Chapter V
The changing context of development and inequality

Previous chapters build the case for focusing on inequality, highlighting the stark contrasts within and between countries. It is appropriate at this juncture to explore the dynamics underlying this unwelcome reality.

National and international events and circumstances have had a major impact on the pace and level of social development. Globalization stands out as one of the most important phenomena influencing social development in the twenty-first century; of particular significance is the asymmetry of globalization, which has led to the emergence of "winners" and "losers". The new international trade regime has serious implications for the hopes raised at the World Summit for Social Development in 1995. Structural adjustment programmes and market reforms have shaped the economic and institutional context in which financial and trade liberalization have unfolded in recent decades. These changes have generally had a negative impact on the welfare of individuals, groups and communities worldwide, and have some negative implications for future development.

With the combined challenges of globalization and market reforms, including financial and trade liberalization, it becomes evident that the path towards social development can only be charted once the political and institutional dimensions of the current international context are better defined and any shortcomings identified and addressed. Clearly, the quality of governance and of policies formulated within national frameworks can either promote or impede social development. One pressing issue requiring closer attention is financing for development.

Theories of economic convergence suggest that the increasing integration among countries brought about by globalization will promote the convergence of income levels and a consequent reduction in overall income inequality (Barro, 1991; Barro and Sala-i-Martin, 1992; Ben-David, 1993). Existing evidence seems to refute this premise, however, and some studies question whether globalization in its current form can contribute to reducing inequalities worldwide.

Globalization: asymmetries and the loss of policy space

The current global economic system is circumscribed by an international agenda dominated by the issues of free trade, intellectual property rights, financial and capital account liberalization, and investment protection. Conspicuously absent from the agenda are items of critical importance to developing countries, including international labour mobility, international taxation of capital income, financing mechanisms to compensate marginalized countries and social groups, and mechanisms for ensuring macroeconomic policy coherence among industrialized countries and a consequent reduction in the exchange rate volatility among major currencies. The same issues tend to be assigned varying levels of priority and urgency by different groups of countries, and market competitiveness can place countries in direct opposition to one another. For example, products of vital economic importance to developing countries, such as agricultural and labour-intensive manufactured goods, are given the highest levels of trade protection in developed countries, as evidenced by the provision of massive subsidies. In addition, service negotiations remain focused on products and services of major concern to developed countries, including telecommunications and financial services, while modalities that are of particular interest to developing countries, such as the mobility of labour (particularly unskilled labour) for the provision of services, are neglected (Ocampo and Martin, 2003).

One of the more important asymmetries relates to the unbalanced agenda underlying the current process of globalization; more precisely, there is a contrast between the rapid pace of economic globalization and the relative weakness of the international social agenda (deriving largely from the very poor accountability and enforcement mechanisms in the realm of social development). There is increasing recognition of the need to provide the necessary space in the international system for the protection of political, social, economic and environmental "global public goods" (Ocampo, 2005).

As implied in this *Report*, the "policy space" in most countries is somewhat constricted under the current international trade and financial system. Global competitive pressures tend to restrict a country's policy choices and often have an adverse effect on social development, since decisions or actions required to advance social policies and social equality are usually perceived as unnecessary costs. Put simply, social development policies are often mistakenly considered to be in conflict with the preservation of a country's international competitiveness.

The desire of developing countries to attract foreign investment and expand exports has frequently led to a "race to the bottom" in which labour protection and environmental standards are ignored or compromised to make the countries more competitive in the international market. As this suggests, external competitive pressures have restricted the ability of some countries to pursue certain aspects of social policy and have therefore undermined the progress of social development.[1]

Noting the prevailing asymmetries in the world economy, the United Nations Conference on Trade and Development (UNCTAD), in the Plan of Action adopted at its tenth session in Bangkok in February 2000, calls for enhanced bilateral and multilateral efforts to safeguard vulnerable populations and for the benefits of globalization to be more widely shared, stating that "there is no automatic process by which the income levels of developing countries will converge towards those of developed countries" (United Nations Conference on Trade and Development, 2000, para. 4). The Plan of Action stresses the importance of effective social policies for economic growth, noting, for example, that "good health and the attainment of basic education are essential building blocks of development and indispensable for reducing poverty and inequality" (United Nations Conference on Trade and Development, 2000, para. 9).

At its eleventh session, held in São Paulo in June 2004, UNCTAD "built on its previous session by appealing for more coherence between national development strategies and global economic processes in order to achieve economic growth and development. It emphasized that most developing countries have not benefited from globalization and are still facing major challenges in realizing their economic potential, developing their productive sectors and creating employment for a large proportion of their population" (United Nations Conference on Trade and Development, 2004b).

In addition, "the debate focused on ways to make trade work for development, particularly the capacity of international trade to contribute to poverty alleviation and reduce instability in world commodity prices" (United Nations Conference on Trade and Development, 2004b). These themes were reiterated by the ILO in the 2004 report of the World Commission on the Social Dimension of Globalization, "which stressed the importance of policy coherence in achieving a far more inclusive globalization" (International Labour Organization, 2004).

While UNCTAD emphasized at its eleventh session that "development was the primary responsibility of each country, it also recognized that domestic efforts should be facilitated by an enabling international environment based on multilaterally agreed and applied rules" (United Nations Conference on Trade and Development, 2004b). The Conference concluded that "to achieve … sound global economic governance … it was necessary to improve coherence between national and international efforts and between the international monetary, financial and trade systems, so that they were more capable of responding to the needs of development" (United Nations Conference on Trade and Development, 2004b).

Some aspects of the current international agenda pose special challenges for developing countries. A prime example is the World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). Although the basic presumption is that effective protection of intellectual property rights will increase technical innovation and the transfer of technology, there are recent indications that the Agreement may actually restrict technology transfer and jeopardize the interests of poorer countries to protect those of richer countries. More broadly, the TRIPS Agreement may increase the cost of, and thus narrow the range of modalities for, transferring technology to developing countries.

Liberalization policies implemented in many countries in the past couple of decades have produced important changes in the labour market and in labour laws and institutions, including a shift towards greater wage flexibility, the downsizing of public sector employment and a decline in employment security and protection. These changes have led to expanded informal employment, higher labour mobility and less job stability. There has also been greater diversification of the issues of particular concern to workers, and a decline in the importance and bargaining power of trade unions and other labour institutions.

The changes highlighted above have contributed significantly to increases in wage inequality and overall within-country inequality, especially in medium-income developing and transition economies and OECD countries (Cornia and Court, 2001). In view of the fact that wages constitute around 60-70 per cent of total income in most developed countries, this rising earnings inequality is an important component of the increase in overall income inequality.

In many cases, there has been a drop in real minimum wages and a sharp increase in the highest incomes. Among industrialized economies, the widening of the income gap has been especially marked in Canada, the United States and the United Kingdom, where the share of the top 1 per cent of income earners has risen sharply (Atkinson, 2003). In the United States, this group's share reached 17 per cent of gross income in 2000, a level last seen in the 1920s (International Labour Organization, 2004). In developing and transition economies, the rise in earnings inequality has followed a similar pattern. In Brazil and Mexico, for example, trade liberalization has caused wages to decline, especially among unskilled labour, further increasing the wage gap between skilled and unskilled workers (International Labour Organization, 2004). The liberalization of trade has widened the wage gap in six of the seven Latin American countries for which reliable wage data are available, as well as in the Philippines and Eastern Europe (Lindert and Williamson, 2001). Data indicate that in the OECD, Latin American and transition economies, the rise in wage inequality was particularly dramatic between the mid-1980s and mid-1990s, though the extent of the problem varied (Cornia, 2004).

The impact of liberalization and stabilization policies on inequality

Foremost among the global dynamics that help explain the root causes of persistent inequality trends are the liberalization policies implemented in many countries during the past two decades. These reforms have been applied by countries worldwide and have had a major adverse impact on inequality trends.

Many of the new policies and measures adopted to enhance economic performance have not contributed to a more balanced distribution of the benefits of economic growth, but have in fact exacerbated inequalities. Available data indicate that the OECD countries that have applied the strictest regimes in implementing these policies have been among those that have exhibited the greatest increase in within-country inequality in recent decades (Weeks, 2004).

The liberalization and adjustment policies implemented over the past two decades have contributed to the rise in inequality in several ways. The subsections below outline some of the components of these policies and provide insight into the negative impact they have had on income distribution within the countries concerned and worldwide. The review concentrates on two of the more salient elements of these policies: financial liberalization and trade liberalization.

The current international economic approach evolved in the 1980s as the market-guided development perspective gained dominance. As noted in previous chapters, this approach to development was based on the premise that market forces would lead to the most efficient allocation of resources, resulting in faster economic growth and ultimately an improvement in overall development.

The financial crises of the 1990s and the subsequent economic recessions in Asia, Latin America and the Russian Federation demonstrated the social devastation that could result from unrestricted, and at times heavily speculative, international capital flows coupled with procyclical macroeconomic policies. The human impact of these crises—including increased unemployment, poverty and inequality, and the erosion of social cohesion in many countries—underscores the crucial importance of fostering social development.

Experience with structural adjustment programmes exposed the drawbacks of pursuing economic liberalization policies at the expense of social policies. Analysis of the impact of IMF/World Bank structural adjustment and macroeconomic stabilization reforms found increases in poverty during periods of recession (Easterly, 2001). As mentioned in the first chapter, policy makers gradually realized the need for a change, which culminated in the introduction of the World Bank Poverty Reduction Strategy Papers (PRSPs) and the IMF Poverty Reduction and Growth Facility (PRGF).

Further to the development and adoption of poverty reduction strategies with pro-poor and pro-growth programme measures supported by more equitable government budget allocations and increased fiscal flexibility, a new feature of the PRGF is the use of social impact analysis in connection with major macroeconomic and structural reforms. Internal reviews indicate, though, that the systematic incorporation of such analysis into programme design remains one of the areas most in need of improvement (see, for example, World Bank, 2004c; International Monetary Fund and International Development Association, 2003).

External reviews of the PRSP and PRGF initiatives point to heightened concern among civil society organizations over the imposition of structural adjustment conditionalities, given their proven negative impact on poverty. There is also criticism that the IMF and World Bank have not backed up their stated commitment to poverty and social impact analysis with actual implementation. For example, a review by the Nordic Governments of the PRSP process revealed only a nominal linking of macroeconomic and structural adjustment measures with poverty reduction and also a failure to rely on empirical evidence in the adoption of actual policies (Norwegian Agency for Development Cooperation, 2003). These findings led the World Bank to acknowledge an "implementation gap" between planning and action, or more precisely, the disconnection between the discourse on incorporating social dimensions (particularly poverty reduction) in economic programmes and actual practice (World Bank, 2004c).

Financial liberalization

Since the mid-1980s, most developing countries have taken steps to liberalize their domestic banking and financial sectors and open their markets to international capital flows. These processes have been an important cause of the increased poverty rates and inequalities in income distribution documented by various studies. Analysis by the World Bank shows that financial crises have a negative impact on wage distribution, and that this effect persists even after economic recovery (World Bank, 2000). Another study suggests that in Latin America the implementation of financial liberalization measures had the strongest disequalizing impact on wage differentials (Behrman, Birdsall and Szekely, 2000).

Financial liberalization has increased the level of instability and the frequency of financial crises, especially in developing countries (Caprio and Klingebiel, 1996). For example, the liberalization of international capital flows has made countries more vulnerable to capital flight. The flow of capital into a country following the liberalization of its financial system tends to lead to real exchange rate appreciation, which is often linked to higher real interest rates. Higher interest rates often attract additional capital flows. The resulting credit expansion can trigger a consumption and import boom or a speculative asset price bubble. "The demand expansion may prove to be short-lived, if the consequent widening of the external balance is unsustainable, or if capital flees the economy when the bubble begins to deflate" (Taylor, 2004). In short, countries that have undertaken capital account liberalization have to a large extent lost autonomy over their exchange rate and monetary policies, which in turn has severely limited their capacity to implement countercyclical macroeconomic policies (Ocampo, 2002a).

Problems of incomplete information and information failure have prevented deregulated financial systems from operating effectively and have led lenders to finance unsound investments, misallocating valuable resources. The prominence of short-term speculative flows within these systems has decreased the availability of resources for productive investment and created new constraints to development policy.

Some of the crises that have occurred in connection with major economic developments have produced severe economic and social losses. A study of countries that experienced financial crises between 1975 and 1994 showed that national GDP growth declined by an average of 1.3 per cent over the five years immediately following the respective crises (Stiglitz, 1998).

Economic crises have also raised levels of inequality within countries. During such crises, job scarcity reduces the demand for labour, which drives down wages, especially among unskilled workers. These circumstances lead to increased inequality both in earnings and more generally, especially in countries in which the wage declines have been substantial and in which social protection systems have not yet been developed. This has been empirically demonstrated in different studies that have analysed the effects of financial crises on wage inequality in over 60 countries since the 1970s. For example, wage inequality increased in 62 and 73 per cent of the countries in Asia and Latin America, respectively, following their financial crises; however, no such post-crisis impact was evident in developed countries such as Finland, Norway and Spain (Diwan, 1999; Galbraith and Jiaqing, 1999).

The liberalization of financial and capital markets has led to substantial foreign direct investment (FDI). The effects of FDI on employment and growth have been mixed (International Labour Organization, 2004). Such investment has benefited certain countries, with the transfer of technology and know-how contributing to economic development. However, these countries already had a number of important conditions in place, including a certain level of education among wide sectors of the population, training institutions and some level of technological development to support the investments, and the existence of local firms able to absorb and benefit from the technology and skills transferred. Countries without such conditions, in which the links between FDI and the local economy have been weak, have benefited little from such investment. While the flow of investment capital into developing countries has increased overall, FDI remains highly concentrated in particular areas, further exacerbating inequalities between countries (International Labour Organization, 2004).

Trade liberalization

As mentioned previously, liberalization policies and market reforms have produced many asymmetries. In the case of trade liberalization, the transformation of the General Agreement on Tariffs and Trade (GATT) into the WTO has been crucial, broadening the scope of international trade negotiations and regulations beyond the reduction of tariffs and other direct barriers to trade in manufactures. Many other issues viewed as impediments to the free flow of goods and services between countries have come under the purview of the WTO. An important consideration in the present context is that WTO rules place restrictions on national policies, including social policies, if they are judged to be inconsistent with the provisions of WTO agreements. Any party, whether it be a country or a private interest or enterprise, can use the WTO dispute settlement mechanisms to challenge the local and national laws and regulations of another member country (Guimarães, 2004).

Even the staunchest advocates of the market economy agree that trade liberalization does not ensure that all actors will prosper without support either directly from the State or through some form of regulation, particularly in emerging economies (Lowi, 2001). One of the more difficult challenges linked to the inequalities characterizing the new international trade regime is the undue primacy given to free trade to the detriment of the long-term sustainability of economic growth and social development.

Research suggests that the proliferation of free trade agreements may further widen inequality between countries (World Bank, 2004a). A World Bank study estimates that a broad global trade agreement could increase world income by US$ 263 billion by 2015, with the developing country share amounting to US$ 109 billion. However, if all developing countries had bilateral agreements with the largest trading partners, namely the EU, the United States, Canada and Japan, global income would rise by just US$ 112 billion, or less than half the previous estimate. Further, this US$ 112 billion increase would derive from a US$ 133 billion rise in income among the wealthiest countries and a corresponding loss of US$ 21 billion among developing countries (World Bank, 2004a).

The relationship between trade liberalization and poverty eradication has recently been subjected to close scrutiny by both international organizations and academia. UNCTAD, for example, examined the trade liberalization experiences of 66 developing countries over five-year periods (1990-1995 or 1995-2000) and concluded that the relationship between trade liberalization and poverty reduction was neither automatic nor straightforward.[2] Similarly, a review of relevant academic studies found no simple general conclusion about the relationship between the two (Copeland and Taylor, 2004). UNCTAD did indicate, however, that countries that had opened up more gradually tended to exhibit a better trade-poverty relationship than did those that had opened up furthest and fastest and those that had retained the most trade restrictions against other countries.

The empirical literature on trade liberalization in Africa identifies various channels through which trade has impacted the continent in terms of investment composition, household welfare, income distribution and the competitiveness of local firms (Geda, 2004). Most cross-country regressions show that openness is positively correlated with income inequality (see, for example, Spilimbergo, Londoño and Skezely, 1999; Fischer, 2000).

In industrialized countries, trade and financial liberalization have contributed to the widening of within-country inequalities. The transfer of industries to lower-cost countries has pushed down the salaries of those engaged in low-skilled work in the more traditional manufacturing industries and has reduced the availability of these types of jobs in developed countries. In recent years, this phenomenon has begun to affect other types of jobs as well, including those in the high-technology sector.

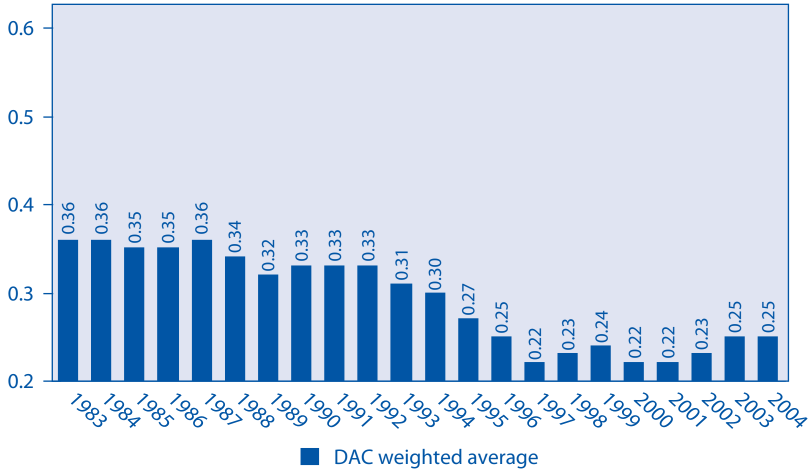
Trade liberalization policies have affected the prospects for poverty reduction in both developed and developing countries. As roughly three quarters of the poor live in rural areas, poverty cannot be reduced in most of the developing world unless agricultural productivity is characterized by sustained growth. The deterioration of already low agricultural incomes is a major factor in the perpetuation of rural poverty. While the decline in the prices of agricultural goods may reduce the cost of consumption for poor people, it also means lower incomes for farmers and a reduction in their demand for other goods and services in rural areas.

Protectionist practices and agricultural subsidies in developed countries are recognized as major factors contributing to low agricultural production and incomes in the developing world. While imports from other developed countries are subject to an average tariff rate of 1 per cent, agricultural products from developing countries are taxed at 9 per cent by the United States and 20 per cent by the EU, and textile levies average 8.9 and 7.9 per cent, respectively. This asymmetry is vividly reflected in the trade situation of Latin America and the Caribbean. The region imposes an 8.5 per cent duty on non-agricultural imports (mostly from industrialized countries), but its own agricultural products are subject to a 20.4 per cent duty when exported to industrialized countries. Overall, developing countries lose in excess of US$ 40 billion annually from agricultural exports due to the imposition of import duties by developed countries. This amount is equivalent to a significant proportion of the projected financial requirements for the successful achievement of the Millennium Development Goals (Guadagni, 2004).

Financing the social agenda

Financing is a crucial element for the new context for social development, and for the concerted national and international efforts to reverse present inequalities within and between countries. While the provision of financial resources alone does not automatically guarantee positive results, such resources are nonetheless a prerequisite for social development. There has been ample discussion of possible ways to finance social development, with many countries undertaking commitments to increase the levels and quality of ODA. Increased attention is also being directed towards the issues of migrant remittances and domestic financing, as well as ways to invest the peace dividend in social development.

Figure V.1. Aid from all Development Assistance Committee (DAC) donors as a percentage of gross domestic product: the long-term trend to 2004



Source: iDevelopment Initiatives, "Briefing on Aid in 2004" (www.devinit.org/dagfigs2004brief2.pdf.; accessed 20 May 2005).

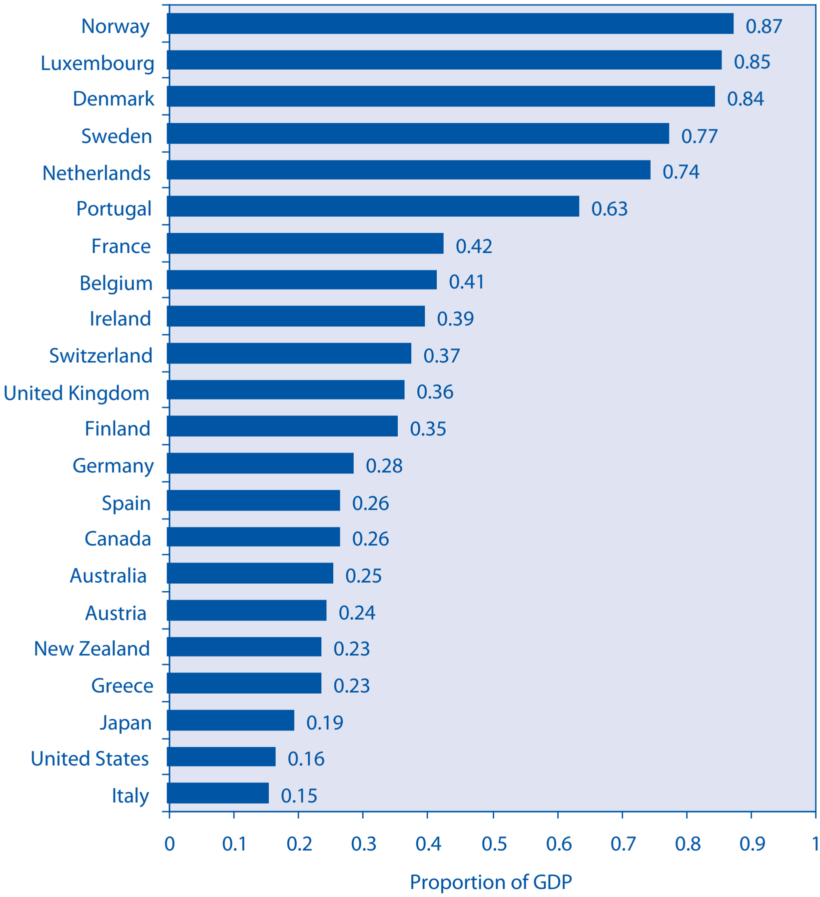
Official development assistance

The International Conference on Financing for Development was held in Monterrey, Mexico, from 18 to 22 March 2002. In the Monterrey Consensus adopted at the Conference, heads of State and Government pledged to undertake actions to improve financing for development. The Conference marked the first quadripartite exchange of views between Governments, civil society, the business community and institutional stakeholders on global economic issues.

As a component of efforts to mobilize international assistance, repeated calls have been made for raising current levels of ODA as soon as possible to increase the flow of resources available for social development. As a share of the combined GNI of the 22 Development Assistance Committee (DAC) donors, the overall level of ODA decreased from 0.36 per cent in 1987 to 0.22 per cent in 2001. Although ODA has recently begun to climb, rising to 0.25 per cent in 2004 from its lowest point in the late 1990s (see figure V.1), it is still far below the internationally agreed target of 0.7 per cent called for by the General Assembly 35 years ago (Organisation for Economic Cooperation and Development, 2005a).

Only Norway, Denmark, Sweden, Luxembourg and the Netherlands have met and surpassed the United Nations ODA target of 0.7 per cent. Figures for 2004 indicate a large gap between these five countries and the other 17 DAC donor countries (with the exception of Portugal, which is close to

Figure V.2. Aid from Development Assistance Committee (DAC) donors as a proportion of gross domestic product[a]



Source: iDevelopment Initiatives, "Briefing on Aid in 2004" (www.devinit.org/dagfigs2004brief2.pdf.; accessed 20 May 2005).
[a] Preliminary data obtained on 11 April 2005.

meeting the target). As shown in figure V.2, most of the G-7 countries[3] allocated a much lower proportion of their gross national income to ODA than the United Nations target.

At the International Conference on Financing for Development, major aid donors pledged to increase levels of development assistance. If donors honour the commitments made in Monterrey, aid flows will rise to approximately US$ 88 billion by 2006, up from US$ 78.6 billion in 2004, the highest level of ODA to date (Organisation for Economic Cooperation and Development, 2005b). While these developments appear to represent a step in the right direction, the Secretary-General of the United Nations has emphasized that substantially greater increases in ODA are needed to reach the target of 0.7 per cent by 2015. Developed countries that have not already established timetables for expanding ODA are called upon to do so, starting with significant increases no later than 2006 and achieving a level of 0.5 per cent by 2009. Action must also be taken to increase the quality, transparency, accountability and predictability of ODA (United Nations, 2005c).

Aid flows tend to be volatile, which can compromise their effectiveness. ODA follows the rise and fall of economic cycles in donor countries and is affected by both shifts in donor policies and assessments of recipient country policies. A decline in aid generally leads to costly fiscal adjustments in the form of increased taxation and spending cuts, which reinforce the cyclical effect of diminishing aid. A surge in aid flows can create macroeconomic problems, especially in countries with underdeveloped financial sectors, which often have low absorptive capacities. Surges can cause exchange rate appreciation, which, when sustained, can lead to currency overvaluation (United Nations, 2005d).

ODA has generally been concentrated among a select group of countries. Because donors have tended to favour certain recipients, more than half of the net bilateral aid disbursed since the 1980s has been directed to just 20 countries. This concentration has evolved largely as a result of donor perceptions of aid efficiency (United Nations, 2005d).

Recent increases in ODA have been earmarked for expenditures on emergency aid, debt relief, technical assistance or aid to countries that donors deem critical for reasons of political or security, and this has effectively reduced the resources available to poor countries for social development (United Nations, 2005c). While emergency aid is important, it does not support long-term development and does not represent a real increase in developmental aid. For this reason, despite the recent increases in donor assistance, the effective contribution of ODA to development programme financing in recipient countries has been limited. In other words, even with the recent recovery in recorded donor contributions, ODA has been a declining source of budgetary resources for developing countries, limiting their capacity to pursue the Millennium Development Goals. In support of these Goals, the call for increased ODA must refer specifically to real cash increases (United Nations, 2005d).

Innovative sources of financing

New proposals are being considered for innovative development financing that complements existing ODA mechanisms and ensures greater predictability in the flow of development assistance. The five-year review of the 1995 World Summit for Social Development gave new impetus to the debate on alternative sources of development financing. A recent study has explored several potential options for development support, proposing both short- and longer-run mechanisms (Atkinson, 2004). Their adoption and implementation would depend, in part, on their feasibility and the consensus of the partners involved. One alternative is the International Finance Facility (IFF), a short-run mechanism that would frontload new long-term donor commitments by issuing bonds in international capital markets. This would substantially increase the development funds immediately available and lend aid flows greater stability and predictability. Another short-run mechanism is the use of special drawing rights (SDR) for development purposes. This instrument could potentially be utilized to supplement the existing official reserves of countries and provide emergency financing during crises.

Potential long-run financing mechanisms include a global lottery and global taxes, the revenues of which would be used for development. The suggested taxes on currency transactions, arms sales and the consumption of fuels producing greenhouse gases could generate enough funds to combat poverty and hunger worldwide. It is estimated that implementation of the currency transaction tax would generate between US$ 16.8 billion and US$ 35.4 billion in revenues per annum. A tax on the emission of greenhouse gases would provide a significant source of development financing while also discouraging harmful behaviour. Building on the 1992 United Nations Framework Convention on Climate Change, the imposition of a US$ 21-per-ton tax on greenhouse gas emissions could yield US$ 130 billion per year if applied globally and US$ 61 billion annually if applied only to wealthy countries. A tax on arms sales could generate between US$ 2.5 billion and US$ 8 billion annually while discouraging military spending (Atkinson, 2004).

Global taxation to finance development would have to be nationally mandated and internationally coordinated to prevent it from being perceived as an infringement on the fiscal sovereignty of participating countries. In applying global taxation, the creation of a new international bureaucracy should be avoided. Universal participation would not be required, though more widespread involvement would translate into higher levels of resources and would also reduce the risk of free-riding (Atkinson, 2004).

Arranging for migrant workers to remit their earnings through regulated financial institutions would provide another significant opportunity to accrue resources for development. By facilitating better access to banking institutions for foreign workers and obtaining the support of local financial institutions in recipient countries, joint efforts could be launched to further reduce remittance costs.

Migrant remittances

Globalization, liberalization and the growing integration of economies have meant that people, and not just jobs and capital, are moving across borders in greater numbers and with increasing frequency (United Nations, 2003b). Persistent and growing income inequalities between countries and widening demographic disparities, combined with the availability of cheaper and more accessible forms of transportation, have raised international migration flows to unprecedented levels. In 2000, an estimated 175 million people (or roughly 1 in 35) worldwide were living outside their countries of birth (United Nations, 2004d). A growing number of migrants are moving from developing to developed countries in search of jobs and better economic opportunities. At their destinations, migrants are often able to earn higher incomes and improve their standard of living. Migrant flows are high even within developing regions, where forced migration and heavy refugee movements often exert considerable pressure on limited resources.

Although many recent migrants have been admitted to a number of developed countries on the basis of family reunification (SOPEMI [Continuous Reporting System on Migration], 2003), international migration still occurs largely in response to perceived inequalities of opportunity between sending and receiving countries. Historically, migrant pools have often reflected a bias towards the more skilled segments of the population in the countries of origin; however, this trend is beginning to change in response to labour shortages and new labour demands in many developed countries. Several countries that seek to fill gaps in the supply of low-skilled labour tolerate undocumented migration and visa violations, though this is often not widely acknowledged by Governments (United Nations, 2004d).

The heavy outflow of migrants from developing countries has mixed economic and social repercussions in both sending and receiving communities. In the countries of origin, emigration often depletes an already limited skilled labour force, making the benefits of economic reform even more difficult to realize. Fiscal revenue from taxation may also decline, as migrants are more likely to be among the highest income earners. On the positive side, emigration releases jobs in the countries of origin and may provide opportunities for those previously unemployed (United Nations, 2004d).

Migrant earnings constitute a considerable and growing source of remittance flows to labour-sending countries, in spite of the sometimes precarious economic situation of foreign workers in various host countries. Data on remittances are incomplete and almost certainly underestimate the flows of funds through informal channels. Nonetheless, available data suggest that remittances totalled US$ 130 billion in 2002, with US$ 79 billion going to developing countries. For a growing number of countries, remittances have surpassed ODA in volume and now constitute the second largest source of financial flows after FDI (United Nations, 2004d).

Remittances to developing countries tend to be concentrated in particular regions. The largest amounts go to Latin America and the Caribbean, followed by Eastern and Southern Asia, while sub-Saharan Africa receives only 1.5 per cent of the total. The European Union accounts for the largest source of remittance payments, followed by the United States and countries in the Middle East (United Nations, 2004d).

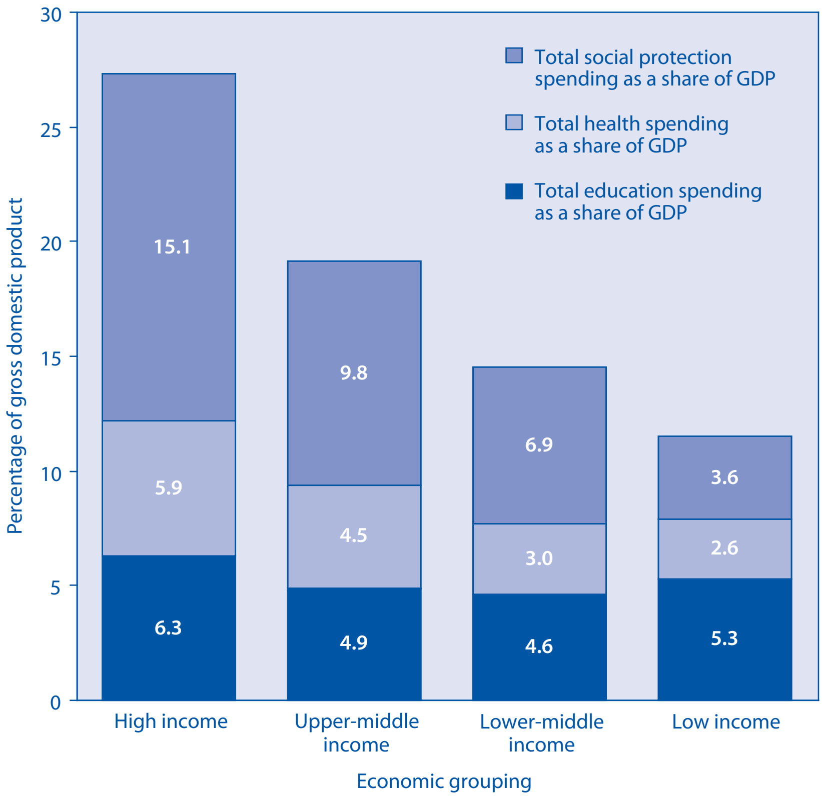
There is a positive statistical correlation between remittances and poverty reduction; “on average, a 10 per cent increase in the share of international remittances in a country’s GDP will lead to a 1.6 per cent decline in the share of people living in poverty” (Adams and Page, 2003). International migration, per se, has also been shown to have a strong statistical impact on reducing poverty; a 10 per cent rise in the proportion of international migrants in a country’s population is associated with a 1.9 per cent decline in the share of people living on less than US$ 1 per day.

The deployment of workers’ remittances and the impact they may have on families and communities are receiving considerable attention. By and large, migrants appear to use their incomes “wisely”, with the benefits generally outweighing the costs of migrating. Remittances tend to be used primarily for consumption rather than investment. However, they are also frequently utilized to pay for the education of children and youth or to improve the quality of housing, which are clearly investments. Even when remittances are spent on consumption, they have an indirect effect on the community, as consumption stimulates local economic growth (Skeldon, 2002). Growing attention has been given to the possibility of using remittances to “bank” the poor at the sending and receiving ends, channelling the funds towards more productive uses such as the financing of small and micro enterprises or the adoption of financial savings and other investment strategies for both migrant and recipient households.

It is difficult to measure the impact of remittances on inequality. Remittances may intensify financial and social inequalities, as those who migrate tend to come from the “wealthier” families in a community. Overall, however, the findings have been mixed. For example, a study in Pakistan found that inequalities had intensified between migrant and non-migrant households, but also found that the distribution of remittances was spread over a relatively wide range of groups and areas. A study in Thailand has indicated that remittances to poor households may have a much greater relative impact on poverty alleviation, even though the per capita amounts are much lower than those sent to wealthier families (Skeldon, 2002).

The economic impact on migrants’ families is often significant, and those who do not migrate may experience envy and growing resentment as they witness the effects of remittances on the households of migrants. According to a study of migration in India, such resentment contributed to an outbreak of violent conflict in which non-migrant households railed against the visible signs of affluence made possible by emigrants’ earnings (Allen, 2003). Sustaining the positive contributions of remittances will require proper management and recognition of the feelings of resentment and exclusion among non-migrant families. Clearly, the impact of migration and remittances on sending and receiving countries is different, with the social costs and benefits also varying at the community and national levels.

Figure V.3. Social sector spending among country groupings classified by income



Source: P. Kelly and V. Saiz-Omeñaca, "The allocation of government expenditure in the world, 1990-2001", unpublished paper (New York, United Nations, Department of Economic and Social Affairs, Division for Social Policy and Development, November 2004).

Domestic financing

With the implementation of liberalization policies, measures with a direct impact on the reduction of inequalities, such as progressive taxation and changes in the level and composition of public expenditure, have become less redistributive in many countries. A survey of 36 developing and transition economies indicated, for example, that during the 1980s and 1990s overall tax progressivity and the share of direct taxes in total taxes declined, and the ratio of taxes to GDP fell by one percentage point on average (Chu, Davoodi and Gupta, 2000). Tax changes in Latin America effectively shifted the burden of taxation from the wealthy to the middle- and lower-income segments of society (Morley, 2000). In OECD countries in which liberalization policies have been most consistently implemented, there have been reductions in expenditures on universal social programmes, resulting in lower transfers from the public budget to low-income households (Weeks, 2004).

In many cases, public finance reforms have transferred responsibility for social sector financing and oversight from the public sector to the private sector. This shift is most visible in the provision of social services in a number of developing countries, where services traditionally provided by the public sector at subsidized rates have in some cases been privatized or outsourced to private contractors. The new orthodoxy favours cost recovery and a fee-for-service approach, which has placed many services beyond the reach of the poor. The introduction of user fees for health care and education has resulted in greater social exclusion, with reduced social assistance and scaled-down public health programmes. The increase in non-economic inequalities in areas such as education and health care both within and between countries is highly correlated with these factors.

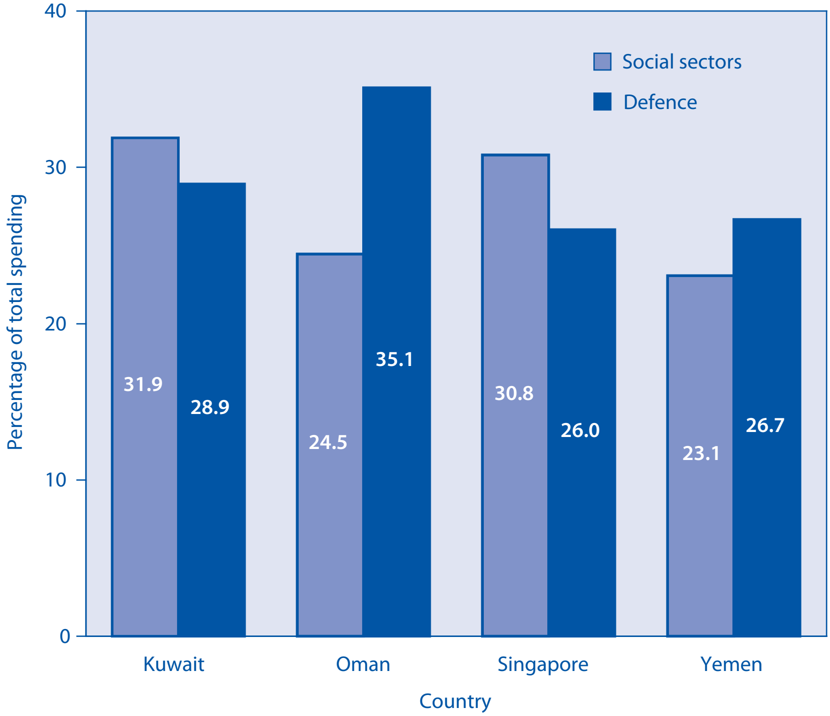
The rise in non-economic inequalities is also partially attributable to the higher government priority given to spending on areas such as economic affairs and defence than to spending on health, education, social protection and other social sector programmes. A recent study has attempted to identify how Governments allocate their resources, focusing on the distribution of resources between the social sectors and other areas of priority and on the impact public spending patterns have on social development (Kelly and Saiz-Omeñaca, 2004).

Research findings point to wide disparities in social sector spending between different groups of countries classified according to their level of economic development. High-income countries spend an average of 27 per cent of GDP on the social sectors, compared with 19 and 15 per cent respectively in upper-middle- and lower-middle-income countries and 12 per cent in low-income countries (Kelly and Saiz-Omeñaca, 2004). Overall, rich countries devote an average of two and a half times more of their national wealth to the health, education and welfare of their citizens than do poor countries (see figure V.3).

Among the social sectors, the greatest variation in spending as a share of GDP is found in the area of social protection, followed by health and, to a lesser degree, education. On average, high-income countries funnel 15 per cent of their GDP into various forms of social protection such as pensions, unemployment and disability benefits, and accident and medical insurance, while upper-middle-income countries allocate 10 per cent and lower-middle-income countries 7 per cent. Most strikingly, low-income countries allocate less than 4 per cent of GDP to social protection, or about one quarter of the share spent by high-income countries.

Health spending also varies significantly among economic groupings. High-income countries spend an average of 6 per cent of their GDP on health, or more than double the 3 per cent allocated by low-income countries. Considering the importance of health to people's well-being, not to

Figure V.4. Defence and social sector spending in countries with the highest defence expenditures



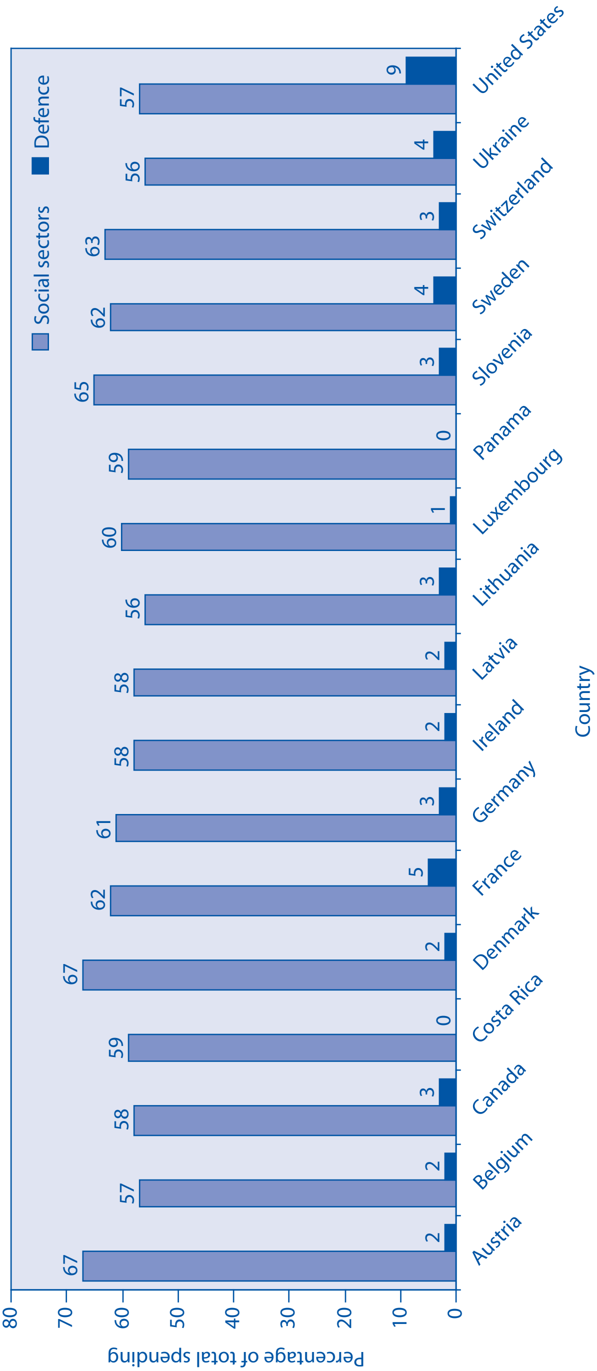
Source: P. Kelly and V. Saiz-Omeñaca, "The allocation of government expenditure in the world, 1990-2001", unpublished paper (New York, United Nations, Department of Economic and Social Affairs, Division for Social Policy and Development, November 2004).

mention its link to poverty reduction, the low level of resources invested in health care by poorer countries is especially troubling.

Education constitutes the one bright spot among the social sectors in terms of relative proportions of State spending. Although high-income countries still allocate more of their GDP to education (6.3 per cent, versus 5.3 per cent among lower-income countries), the difference is far less pronounced than in the social protection and health sectors. Moreover, low-income countries actually spend a higher proportion of their GDP on education than do lower-middle- or upper-middle-income countries. The importance attached to education by many lower-income countries is laudable, and the trend towards investment in education should continue. However, education alone is not enough to reduce poverty and improve living standards. Adequate investment should be made in all the social sectors, including health and social protection, in order to achieve marked improvements in social development.

The financing of social sector programmes is directly related to the collection of taxes, the primary component of the State resource base. Rather

Figure V.5. Defence and social spending in countries with the highest social sector expenditures



Source: P. Kelly and V. Saiz-Omeñaca, "The allocation of government expenditure in the world, 1990-2001", unpublished paper (New York, United Nations, Department of Economic and Social Affairs, Division for Social Policy and Development, November 2004).

than raising taxes to provide additional funding for social programmes, many Governments have felt compelled to lower average corporate tax rates in order to attract and retain FDI; among the world's 30 richest countries, the average rate of corporate tax fell from 37.6 per cent in 1996 to 30.8 per cent in 2003 (International Labour Organization, 2004). A similar phenomenon can be seen in the taxation of high-income earners, who are also relatively more mobile. In many cases, to compensate for these tax cuts, Governments have gradually increased their dependence on indirect taxes such as sales taxes (especially the value added tax, or VAT) and taxes on relatively immobile (or less mobile) factors such as labour.

The peace dividend

Financing for development would also benefit from reductions in military expenditures, as the freed-up public resources could be redirected to investment in social development. According to a recent study of worldwide government spending over a 10-year period, countries that dedicated a higher share of total public expenditure to the defence sector tended to be among those that allocated the lowest portion of the State budget to the social sectors (see figure V.4). Likewise, as shown in figure V.5, countries with the highest levels of social sector spending were found to have the lowest defence spending (Kelly and Saiz-Omeñaca, 2004).

Over the past several years, the reallocation of resources from defence to social development has not taken place. Estimated world military expenditures[4] declined for five straight years, falling from US$ 762 billion in 1993 to a low of US$ 690 billion in 1998, after which they began to rise (Stockholm International Peace Research Institute, 2003; United Nations, 2004b). By 2002, defence spending had increased to an estimated US$ 784 billion, surpassing the 1993 level for the first time. World military expenditures reached US$ 956 billion in 2003, representing 2.6 per cent of global GNP (United Nations, 2004b; Stockholm International Peace Research Institute, 2004), and will probably exceed US$ 1 trillion in 2005 (United Nations, 2005b). This figure is almost 20 times the current level of development aid.

As indicated above, the global decline in military spending during the 1990s has been dramatically reversed. These figures stand in sharp contrast to the current levels of ODA and those projected for the period 2006-2010. It has been asserted that all of the Millennium Development Goals could be met in developing countries by 2015 if ODA were increased by US$ 150 billion (United Nations, 2005d). This amount represents only a fraction of the more than US$ 900 billion the world is now spending in a single year on arms and other means of destruction (United Nations Millennium Project, 2005). The reallocation of defence-related expenditures to social development requires the concerted action of the international community, with the aim of realizing the double dividend of sufficient funding for social programmes and the reduction of armed conflict and violence.

The role of the State and civil society

The trend towards economic liberalization that characterized the 1980s and 1990s provoked a reaction to ensure that the social dimension was taken into account in economic and structural adjustment policies. This response is largely a consequence of the appeals by civil society and NGOs, which have seen their numbers and influence rise substantially over the decades. Civil society activism has also helped promote greater self-awareness of rights and awareness of the relative inequality between people, which has been bolstered in recent years by the growing interest in human rights and increased access to information on a global scale.

The last decade has witnessed growing interest in improving the status of various social groups, as evidenced by the considerable attention given to the rights of indigenous peoples and persons with disabilities and to poverty among older persons and unemployment among youth; however, there has been less interest shown in developing policies to equalize the distribution of income and wealth. The focus of many political struggles has shifted away from the latter to other kinds of differences and inequalities, especially those based on race and gender, with particular attention given to political and civil rights.

There has been a very important shift in the past two decades in the way individuals and social groups have chosen to be represented and defend their interests nationally and internationally. Through the last decade of the twentieth century, "trade unions represented civil society interests, not only on issues such as employment and wages, but also on many other issues related to social development, such as pensions, health care and social protection. The trade unions appear to have been affected by the long-term trend of declining relative size in union membership, as measured by union 'density rates'—the percentage of workers who belong to unions" (International Labour Organization, 1997).

As the role of trade unions in social activism has declined, other types of civil society organizations and non-profit groups have flourished. The social environment has favoured non-governmental actors and has supported the growing trend towards partnership in fulfilling many of the responsibilities hitherto carried out solely by State. The participation of civil society organizations in the national and international arenas has become crucial, as these entities defend the interests of groups whose voices might otherwise never be heard. Starting with their active participation in the major world conferences of the 1990s, civil society organizations "have articulated new ideas and proposals, argued and negotiated, protested and exercised political pressure" (Cardoso, 2004), and in so doing have created an unprecedented new international public space.

The contribution of religious organizations should not be underestimated. Traditionally, these organizations have played an important role in social development, mainly through the direct provision of social services in areas such as health and education. In some countries, the involvement of religious and/or other civil society organizations in service delivery has been of such magnitude that these countries have been able to resist the wave of privatization driven by market reforms in recent decades. Religious organizations have expanded their role to include greater advocacy and have acquired a more directly political voice. These groups are much more inclined now than in the past to assume an active role in the international debate and to try to influence significant decisions in the social arena. Their scope of activity now encompasses not only education and health, but also the environment, human rights and democratic governance.

International organizations and even private voluntary concerns have recently begun to establish their own labour standards and environmental rules, and while this trend is welcome, it is also believed to represent a response to the possible impact of an apparent "race to the bottom", during which market forces are left unchecked. The Global Compact, launched in July 2000, and the Equator Principles, drafted in October 2002 and adopted by a growing number of major investment banks since then, are noteworthy among the voluntary schemes that, by virtue of their emergence, lend credence to the notion that a "race to the bottom" has occurred and corroborate the need for initiatives to counter the tendency.

The Global Compact's 10 universal principles on human rights, labour, the environment and anti-corruption, which are meant to inspire more responsible and sustainable business practices, reflect a growing consensus and a coming together of United Nations agencies, labour and civil society organizations, and corporate interests. It is important to note that these commitments, while welcome, represent a set of *promises*, as there is no enforcement mechanism to hold private-sector actors accountable for adhering to the principles of the Global Compact. The 17 Equator Principles are intended to serve as a common framework for assessing and addressing environmental and social risks in project financing, and for the implementation of relevant procedures and standards across all industry sectors globally (Equator Principles, 2004). The overall framework derives from policies and guidelines established by the World Bank and the International Finance Corporation (Equator Principles, 2004). The Equator Principles have been adopted by a number of organizations, and it is estimated that the 23 banks among the 25 financial institutions applying the Principles approved US$ 55.1 billion in project loans in 2003, representing 75 per cent of the US$ 73.5 billion in project loans approved by this group of banks that year (Dealogic, 2004).

It should be emphasized that the relative decline in some traditional forms of societal representation and the emergence of other non-State actors do not presuppose the further weakening of the State. In recent years it has been increasingly recognized, in spite of the ideological swings of the past decade, "that the State still holds key responsibilities in regulatory matters and in its role of articulating diverse productive, community and social sectors" (Cardoso, 1995; World Bank, 1997; United Nations, 2004c, para. 47).

In line with the structural adjustment and transition policies implemented over more than a decade, there emerged a growing tendency to reduce the role of the State; however, in the late 1990s, this trend began to reverse itself as country experiences demonstrated the folly of privatizing State functions on a large scale. Gradually, a consensus has evolved that the State plays an important role in social and economic development and that its functions cannot be completely taken over by the private sector or executed within the framework of public/private or public/civil-society partnerships.

In the current approaches to development it is acknowledged that public regulation and State-led policies still represent contributions to the development process that are unique, necessary and indispensable (Guimarães, 1996). The essential importance of the State transcends the logic of market forces, particularly in areas such as ethics, equality, social justice and the defence of rights intrinsic to citizenship, which are foreign to market mechanisms and institutions. The State role is necessary because the very logic of capital accumulation requires the provision of "public goods" and "merit goods" that either cannot be spontaneously produced in the market or can only be produced in suboptimal quantities.[5] The State is also more effective in addressing risk, vulnerability, social exclusion, destitution and many other issues not amenable to microeconomic calculus, particularly when future generations (who, by definition, do not participate in today's market) are brought into consideration.

While it is recognized that the separate and combined functions of governmental and non-governmental actors are essential, the manner in which they carry out these functions is equally critical. Over the past two decades, the changes in the roles and functions of the State and civil society and the respective approaches they have adopted have not always been favourable to the reduction of inequality and the pursuit of social justice. While the renewed recognition of the necessary involvement of the State in promoting development and poverty eradication is a welcome reversal of the earlier trend towards minimizing the State's role in ensuring social justice, little has been done to instigate progressive taxation and other redistributive measures in order to reduce inequality. Likewise, while equal political and civil rights for vulnerable and marginalized groups have been placed on the public agenda largely as a consequence of the growing numbers and rising influence of civil society organizations, the focus of advocacy appears to be shifting away from the equitable distribution of income and assets towards more general political and civil rights. This state of affairs represents the political and institutional framework in which issues of inequality are considered today.

Conclusion

As stated in the Millennium Declaration, "the central challenge we face today is to ensure that globalization becomes a positive force for all the world's people. For while globalization offers great opportunities, at present its benefits are very unevenly shared, while its costs are unevenly distributed. … [O]nly through broad and sustained efforts to create a shared future, based upon our common humanity in all its diversity, can globalization be made fully inclusive and equitable" (United Nations, 2000, para. 5).

It is in this context that efforts must be undertaken to ensure that market-driven reforms, the multilateral trading system embodied by the WTO, and other aspects or components of the international economy do not interfere with the possibilities for realizing the progressively redistributive dimensions of social development. Actively pursuing such possibilities not only represents a requirement for reducing poverty and inequality, promoting employment and fostering social integration (the major priorities on the social development agenda today), but also constitutes a moral and ethical imperative.

In the context of development, the quantity of growth (the simple increment of material output or economic growth) has remained the primary focus. It is becoming increasingly apparent, however, that the single most important challenge facing the world in this new millennium is enhancing the quality of growth (increasing levels of well-being and reducing socio-economic inequalities). In acknowledgement of this fact, measures to foster sustainable economic growth "must be accompanied by indispensable distributive policies and corrective and compensatory policies to redress the injustices and imbalances of the past" (Ricupero, 2001).

National, regional and international efforts should be aimed at strengthening global governance and mechanisms to promote a more balanced and inclusive globalization. As the Secretary-General of the United Nations has stated, "millions of people around the world experience it [globalization] not as an agent of progress but as a disruptive and even destructive force, while many more millions are completely excluded from its benefits" (Grumberg and Khan, 2000).

While the main engine of globalization is "technology and the expansion and integration of markets, it is not a force of nature but the result of processes driven by human beings. Thus, globalization needs to be controlled so that it can be put at the service of humanity, which means that it needs to be carefully administered, by sovereign countries at the national level, and through multilateral cooperation at the international level" (Grumberg and Khan, 2000). Adequate management of the multifaceted processes associated with the current wave of globalization is required; more to the point, "open-minded, tolerant and pragmatic approaches to the development challenge, consistent with today's increasingly interdependent world, are urgently needed to place economic policy once again at the service of social justice and stability" (United Nations Conference on Trade and Development, 2003).

Notes

1 It should be noted, however, that there are instances in which, as a result of pressure from civil society organizations (in particular those in developed countries), multinationals have begun to promote higher social and environmental standards.

2 Among these 66 countries, 51 succeeded in increasing exports over the five-year period. Further analysis of the average private per capita consumption of these 51 countries indicated that 22 of them (less than half) had experienced the "virtuous trade effect", meaning that average private per capita consumption had increased with export expansion during the five-year period examined; 11 had experienced an ambiguous trade effect; and 18 had experienced an immiserizing trade effect, meaning that average private per capita consumption had decreased with export expansion (see UNCTAD, 2004a, p. 10).

3 The Group of Seven major industrialized countries (G-7) includes Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

4 Measured in constant 2000 United States dollars and at market exchange rates.

5 "Merit goods", often mentioned in the literature on welfare economics, are also referred to as "goods of social value". The concept of "public goods" focuses on the interdependence of consumers and other economic agents, whereas the notion of merit goods, or goods of social value, emphasizes the decision of society to provide certain goods to all citizens. Although the differentiation between these concepts is appropriate in the context of welfare economics, the common use of the term "public goods" in social and political analysis typically encompasses both (see José Antonio Ocampo, 2005, pp. 11-20).