Geo Factsheet

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How might the development gap be reduced?

This Factsheet will critically analyse and evaluate the arguments for how the development gap can be reduced and by whom. Although the debate is often split into trade versus aid, this article will argue that this ignores the complexity, and both trade and aid are required.

The concept of development has changed. Forty years ago the development challenge was a world of one billion rich people facing a poor world of five billion. It is now clear that 80% of the five billion are no longer in poverty, and as the development economist Paul Collier argues, the story of development should now be about the 'bottom billion' who live in countries that are falling behind as the development gap widens (the Least Developed Countries).

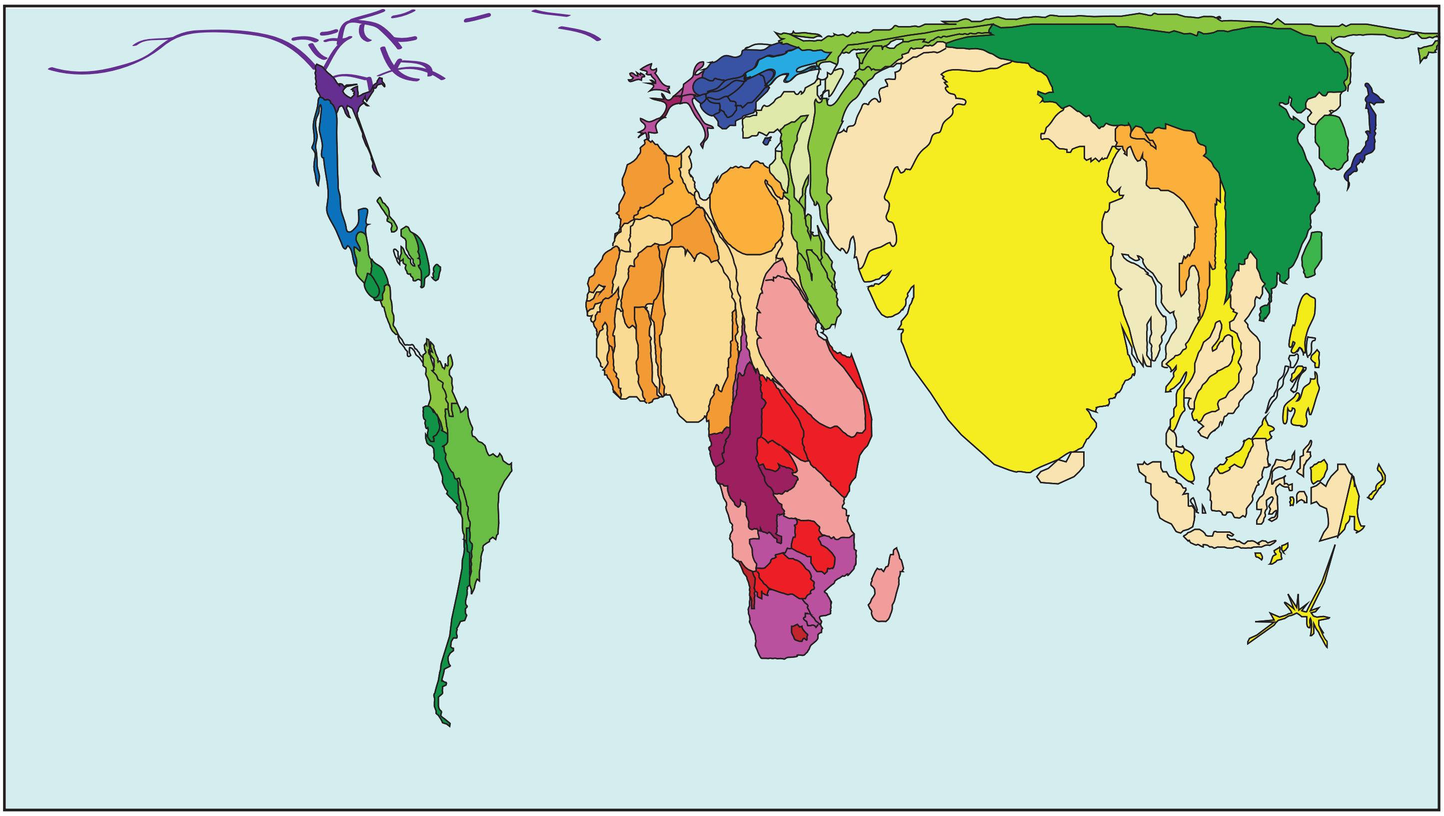
The poorest countries can:

- be politically unstable
- experiencing or have experience conflict
- have a high population growth
- have poor economic management
- suffer from endemic corruption
- be dependent on one primary product for trade
- be landlocked with poor infrastructure for trade.

They are often referred to as fragile economies.

Figure 1 below indicates the global distribution of those people in the 'bottom billion' living in poverty. Note the concentrations in the Indian subcontinent and Sub Saharan Africa.

Figure 1. Global distribution of those people in the 'bottom billion' living in poverty



Territory size shows the proportion of the world population living in poverty living there (calculated by multiplying population by one of two poverty indices).

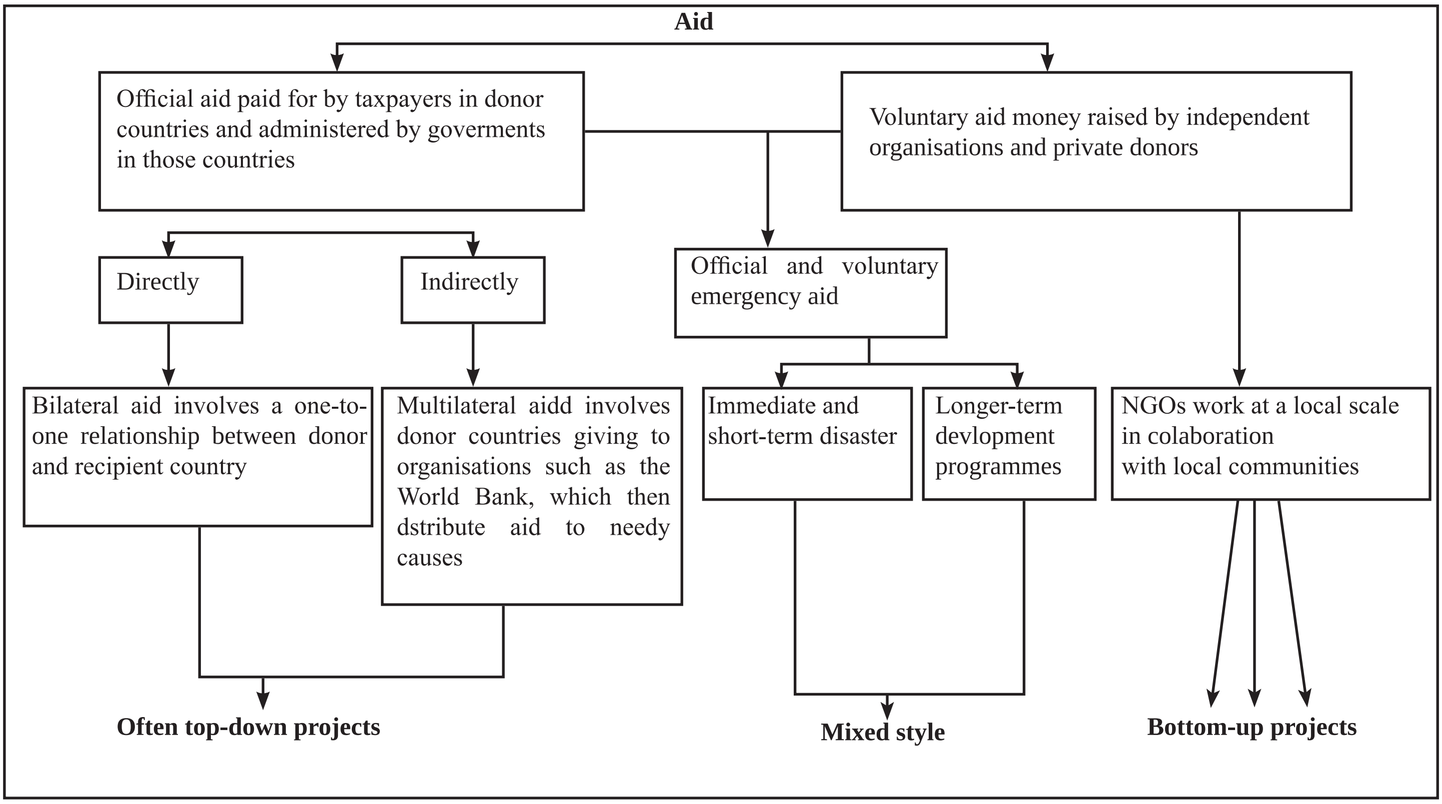
A world in which one billion people are living in poverty, in a world of growing prosperity is unthinkable. It is not only terrible for those in poverty, but dangerous for neighbouring countries, as the effects of conflict and political instability spill over. Development in these countries is achievable, yet complex. For development to occur, change must take place within the country, and international policies will make change more likely and increase the speed at which this change takes place.

Can aid reduce the development gap?

Aid is the voluntary transfer of resources from one country to another, with the aim to improve the human condition in the country receiving the aid. Aid can be classified into three main types.

- Bilateral aid is where aid is given directly by the government of a donor country to a recipient country. It may have strings attached, ie. tied to a particular project.
- Multilateral aid is given by a donor country to an international organisation, such as the World Bank or the European Development Fund, who then use the money in programmes to assist developing countries.
- NGOs (non-governmental organisations) are primarily charities that raise money to use for aid programmes, which can be in the form of short-term assistance (also called humanitarian assistance) or long-term assistance.

Figure 2. Summarises the main types of aid.



The benefits of aid

It is widely recognised that aid can be highly beneficial when assisting countries in responding to emergencies, improving education or health, as well as implementing projects such as technology development or agricultural programmes to increase crop yield. Furthermore, aid does increase the growth process. A reasonable estimate is that over the last thirty years aid has added around one percentage point to the annual growth rate of the bottom billion. This seems minimal, yet one percentage point has made the difference between stagnation and severe cumulative decline.

The failings of aid

Despite political promises, such as that by the G8 countries in 2005 at Gleneagles to double aid to Africa by 2010, it is important to note that increasing the amount of aid will not simply increase the growth rate. Indeed, the Centre for Global Development, came up with the estimate of **diminishing returns**, implying that when aid reaches about 16 percent of gross domestic product (GDP) it more or less ceases to be effective. One argument for the failure of aid to achieve development is that large inflows of money without restrictions do not seem to be well spent in many of the countries of the bottom billion. This is largely due to a culture of corruption. For example, an expenditure tracking survey in Chad in 2004 indicated that less than 1 per cent of the money released by the Ministry of Finance for rural health clinics actually reached the clinics. Aid money is not only going into the pockets of the wealthy politicians, it is also being used to finance military spending. It is estimated that 40% of Africa's military spending is inadvertently financed by aid.

Aid is clearly more effective when the governance and policies within a country have effective financial governance procedures. However, this is problematic as it implies that for the most effective use of aid the countries with the worst problems should get the least money.

Making aid more effective

One way in which we can make aid more effective is to use aid as an incentive for reform. For this to happen, the incentives must closely align with the priorities of the recipient government, with clear implications if the conditions are not met. Aid can also be used to increase the training and level of skills amongst the population, through **technical assistance** and **capacity building** often done very well by NGOs. This must be combined with attracting investment into the country to ensure that the newly skilled workforce have employment opportunities available to them. Suppose that a country receives a large donation to assist with a failed harvest.

While this solves the immediate humanitarian disaster, agricultural reform must be put in place if market forces are to restore the incentive for farmers to plant and harvest crops.

Can changes to trade policy reverse marginalisation?

Given the failures of aid to effectively address the problem of growth and development, it has been argued that trade has the ability to make major contributions to growth and development. This will only happen if the rich countries abandon their **protectionist policies.** One example of a protectionist policy is the money that rich countries give to their farmers in **subsidies** to ensure that they can sustain their production and trade of produce, but in doing so they close off opportunities for people in poor countries who have few alternatives. International organisations, primarily the World Trade Organisation (WTO), have done little to improve the trade conditions for the poorest countries. This is because countries are looking to get the best deal for their own country, which is defined in terms of the least opening of the home markets for the maximum opening of others. The poorest countries have little to offer under these circumstances.

A more effective solution in which trade policies can reverse **marginalisation** is an unreciprocated reduction in **trade barriers** for the poorest countries. It is also argued that aid should be used to overcome obstacles to trade. For example, a portion of aid could be used to support the development of institutions and infrastructure that improve a country's abilities to efficiently export their produce. This approach requires that aid and trade policies are integrated. This would mean that policies are geared towards increasing exports, and support is based on strengthening the ability of developing countries to achieve increases in exports.

Ghana: An example of ineffective trade policies

History has shown that only focusing on increasing exports with no change in international trade policies has the potential to increase debt for the poorest countries. The World Bank's emphasis on export expansion to reduce debt in Ghana in fact increased Ghana's external debt from $1.4 billion in 1980 to $14.7 billion in 2014. Furthermore, Ghana used to be self-sufficient with rice, yet when its markets opened, the Katanga Valley (once Ghana's rice bowl) became fallow as it is cheaper for Ghana to import rice from the US where farmers are **subsided**. Furthermore, residents have to pay for their health care and may have been forced to leave their land to make way for Transnational Cooperation's.

Debt Cancellation

Nearly thirty years have passed since the onset of the debt crises, yet many of the world's poorest countries are still suffering from the consequences. The debt crises emerged when in the 1970s the official flow of aid reduced, and as a result the poorest countries went to borrow money from private banks in richer countries. The banks were happy to lend money due to the oil price shocks of 1973 and 1979 and the subsequent recession, which meant that there were fewer lending opportunities for the banks. The debt crises emerged as the private banks did not predict that the countries would be unable to make the repayments. A further problem also developed as the banks engaged in herd behaviour, and some simply followed the lead of those who were already lending.

Why should third world debt be cancelled?

One argument for the cancellation of this debt is that the commercial banks were reckless in their lending and should share the blame for the crises. Another moral or humanitarian argument is that the poorest countries are diverting scare resources towards debt repayment rather than servicing domestic poverty reduction programmes. For example, it is argued that the cutback in social expenditure has weakened many countries in Africa's ability to cope with the AIDS crises. In contrast, cancelling debt is unfair on the governments who have been able to pay the debt back. Finally, it is possible that cancelling debt may simply lead to the countries running up fresh debts.

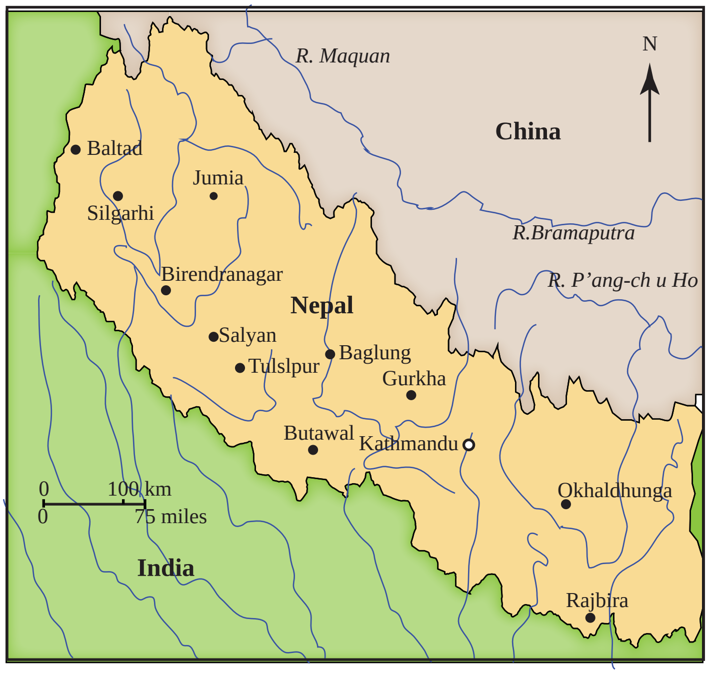
Most concede that cancelling debt would be beneficial if the appropriate conditions are applied. Oxfam has suggested possible conditions; that debt relief finance should be tied to poverty alleviation programmes, or to cancel external debt but not the domestic debt of national governments. These conditions must be applied with the overarching condition that poor countries do not run up new debts as a result of fresh loans. Whilst Structural Adjustment Programmes (SAPs) were often disastrous for the debt ridden countries, the more recent PRSPs have been very successful for many countries such as Bolivia and Ghana.

Remittances

International migration has enormous implications for growth and poverty alleviation in both origin and destination countries. By allowing workers to move to where they are most productive, overall world income will be boosted through money that is sent home in the form of remittance payments. **Remittances** can also reduce the level and severity of poverty and lead to higher human capital accumulation; greater health and education expenditures; better access to information and communication technologies; improved access to formal financial sector services and overall can break the cycle of poverty. It is estimated that in 2013, remittance payments by diaspora to developing countries was an estimated $404 billion, which was an increase of about 3.3% over the previous year. The top recipients of officially recorded remittances in 2013 were India ($70 billion), China ($60 billion), the Philippines ($25 billion), and Mexico ($22 billion). Some argue that remittances are a potential solution to decreasing the economic development gap.

In summary, the path to development for the bottom billion is complex, made more so by the incoherence of the international trade and aid policies. It is clear that these policies need to be better aligned and implemented under an umbrella of more effective global governance.

Figure 3. Map of Nepal



Case Study of Nepal

Nepal is a landlocked country located between India and China (see Figure 1), with a population of 28 million, a **Gross Domestic Product (GDP)** of $1,500 per capita and an estimated 25% of the population living below the **poverty line.** The GDP per capita for Nepal is of a similar level to Rwanda and Uganda, which places it in the bottom 10% of GDP per capita ranked globally. Furthermore, Nepal has an external debt of $3.956 billion and a **budget deficit** of 3.1% annually. The poorest regions of Nepal are the mid-western and far-western regions, where nearly 60% of the population live below the poverty line. Over 80% of the population live in rural areas, and agriculture is a major driver of the economy, contributing 34% of GDP and employing two-thirds of the workforce. Many households are also dependent on **subsistence farming** for their livelihoods, and household food insecurity and poor nutrition are major concerns in these areas, where about half of children under five years of age are under-nourished.

Aid to Nepal

In Nepal between the 1950s and 1970s foreign aid financed about 95% of the government expenditure. Total aid has declined to approximately 7% of government expenditure, yet in 2014 it still totalled $222 million. Despite the vast amounts of money Nepal receives in aid, Nepal only has a **Gross Domestic Product (GDP)** of $1,500 per capita and still has an estimated 25% of the population living below the **poverty line.**

Trade policies in Nepal

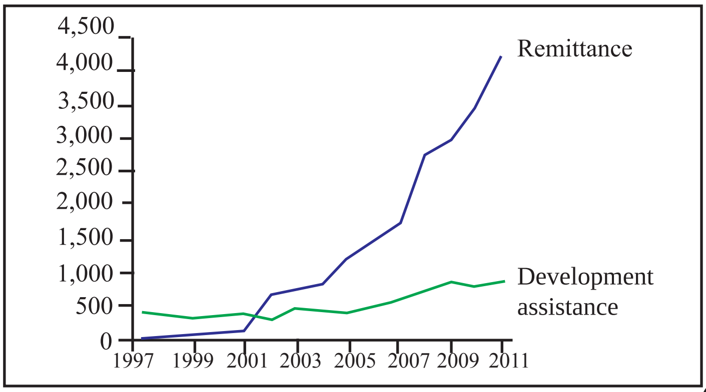
India is Nepal's sole transit neighbour, which means that trade in Nepal is dependent on cross-border political relations. As such, India could easily block their borders or adopt policies to impede trade. Even if there is no direct conflict, Nepal is extremely vulnerable to the political vagaries of India. For example, in 1990 India blockaded the border between the two countries, an action cited as a major cause of the overthrow of the Nepalese government. Moreover, between 2001 and 2002, India instituted significant trade restrictions on Nepal during the negotiation of a bilateral trade agreement. The vulnerability of Nepal to cross-border political relations with India is exacerbated (and perhaps caused) by the dependency of Nepal on India for imports, as Nepal receives 80% of all its imports from India.

Remittances in Nepal

However, Nepal has recently experienced rapid growth in remittance payments, which now make up 25% of its GDP. In 2013, nearly 1,500 Nepalis a day migrated abroad to work and these migrants sent back about $4bn in total to their families. Indeed, in Nepal remittances have been responsible for poverty reduction, an increase in foreign exchange reserves, and the expansion of banks and financial institutions. This flow of capital is supporting some households to improve their quality of life as there are few alternatives available.

The graph below shows increases in remittances in comparison with development aid from 1997 to 2011.

Figure 4. Increase in remittances 1997 - 2011



It is important to note that the international mobility of capital and workers has significantly reduced the talent available to provide for growth within Nepal. In particular the departure of predominantly men to the Gulf States and Malaysia to work in factories and on construction sites is causing a shortage of agricultural labour in Nepal. Furthermore, a substantial spike in revenue from a single industry can have adverse impacts on the rest of the economy, and this is referred to by economists as 'Dutch disease' (after the effects of North Sea gas on the Dutch economy). Worse still is an over-reliance on remittances, so that if there is a shock in terms of decline in that money, the country's economy will have no way to cope. Indeed, whilst remittances provide short-term relief, the economy of Nepal remains very vulnerable.

Glossary

Budget Deficit: A budget deficit occurs when government spending exceeds its income. Budget deficits as a percentage of GDP often decrease during periods of economic prosperity when there is lower unemployment and governments tend to be abe to increase tax revenue and reduce costs**.**

Capacity building: This is the training and development of the workforce within the country.

Diminishing returns: A term used to refer to the point at which the money made is less than the amount invested.

Gross Domestic Product (GDP): The monetary value of all the finished goods and services produced within a country's borders in a specific time period.

International migration: The movement of people across international boundaries

Marginalization: the social process of exclusion (e.g. countries being unable to trade within global markets).

Poverty line: A person is considered poor if his or her consumption or income level falls below some minimum level necessary to meet basic needs. The World Bank has defined this as living on less than $1.25 dollars a day.

Protectionist policies: These are economic policies of restraining trade between countries through the use of taxes imposed on imported goods and restrictive quotas on imports.

Remittances: A *remittance* is a transfer of money by a foreign worker to an individual in his or her home country.

Subsistence Farming: self-sufficiency **farming** in which the **farmers** focus on growing enough food to feed themselves and their families

Subsidies: This is a sum of money granted by the government to help an industry or business to keep the price of a commodity or service low.

Technical assistance: This is non-financial assistance usually in the form of sharing information or skills training.

Exam Guidance: Structured Answer

"Aid has *not* improved life for the world's poorest people." Discuss this statement.

Guidelines

- Define what is meant by aid and the different forms in which aid can take
- What are the different aims of aid in the short and long term
- Good responses may query what is meant by "poorest" and may take a broader approach than focusing solely on changing income distributions, for example, you may distinguish between economic and social development criteria or consider the lives of women, primary school children, elderly, HIV/AIDS sufferers, *etc*.
- You must address both the positive and negative impact of aid on the world poorest people. At least one paragraph should be on the positives of aid and one paragraph on the negatives of aid.
- You could conclude by discussing the need for the effective management of aid and incentives for reform.
- The strongest answers may conclude that aid can be more effective in some places than others and that some sectors of the population are more or less marginalized than others.
- Top band answers will link to country case studies such as Nepal, be well supported with statistics and discuss possible alternatives to aid.

Suggestions for further reading

Collier, P. (2007). *The bottom billion: Why the poorest countries are failing and what can be done about it*. Oxford: Oxford University Press.

Sachs, J. (2005). *The End of Poverty*: *Economic Possibilities for Our Time*. New York: Penguin Books.

Global development pages on the Guardian Website, http://www.theguardian.com/global-development

Jubilee Debt Campaign http://jubileedebt.org.uk/

World Bank summary of development in Nepal http://www.worldbank.org/en/country/nepal

BBC News profile on Nepal http://www.bbc.co.uk/news/world-south-asia-12511455

A report on Nepal migrant labour from The Guardian http://www.theguardian.com/global-development/2014/may/20/nepal-migrant-deaths-treated-murder

A UN report on Nepal's progress towards the Millennium Development Goals http://www.np.undp.org/content/nepal/en/home/mdgoverview.html

Acknowledgements;

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