissions of conventional pollutants that are jointly produced with carbon dioxide. Thus, sulphur and nitrogen oxides would be reduced, as would the level of particulate matter which, epidemiology suggests, has the largest effect on life expectancy and morbidity (Lvovsky et al., 2000). In this way, the immediate benefits of improvements in human capital (via health improvements) can be combined with assisting the long run goal of reduced warming.

53. In addition to emission reduction, there is a need to invest significantly in *impact mitigation*, i.e. in reducing the impact of that climate change that will occur regardless of international efforts to reduce emissions. There is an argument for enhancing the role of the Global Environment Facility (GEF) to include mitigation investments such as protection against sea level rise, new strains of climate-resistant crops, more weather-resilient housing and infrastructure, and so on. The difficulty of developing such a mitigation strategy is that it may be perceived as an excuse by the developed world to reduce its obligations to cut emissions.

H. Invest in human capital generally, but correct gender bias through equal access to education and health, emancipation and listening to the voices of women.

54. Investments in education and health need to be better targeted on the poor. Since, in many cases, such social expenditures are 'captured' by the better-off in developing countries, the poorer parts of society need to have a bigger 'voice' in decision-making generally and in allocation decisions. In turn, this requires defining, establishing and enforcing the property rights of the poor so that they have countervailing power against the interests of the better off, and improving their participation in all levels of decision-making. Narayan et al. (2000) summarises the conclusions of an extensive study of poor communities world-wide, utilising the expression of concerns by the poor themselves. Limited capital assets and limited voice produces the sense of pervading powerlessness. The poor are disadvantaged in their dealings with officialdom and the state, often suffering more than higher income groups from corrupt attitudes and indifference. Thus reform has to be pervasive, challenging the very attitudes that treat the poor as inferior. Social and political reform on this scale is probably the most serious challenge for sustainable development.

55. Within that reform, a special and renewed focus on women is called for. There is a need for substantial acceleration of measures to secure equal access to education and health, and a better understanding of the comparative advantage that women have in knowledge about entrepreneurship and natural resources.

I. Recognise investment in natural capital as complementary to investing in human health.

56. Investment in a cleaner environment needs to be seen as integral to investment in human capital. Health improvements from reduced indoor and outdoor pollution are significant and take on the nature of a public good that is especially suited to official aid and investment.

J. Cushioning institutions and resources need to compensate for short run impacts.

57. As noted above, globalisation can have short run disruptive effects, especially on industries that have been protected within developing economies. The World Bank (2001) recommends specific social protection measures, e.g. forms of social insurance and mandatory saving that can act as buffers during periods of readjustment due to globalisation.

K. Re-target social expenditures to where they are most needed. Tackle corruption and rent seeking.

58. Social expenditures often themselves take on the form of 'rents' for which the better off will compete against the poor. The unequal balance of power often means that the poor fail to secure their fair share of available social benefits but they also fail to secure the benefits if improved drinking water supplies and irrigation water. The scope for corruption in seeking special favour is substantial and can only be improved by political reform, adherence to human rights, and the creation of a countervailing power among the poor.

L. Encourage local community formation, NGO activity, compliance with human rights, reduced corruption in government. Encourage common property.

59. Disorganised and unempowered, the poor are no match not for legally valid agents who compete with them for resources or indeed corrupt officials and legislators. Suitably empowered, the voices of the poor can be heard. The creation of self-help groups and pressure to enforce property rights among the poor, including the registration of traditional rights to resources and the land, can greatly assist the redressing of the imbalance between the poor and others.

M. Encourage 'corporate social responsibility' in FDI and in all official aid. Invest in niche markets utilising indigenous skills and knowledge.

60. By far the greatest financial flows to developing countries are those from foreign direct investment. Yet much of this investment is not associated with any regulation relating to the social and environmental responsibilities of the investors. Establishing and enforcing those regulations is a two way process: the developed world has to insist that its own corporations adopt responsibility guidelines and enforce them through independent monitoring and assessment; the developing world has to demand that investors adopt those codes. It is tempting to relax standards in an effort to attract investment away from potential competing hosts. Acting together the developing countries can prevent this damaging competitive process.

PART III

I. FINANCING SUSTAINABLE DEVELOPMENT

61. All the actions listed in Part II require financing in one form or the other. Widespread discussions have taken place internationally about ways to finance sustainable development and the issue will be a priority at WSSD and is the subject of a dedicated meeting in Monterrey, Mexico in March 2002¹⁷. A 'menu' of policies beyond those of increasing official aid and debt relief, which were discussed in Part II, is outlined below.

A. External actions

(i) *Subsidy removal*

62. World-wide subsidies total at least some \$600 billion in OECD countries and another \$150 billion in the non-OECD world. (Pearce and Finck von Finckenstein, 1999). Not all these subsidies are distorting, but most are. Subsidies in the developed world designed to protect labour and resources against competition probably impose a cost on the developing world of \$100 billion p.a. (World Bank, 2001). In addition, the \$150 billion subsidies in the developing world are focused mainly on water and energy, encouraging wasteful use and a host of environmental problems. This suggests that removal of subsidies that are harmful to the development of the developing world might release at least \$200 billion p.a., around four times the annual ODA. Removing subsidies is difficult because of the 'rents' they create, resulting in interest groups who utilise economic resources to ensure the subsidies are retained, but numerous examples exist to facilitate the building up of international experience in strategies to reduce subsidies (Pearce and Finck von Finckenstein, 1999). Developed countries may argue for subsidy removal in developing countries as a requirement for economic efficiency, but in so doing they should take prior steps to remove those subsidies designed to protect their own industries and labour force and which damage the developing world's interests.

63. Will reduced protection help the poorest developing countries? One problem here is that it will initially help by reducing the barriers to agricultural exports, but it may at the same time 'lock' those poor countries into primary commodity exports which have volatile international markets. One issue is how those economies can join the faster growing developing countries in sharing in the growth of manufacturing exports. Another is how developing countries with a competitive potential in agriculture, can also be allowed to benefit from globalisation. It may require interim subsidies.

(ii) *Carbon trading*

64. The notion of a carbon offset has been formalised in actual deals since 1989. Effectively, they amount to 'joint implementation' as defined under the Kyoto Protocol. In return for financing emission reductions in the developing world, Annex 1 emitters can claim credit against their Kyoto targets for the emissions reduction in the host country. The Kyoto Protocol could therefore provide an incentive for such carbon trades. However, it should not

¹⁷ The International Conference on Financing for Development in Monterrey is preceded by the PrepCom Session in New York January 14-15. See UN (2001) and CCGE(02)(INF)1.

be overlooked that many such trades exist independently of the Kyoto Protocol. Many firms have invested in carbon deals either in anticipation of Kyoto compliance or to secure some 'green' marketing advantage. Some of these deals are large, as with the Peugeot deal with Brazil and the Shell deal with Gabon, both brokered by the NGO 'Pro Natura'. Governments can encourage such deals by encouraging corporations to adopt voluntary emission ceilings. The deals effectively finance sustainable development initiatives since these are contained in an overall development package linked to the carbon reductions.

65. Some concern may be expressed about factors limiting such deals in the context of Kyoto. Some of the voluntary deals in place relate to carbon sequestered in biomass, and a few relate to avoided emissions from reduced deforestation. Where the deals relate to forested land, carbon sequestration may be associated with other benefits such as biodiversity conservation.

(iii) 'Greening' multilateral funds

66. While all multilateral and bilateral financing of aid to the developing world now honours environmental safeguards, some suggestions have been made that would turn at least one of the multilateral agencies into an International Bank for Environmental Settlements (IBES)(Chichilnisky, 1997). Essentially, the proposal elaborates on the notion of market creation above. But in this case the natural capital assets of the developing world (forests, wetlands etc) would become the collateral of the IBES. The IBES would facilitate tradable carbon emission permits, extending joint implementation by enabling any credits secured from JI to be securitised and sold on to other parties. The IBES would deal in loans of emission rights rather than their direct sale thus avoiding a problem with current emission trading proposals, namely that developing countries may feel that in selling emission rights they are placing at risk any future economic development that relies on emission rights being held. The desire of developing countries to lend 'short', i.e. loan rights for short periods, could be made compatible with the developed countries' desire to borrow 'long' through the IBES. The IBES would borrow short and lend long to finance the transactions, charging a borrow-lend spread. Similar ideas could relate to other developing country environmental assets.

67. Realisation of the notion of an IBES is perhaps some way into the future. Nonetheless, if the problem of financing sustainable development is to be tackled, highly original thinking will be required. The central notion is that the world's ecosystems are stores of great economic value, but that value is not realised through current market structures.

(iv) Potential sources of major finance

68. Various suggestions have been made for ways by which revenues could be obtained for sustainable development. Suggestions range from modest taxes on foreign exchange transactions to taxes or charges on 'real' transactions which can be thought of as contributing to non-sustainability. The former approach is exemplified by the 'Tobin tax' (Felix, 1995)¹⁸. The essence of a Tobin tax is that free speculative capital mobility between nations is not consistent with stable exchange rates and free trade. Speculative capital often moves in such a way as to destabilise efforts to regulate the real economy, as might be witnessed in major financial crises. Hence some regulation of capital mobility is required and a tax on foreign exchange transactions might achieve this. Another way of thinking of the Tobin tax is that it

¹⁸ The Tobin tax is named after James Tobin who advanced the idea in the 1970s - see Tobin (1978).

is a tax on financial globalisation. A 0.25% tax might raise well in excess of \$200 billion. Tobin's original proposal was that any revenues should be diverted to international agencies for use in developing country projects, so the idea is relevant to the notion of financing sustainable development. Moreover, it can be argued that exchange rate instability does serious potential damage to developing countries since they are more likely to suffer from such short-term speculation. If so, then the tax has a link, albeit indirect, to the factors creating non-sustainability. The central problem with such a tax is the international co-operation needed to make it effective. No one country will have any incentive to adopt such a tax if it does not believe others will do likewise. The idea continues to be discussed internationally.

69. A second category of financing proposals attempts to link taxes or charges to factors giving rise to environmental non-sustainability. C  men  on (2000) reviews these proposals, a number of which are fairly radical:

- A modest tax on carbon or energy. A 15 cents/barrel tax on oil consumed in developed economies, for example could yield a little under \$2 billion p.a. This might be levied as an addition to domestic gasoline/diesel taxes.
- A charge on new car registrations in OECD countries might yield \$1.5 billion.
- A tax on international air transportation, especially as aviation kerosene is currently untaxed under the Chicago Convention. of 1944.
- A charge on international tourism. A \$1.5 fee per international arrival would raise \$1.5 billion.
- A per capita \$1 charge on all people in OECD countries. This would raise around \$1 billion.
- A global trust fund based on one-off contributions from OECD countries.

70. Once again, the problem with all these measures is that of securing international agreement to any of them. There are strategic advantages to 'holding out' against such measures, making international agreement very difficult. A second problem is that, compared to the Tobin tax, and compared to any realistic assessment of the financing needs of developing countries, the measures in question yield very modest sums. To make them yield significant sums, major increases in the tax or charge rate would have to be secured, making the chances of international agreement even less.

B. Domestic actions

71. Resources within developing countries need to be mobilised, which effectively means raising savings rates. A number of initiatives is possible.

(i) Economic instruments

72. Traditional environmental and resource conservation policies focus on 'command and control' measures, dictating the environmental goals that resource users should achieve and, often, the way they should achieve them. Not only do such measures not generate any regulatory revenues, they actually diminish the resources available to firms seeking to comply with the regulations. The latter effect arises because such measures are more expensive in compliance terms than the alternative of market-based instruments. Market based instruments such as environmental taxes and auctioned tradable permits have the potential to raise revenues which can then be used directly for conventional development

purposes or hypothecated to specified sustainable development goals. In the OECD countries, revenues from environmental taxes already account for an average of 2 per cent of GDP (OECD, 2001). A significant number of such taxes are now hypothecated either for reducing taxes on labour (thus encouraging employment) or for other environmental purposes. While the scope for such taxes in the developing world may be less, due to institutional weakness, it is far from the case that there is no scope at all and many initiatives exist (Panayotou, 1998).

(ii) *Making existing environmental markets more efficient*

73. Many environmental goods and services are already bought and sold. Ecotourism, for example, is a vital industry for Africa, the one continent that has been marginalised by globalisation. In Southern Africa, international tourist arrivals have risen from 4 million people p.a. in 1990 to 12 million p.a. in 1998. Most of these visitors experience a 'consumer's surplus' - i.e. they are willing to pay more for the tourism experience than they actually pay. Tourist resorts, safaris etc. are unwilling to raise charges for fear of losing revenues, but many studies now show that there is ample scope for raising charges for access to wildlife areas, and for schemes that differentiate charges between local, regional and international visitors. If some of the consumer surplus is diverted to the ecotourism area: visitors are no worse off than before (they are willing to pay the extra charges) and the ecotourism area is better off. If funds can be directed towards ecological conservation efforts, the environment gains. Local communities can also gain by being paid a share of the increased revenues in return for adopting communal protection policies towards local wildlife and ecosystems. Numerous experiments have now been developed based on this simple idea. Extracting the consumer surplus is good for the ecosystem and wildlife, and good for the usually very poor local communities. This is not to deny the complexity of implementing such measures successfully over the longer-term.

(iii) *Privatisation*

74. In the same vein, many ecological assets are nominally managed by local or national governments who have no comparative advantage in that field, nor the finance to carry out the role effectively. The availability of government funds falls far short of the minimum necessary for the conservation of national parks and other protected areas (Krug, 2002). Traditional reluctance to permit the private ownership, or to lease the private management of such resources, is now giving way to a recognition that privately managed ecosystems and services can improve the quality of the ecosystem, avoid the public expenditure that would otherwise be incurred, and provide benefits for local communities. Governments can play several roles. The benefits of privatisation frequently need to be demonstrated due to innate resistance to the idea. Aid packages could help with the reform of property rights laws that frequently inhibit foreign ownership or licensing.

(iv) *Micro-credit*

75. Due to their lack of collateral, small businesses and individuals in poor countries frequently rely on informal credit markets where real interest rates are extremely high. The effect is to depress the vast reservoir of entrepreneurial ability in these countries and effectively exclude whole sections of the population from an enterprise culture. The experience with microcredit institutions, frequently lending extremely small, but effective, sums to individuals and community groups has shown that borrowers can react successfully to such initiatives. The effects appear to be especially important where women are borrowers

since (a) they tend to be discriminated against in size and price of loans in conventional markets, and (b) they may well be wiser judges of good investments.

(v) *Financial markets*

76. The strengthening of financial markets can do much to 'liberate' financial flows in developing countries. Even where total funds may not increase, more efficient markets can channel funds more effectively by 'matching' borrowers and lenders.

(vi) *Market creation*

77. Carbon trading is an example of 'market creation', a process whereby a hitherto unmarketed good, such as global atmospheric quality, is marketed via a trade between two or more agents. A carbon trade effectively establishes a market in carbon emission reduction, and the resulting market establishes a price for carbon. This price will be somewhere between the price which those with emission ceilings are willing to pay, and the price implicit in what the host country is willing to accept by way of financing.

78. But this principle is perfectly general and can be applied to any environmental effect where someone gains from reducing the effect. A downstream farmer has an incentive to pay an upstream forest owner to reduce deforestation in order to conserve a regulated water supply. The payment will be less than the cost to the farmer of crop damage due to irregular water flows or floods. The upstream owner has an incentive to accept such a payment so long as it is more than the value of the alternative use of the forest land, e.g. crops, logging, livestock. In Colombia, downstream farmers are beginning to pay upstream forest owners to conserve the forests. New York City has chosen to protect upstream catchments in the Croton and Catskills watersheds, rather than pay nearly \$5 billion for water treatments plants that it will need to deal with the projected pollution of water if the catchment is not protected. US experience is showing that for each \$1 invested in catchment protection, several dollars can be saved in avoided treatment expenditure. In 1996 Costa Rica developed a new Forestry Law which recognised the role of forests in carbon fixation, watershed protection, biodiversity protection and scenic beauty. Funds raised by an energy tax are to be used to pay forest landholders who provide these environmental services. The government also brokers deals whereby carbon is 'sold' to international and domestic buyers, the funds again being used to pay forest landholders to conserve these functions. Prices are set for the compensation on a per hectare per time basis, but these may change over time. Other examples are already familiar as with the deal between Merck and Costa Rica for genetic material prospecting in tropical forests.

79. To what extent do such developments require intervention by governments? While many deals have simply evolved, the Cost Rican experience shows how government intervention can accelerate the process. Additionally, such trades may need to be brokered, regulated and enforced, requiring government action. Finally, governments can disseminate information about the experience with such deals.

II. CONCLUSIONS ON FINANCING SUSTAINABLE DEVELOPMENT

80. The overwhelming conclusion of this brief 'tour' of financing mechanisms is that there is abundant finance for sustainable development in the developing world. What has happened

is that the natural resources and environments in the developing world are undervalued by current market structures, and are further debased by misguided policies in the developed and developing world alike with respect to protection and the support of special interest groups. According to some estimates, subsidy reform alone could release at least \$100 billion in developing countries, and a further \$100 billion could be secured as a benefit to developing countries by reducing protection in developed economies. The immense financial value of natural resources needs to be unlocked through market creation and other incentive systems. Private capital flows need to be 'greened' by ensuring that such flows finance the full social costs associated with economic development. At the same time, there has to be more commitment to the traditional policies based on official aid, both in terms of the quantity of aid and its quality.

III. ARE NEW INSTITUTIONS NEEDED?

81. A significant number of suggestions have been made for new international agencies to co-ordinate financing for sustainable development. Thus, there have variously been suggestions for a World Tax Authority, a World Environment Agency, a World Financial Authority/Organisation, and a revamped International Labour Office. In all cases, the proposals reflect the view that existing organisations either do not have the power or the outreach to deal with the potential problems of globalisation. However, it is far from clear that creating new organisations resolves the problem. An example of a relatively successful new organisation would be the GEF, yet the most the world appears able to do is to grant the GEF a modest \$1 billion or so per annum, barely scratching the surface of international problems. The analysis earlier in the paper suggests that there are many things that can be done without new institutions, but which certainly do require international political will to encourage them.

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