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**SHAPING THE DEVELOPMENT
OF DEVELOPING COUNTRIES
FOCUSED ON CHINA AND INDIA**

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FOCUSED ON CHINA AND INDIA

JIŘÍ NOVOSÁK, ROBERT STOJANOV

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SHAPING THE DEVELOPMENT OF DEVELOPING COUNTRIES. FOCUSED ON CHINA AND INDIA.
JIŘÍ NOVOSÁK, ROBERT STOJANOV

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PREFACE

Sometimes, one may ask “Why was I born just in the Czech Republic?” If I had been born only several hundred kilometres westwards I would have been a citizen of one of the most developed countries in the world with all benefits implying from this. However, the question may be extended: “What do the people think who were born in a country on the lowest level of development?” Each day, it is possible to see the sad destinies of hungry children, of the people living under the pressure of an autocratic regime, or of the homeless people waiting for some form of humanitarian aid. Perhaps everybody thinks whether there is a chance to help these people. How to spark the development of these countries?

The prime aim of this book is to sketch out the opportunities how to shape the development of developing countries. These opportunities are rather well-known and they include such various topics as a broader incorporation of developing countries into the international trade structures, a broader attraction of foreign direct investments, a sound macroeconomic policy, a larger inflow of official development assistance, and various migration-development aspects. With all these facets of development, the book deals with, pointing not only at fundamental terms, but also at pros and cons of these development strategies and especially at broader economic, social, political, and environmental relations.

The book is structured in a rather straightforward way. The first chapter deals with the basic concepts and indicators of development. Furthermore, spatial differences in development are introduced and explained. Finally, a brief review of fundamental development theories is a part of the first chapter. The second chapter supplements the first chapter by an assessment of the most relevant development strategies – international trade, foreign direct investments, official development assistance, and macroeconomic policies. The third chapter of the book analyzes causes of international migration from the theoretical point of view and with respect to the relationship between causes of migration and development. The fourth chapter of the book adds the most important developmental aspects of migration, notably remittances and skilled migration and moreover it documents selected findings from the previous parts using international migration flows in Bangladesh, India and China as examples. The last two chapters are focused on economic, social, political, and environmental aspects of development. China and India are used as two case studies in this way. Note that the choice of these countries was a bit naturally given by their increasing economic, political and environmental importance in the contemporary world.

This book represents an output of the project CZ.04.1.03/3.2.15.3/0439 titled *Innovation and Internationalization of Selected Study Programmes at the University of Ostrava* which was supported by the European Social Fund. This support is warmly acknowledged by the authors. Because of this background, the book was primarily written for all participants in the project. However, the authors hope that the book will be of a much broader interest. Now, it remains only to wish you a pleasant reading.

CHAPTER ONE

DEVELOPMENT – CONCEPTS AND THEORIES

After the Second World War, the concept of development became to be perceived as a desirable way for a better future of mankind. Originally, the development efforts were focused on industrialized countries in war-damaged Europe, with the Marshall Plan as the best-known policy of this kind. After the European recovery, the attention was shifted to the problems of economically less advanced countries, development of which was perceived as beneficial also for their more developed counterparts. However, no consensus was found what development is or should be and how to measure it (MARTINUSSEN 1997).

Since this time, several approaches were proposed not only how to define and measure development but also how to shape the development of developing countries. Based on the successes of Japan or Asian Tigers on one hand and the failures of many African countries on the other one, a number of economists, politicians, and other development scientists tried to extract a correct mix of ingredients which were necessary to spark the development trajectories. Nevertheless, the most important conclusion from these efforts is that there is no easy remedy for the development illnesses of developing countries. The introductory two chapters of this book summarize the most important concepts, indicators, theories (Chapter 1) and strategies (Chapter 2) with respect to the development of developing countries. Note that concluding remarks are given jointly for the both chapters.

Development Concepts

In the early years of development studies, economic growth was regarded as the main feature of development. The fundamental idea of the development concept based on economic growth claims that economic growth will result not only in an increasing personal income but also in a higher quality of life. However, the correlation between economic growth and improvements in living standards of a large part of population appears to be inconclusive and thus the application of economic growth as a proxy of development unjustifiable (KAMBHAMPATI 2004). This fact is caused especially by an uneven distribution of gains from economic growth when already rich people are becoming even richer while poor even poorer.

The problems of the definition based on economic growth led to an extended definition of development. The goals to eradicate poverty and to reduce social inequalities were added. However, also the enlarged concept of development appears to be not sufficient

to consider all nuances of the term. There is a widespread idea now that to speak about development it is necessary to improve a whole set of factors which influence quality of life. Therefore, human beings and not income are positioned in the centre of the term development. On this basis, a broad concept of development emerged represented especially by the *Basic-Needs Approach*, the *Human Development* concept and the *Millennium Development Goals* (see Box 1-1).

Box 1-1: The Basic-Needs Approach, Human Development, and the Millennium Development Goals

The main idea of the Basic-Needs Approach claims that the development efforts should be oriented especially towards the poor part of population which is not capable to grasp benefits from economic growth. Development is understood as the satisfaction of basic needs, ideally of the whole population. The basic needs include food, education, health, sanitation, water supply and housing. The Human Development concept is defined as a process of enlarging people's choices, which include the opportunity to live a long and healthy life, to be educated, to have an access to the resources necessary for a decent standard of living, and furthermore political freedom, human rights, gender equality, and environmental sustainability.

The Millennium Development Goals (the MDGs hereafter) represent a set of ambitious goals formulated at the United Nations Millennium Summit in 2000. With the state-of-the-art in 1990 as the benchmark, the MDGs aspire by the year 2015¹:

- *To eradicate the extreme poverty and hunger, with the specific targets to halve the proportion of people living on less than a dollar a day and suffering from hunger; measured by the proportion of children under age five who are underweight*

The number of people living on less than a dollar a day decreased substantially from 1.25 billion (31.6 % share of the population in developing countries) in 1990 to 980 million (19.2 %) in 2004. However, this drop was enabled especially by the economic boom of Eastern and South-Eastern Asia where the share of people living on less than a dollar a day fell from 33.0 % and 20.8 % respectively in 1990 to 9.9 % and 6.8 % respectively in 2004. The recent Indian growth reduced the share substantially also in Southern Asia. However, the figures of Sub-Saharan Africa, with still 41.1 % share of people living on less than a dollar a day in 2004, were less optimistic. The results were similar also for the second specific target of the goal. However, there are doubts whether the second specific target will be fulfilled because the proportion of children under age five who are underweight fell from 33 % in 1990 only to 27 % in 2005 (UNITED NATIONS 2007b).

The first goal is the most prominent one from the MDGs and the trends described above are generally used to celebrate the development progress in developing countries. However, POGGE (2004) is much more sceptical in this respect. He claims that the first goal is modest compared with the goal formulated at the World Food Summit in Rome 1996 to halve the number, and not the proportion, of extremely poor people by 2015. Inevitably, the goal from Rome is more stringent because of a clearly defined final state regardless a population growth. Furthermore, POGGE (2004) asks whether

¹ The MDGs are expected to be met for aggregate figures of all developing countries and simultaneously for regional groups of countries.

it is moral to reduce poverty only by half when the global financial sources are sufficient to eradicate poverty completely. Finally, POGGE (2004) points to several methodological problems how the World Bank calculates poverty figures.²

- *To achieve the universal primary education, with the specific target to ensure that all boys and girls will be able to complete a primary school*

The net enrolment ratio in the primary education in developing countries increased from 80 % in 1990 to 88 % in 2005. Sub-Saharan Africa was again the worst performing region with only 70 % of school-age population enrolled in the primary or secondary education (UNITED NATIONS 2007b).

- *To promote gender equality and empower women, with the specific target to eliminate gender disparities in primary and secondary education preferably by 2005 and in all levels of education no later than 2015*
- *To reduce child mortality, with the specific target to reduce by two-thirds the under-five mortality rate*

A progress was made in the fulfilment of this goal because the under-five mortality rate in developing countries decreased from 10.6 % in 1990 to 8.3 % in 2005. However, these figures unambiguously show that much more must be done especially in the worst affected regions, Sub-Saharan Africa (16.6 %), and Southern Asia (8.2 %). Note that diseases (AIDS, malaria) and violent conflicts belong to the most frequent causes of the high under-five mortality rates (UNITED NATIONS 2007b).

- *To improve maternal health, with the specific target to reduce by three quarters the maternal mortality ratio*
- *To combat HIV, malaria and other diseases, with the specific targets to halt and begin to reverse the spread of HIV/AIDS and to halt and begin to reverse the spread of malaria and other diseases*

The number of people living with HIV increased from 32.9 million in 2001 to 39.5 million in 2006, with Sub-Saharan Africa as the worst affected region (63 % of the total world's infected population). However, Eastern Asia and the CIS showed the fastest growth of the number of HIV infected people in this period. Treatment and prevention measures were not able to keep pace with HIV spread.

² First, the critique concerns with the low 1 USD threshold. Naturally, it is possible to claim that it does not matter in the relative comparison. However, the whole essence of the critique emerges when we consider that while the number of people living on less than a dollar a day decreased in the period 1981-2001 the opposite was true for those living on less than two dollars. With a higher threshold, the development progress would have been not so rosy. Second, the PPP method which is used to derive the threshold in particular countries overestimates the economic strength of developing countries. In developing countries, the prices of the goods, which are easily traded (tradeables – e.g. food), correspond to the prices in developed countries. On the other hand, the prices of the goods, which are not easily traded (non-tradeables – e.g. services), tend to be much lower in developing countries. Altogether, an inclusion of the non-tradeables leads to a lower PPP adjusted exchange rate than the market exchange rate is. However, the non-tradeables are usually of a low importance for poor people because much of their income is oriented towards the basic necessities. Thus, the PPP method based on a large number of non-tradeables poses the poverty threshold in developing countries lower than it should be.

The same problem was recorded also in the fight against malaria, e.g. with an insufficient use of insecticide-treated bed nets. In addition, chloroquine, the most widespread medicine, is becoming less efficient, worsening the treatment possibilities (UNITED NATIONS 2007b). Note that a high HIV/AIDS incidence may have fatal impacts on development because people in the productive age 15-49 are the most frequent group infected. NAFZIGER (2006) illustrates the seriousness of this problem in Botswana, claiming that around 40 % of the population age 15-49 was infected by HIV/AIDS in this country.

- *To ensure environmental sustainability, with the specific targets to integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources, to halve the proportion of the population without an access to safe drinking water and basic sanitation and to improve the lives of at least 100 million slum dwellers*

A lot of problems exist to fulfil this goal. First, deforestation continues in the world's most biologically diverse regions. New planting of trees is still not sufficient to reverse this trend and the number of endangered species increases. Second, global warming has become one of the most frequently cited threads of the contemporary world. While carbon emissions tend to increase, the efforts to find a political consensus to fight against these threads founder at economic and political interests. Third, although the access to safe drinking water and sanitation was improved it will be very difficult to fulfil the defined goal (UNITED NATIONS 2007b).

- *To develop a Global Partnership for Development, with the specific targets to address the special needs of the least developed countries, land-locked countries and small island developing states; to develop further an open, rule based, predictable, non-discriminatory trading and financial system; to deal comprehensively with the debt of developing countries; to develop and implement strategies for decent and productive work for youth; to make available benefits of new technologies, especially information and communications*

The fulfilment of the MDGs represents a very desirable way how to contribute to the development of developing countries. As NAFZIGER (2006) points out it is possible to expect a progress in many of the goals. However, he adds that especially the Africa's prospect looks gloomy with an increasing environmental degradation of rural areas and with an overpopulation of urban areas, triggering hunger, poverty, congestion, and crime. In many countries, the situation is further worsened by an authoritarian and corruptive political regime, civil wars, and spread of diseases. Overall, barriers to any form of development seem to be very strong. Note that there are pockets of development also in Africa but these are rather scarce.

AMIN (2006) criticizes the MDGs from several angles. He claims that the goals are formulated vaguely with an unspecified way how to fulfil them. Will the traditional Muslim countries such as Saudi Arabia agree to eliminate gender disparities? Do the neoliberal idea of an open, rule-based and non-discriminatory financial and trading system fight against poverty? Who will grasp the benefits from free trade? What is hidden behind the Western idea of good governance? How is the destiny of the Kyoto Protocol in accord with the MDGs? Do developed countries joke with the goal of a more generous ODA? These are only some questions formulated by AMIN (2006). Altogether, he labels the MDGs as a pious hope which follows the interests of global capitalism not of developing countries.

Source: UNITED NATIONS (2007b), AMIN (2006), NAFZIGER (2006), MARTINUSSEN (1997)

The question remains whether the aforementioned development concepts are in accord with the sense of happiness, declared directly by particular persons. As usual, the answer is not straightforward. If the sense of happiness is understood as an improvement in material well-being, including a better access to sanitation, health-care, education, or social services, development represents the best way how to make people happy. This may be true especially in developing countries where one dollar more in income has usually a much higher impact on material well-being than in developed countries (KENNY 2005). However, the whole idea of happiness has an important relative dimension. In developed countries, it may be important to possess some goods to be happy while the same does not have to be necessary in developing countries. This is given by the natural efforts to “compare oneself with my neighbours”. The sense of happiness is then understood more in social relations than in material well-being. Altogether, development improves not only income and other indicators but also increases social expectations and therefore it is not possible to say that there is a direct relationship between increasing income and increasing happiness.

Finally, it is necessary to mention the thought stream which perceives development as the liberation (independence, freedom) from the Western way of development. From this point of view, development strategies should not be prepared by experts from developed countries but directly by actors in developing countries. This idea seems to be natural and correct and the efforts to stimulate endogenous resources must be firmly positioned in all development programmes. However, the idea of freedom may be only a luxurious building in an intellectual desert when not accompanied by an adequate lesson on its real meaning. MAKUWIRA (2006) warns from the understanding of freedom in developing countries as an unlimited choice what to do, including a criminal behaviour.

Development Indicators

The preceding paragraph clearly illustrates various approaches how to understand the concept of development. Each of these approaches is also connected with different ways how to measure development. The approach based on economic growth traditionally uses the indicators such as **Gross National Product** (GNP), **Gross National Income** (GNI) or **Gross Domestic Product** (GDP). Whereas GNP and GNI measure the total output of goods and services in terms of income earned by country's residents and institutions³, GDP measures the total output of goods and

³ There are only slight differences between the terms GNI and GNP. Currently, the World Bank prefers the term GNI in accord with the terminology of the 1993 System of National Accounts.

services in terms of income earned within the country's boundaries (NAFZIGER 2006). For a comparison, these indicators are usually given per capita and in a same currency. Furthermore, because of different prices of goods and services in particular countries, the Purchasing Power Parity (PPP) recalculation is usually used as well. In this way, the so called price level GNP (GNI, GDP) or alternatively ***Purchasing-Power Adjusted GNP*** (GNI, GDP) is gained.⁴ Note that the adjusted figures depict the reality better than GNP (GNI, GDP) transformed only by a currency exchange rate.

Nevertheless, there are another problems with the application of all versions of the GNP (GNI, GDP) indicators when the development level of particular countries should be compared. The incorporation of the facilities, which hardly contribute to a higher quality of life (e.g. water clearance facilities), into and the omission of traditional household activities from the GNP (GNI, GDP) calculation belong to the most often cited drawbacks in this regard. The former case is more typical for developed while the latter for developing countries, thus contributing to an increasing discrepancy in the GNP (GNI, GDP) figures between these two types of countries. Existence and reliability of data and some methodological issues represent another potential problems of these indicators.

The traditional GNP (GNI, GDP) indicators are not able to address the broad definition of development. Therefore, several alternatives, how to measure the broad concept of development, were proposed. The ***Human Development Index***⁵ (the HDI hereafter), created by the United Nations Development Programme (UNDP), became the most widely known and applied indicator of this kind. Traditionally, the HDI is composed of four partial variables. GDP per capita in PPP considers living standards, the life expectancy at birth health and nutrition, and the adult illiteracy rate combined with the enrolment in primary, secondary and tertiary education social capital of a country. Note that the non-GDP variables are used to better grasp the distribution of economic positives in the whole population (KAMBHAMPATI 2004), such as the poor social conditions of the non-white population in South Africa. Box 1-2 shows how to calculate the HDI.

⁴ The calculation of PPP GNP (GNI, GDP) per capita in USD is rather straightforward. First, the so called price level of GNP is computed as the ratio of the PPP exchange rate to the actual exchange rate. The PPP exchange rate may be derived from a price comparison of the same products in different countries (e.g. the Big Mac is a commodity often used for such purposes). Then the value of GNP (GNI, GDP) per capita in USD is divided by the value of the price level of GNP and the result is the value of PPP GNP (GNI, GDP) per capita in USD.

⁵ The Human Poverty Index is another indicator used by the UNDP, which excludes GDP per capita from the calculation procedure at all. Three other partial variables are used - access to safe water, access to health services, and the share of underweight children under five.

Box 1-2: How to calculate the HDI

To calculate the HDI of particular countries, the following algorithm is applied:

1. To determine the maximum (*maxvalue*) and minimum (*minvalue*) values of four partial variables in a selected year

Example: In the year 2000, the maximum and minimum values were as follows:

- GDP per capita in PPP from 100 USD to 40,000 USD
- The life expectancy at birth from 25 to 85 years
- Both education variables from 0 to 100 %

2. To calculate the indexes of the partial variables according to the formulae:

$$\left\{ index = \frac{(actual\ value - min\ value)}{(max\ value - min\ value)} \right\}$$

Note that logarithm is used for the GDP figures.

Example: The actual values for India are as follows - GDP per capita in PPP (GDP_{index}) 2,358 USD, the life expectancy at birth (LE_{index}) 63.3 years, adult illiteracy (AL_{index}) 57.3 % and the enrolment in primary, secondary and tertiary education (EE_{index}) 55 %. The partial indexes are:

$$GDP_{index} = \frac{(\log 2358 - \log 100)}{(\log 40000 - \log 100)} = 0.53; \quad LE_{index} = \frac{(63.3 - 25)}{(85 - 25)} = 0.64;$$

$$AL_{index} = \frac{(57.3 - 0)}{(100 - 0)} = 0.57; \quad EE_{index} = \frac{(55 - 0)}{(100 - 0)} = 0.55$$

3. To calculate the education index as the sum of two thirds of the adult literacy index and one third of the enrolment index

Example: The India's education index (ED_{index}) is calculated as follows:

$$ED_{index} = \frac{2}{3} AL_{index} + \frac{1}{3} EE_{index} = \frac{2}{3} 0.57 + \frac{1}{3} 0.55 = 0.57$$

4. To calculate the HDI as the arithmetic mean of the GDP, life expectancy and education indexes

Example: The India's HDI is calculated as follows:

$$HDI = \frac{1}{3} GDP_{index} + \frac{1}{3} LE_{index} + \frac{1}{3} ED_{index} = \frac{1}{3} 0.53 + \frac{1}{3} 0.64 + \frac{1}{3} 0.57 = 0.577$$

Source: Based on NAFZIGER (2006)

Factors of Development in the Historical Perspective

The mankind experienced an unprecedented economic growth in its modern history. Only in the last millennium, the World's GDP skyrocketed three hundred times and the world's GDP per capita rose thirteen times (NAFZIGER 2006). But where was the point when the modern economic growth took off? NAFZIGER (2006) highlights the break down of feudalism and the advent of capitalism in the 16th century in this regard, when new relations between major economic actors were created. Thus, the means of production remained in hands of private owners but legally free workers began to sell their work for wages. These two factors enabled to accumulate a sufficient capital for investments because just the private owners were able to grasp the surplus value from economic activities. On this basis, capitalism became the first system which was able to trigger a sustained economic growth.

From the geographical viewpoint, the Western civilization, understood as (Western) Europe, Anglo-Saxon America, Australia and New Zealand, was the first part of the world where the capitalist system was implemented. This resulted in its dominant position in the world economy. But why was just the Western civilization successful? NAFZIGER (2006) answers this question by the following factors typical for the Western civilization:

- *Market competition (laissez-faire)*

Market competition substantially improved the efficiency of economic subjects and helped to implement technological and organisational innovations in production.

- *The Enlightenment*

The Enlightenment was connected with many scientific innovations and inventions (e.g. electricity) which were applied in the production, substantially improving its efficiency.

- *Strong national states*

An emergence of strong national states in the 16th century enabled to create the conditions which were necessary for the capitalistic development of the Western civilization. These conditions included the establishment of police and army to control internal and external threads, the creation of a unified monetary system and property law, the construction of new infrastructure, and the removal of internal and later external trade barriers.

- *A changing role of churches*

Since the 16th century, the Western civilization was characterized by a weakening authority of the Roman Catholic Church which was not development-friendly because of its hierarchical organisation of society, a low work ethic, and a lack of public spirit (GRIER 1997). On the contrary, the importance of Protestantism increased substantially and the Protestant ethic, which stressed hard work, freedom and efficiency in the name of the God, contributed a lot to the advent of the Western-type of capitalism. Note that GRIER (1997) identified a positive relationship between Protestantism and economic growth in the British colonies. Moreover, he points out that the former British colonies reached a higher development level than the Spanish or French ones. Protestantism and its values may be a part of explanation though GRIER (1997) warns from an undue simplification.

Note that the historical path-dependency process may be added to these factors. Once established, the Western civilization gained substantially from its primacy in the adoption of capitalism. There are also another causes of the differences in the development progress of developed and developing countries (NAFZIGER 2006):

- *Geographical conditions*

The ***Evolutionary biological approach*** stresses the differences in environmental conditions of particular regions to explain their development progress. Climate plays the most important role in this regard because it influences e.g. the existence of species appropriate for animal production or the quality of soils. Furthermore, Africa and Latin America are disadvantaged by their South-North axes which work as a natural climatic barrier for a spread of species. In addition, several other environmental conditions may be mentioned such as the spatial remoteness and isolation from other regions (e.g. Pacific Islands) or a high share of arid areas (e.g. Sub-Saharan Africa).

- *Colonialism, structural weaknesses, human capital and technologies*

Colonialism is often regarded as one of the causes which undermined the development potential of developing countries. The explanation is based on the absence of a political independence of former colonies to modernize their economies. Simultaneously, the development of skills and new industries was suppressed for a long time and the colonies remained dependant on traditional economic activities and on a limited number of products exported to developed countries. Consequently, the human capital and technological development of former colonies was very modest and one-way oriented. Note that despite a rather great progress in the 20th century,

the literacy rate is still relatively low in low-income developing countries. Similarly, a huge technological gap undermines development potential of these countries.

However, the impacts of colonialism may not be depicted only in the black colour. Let us illustrate this contention. In 1990, the share of manufacturers in the export from Uganda was only 1 % compared with over 30 % in the export from Zimbabwe (WOOD, JORDAN 2000). WOOD, JORDAN (2000) offer several factors which explain these differences and the colonial past of the both countries belongs to them. Note that Uganda and Zimbabwe were colonized by the United Kingdom and gained the independence only in the 1960s. Despite these similarities, better conditions for further development were created in Zimbabwe. Three aspects are highlighted by WOOD, JORDAN (2000) in this regard. First, the processing of primary products as a form of industrialization was supported in Zimbabwe. Uganda was out of the British interest in this regard. Second, a better transportation infrastructure was built in Zimbabwe, influenced a lot by the industrialization efforts. Third, a relatively high number of white immigrants settled in Zimbabwe. They brought the skills necessary for industrialization, a feature lacking in Uganda.

- *Population growth and socioeconomic inequalities*

Population growth is primarily concentrated in developing countries now (ATOH 2000), causing some negative impacts on development because significant financial means must be allocated towards the dependent part of population (children). Thus, the investment potential is undermined. High population growth has also another negative consequences connected with an overpopulation of urban areas where poor people migrate searching for a better future. Unemployment, slums, transport congestions, and pollution became the synonyms of many cities in the developing world.⁶ Note that socioeconomic inequalities may contribute to a

⁶ Note the increasing number of inhabitants traditionally evokes the question whether the planet is able to provide an sufficient amount of foods. So far, the humankind was able to produce more food than necessary because of the technological progress (e.g. new varieties of crops, pesticides, new irrigation systems and other factors aggregately labelled as the “*Green Revolution*”). The question remains where the limits are. The carrying capacity of the Earth may substantially influence the development not only of developing countries. Are there any ways out of the overpopulation constrains? Two opportunities are mentioned in this way. The first one is oriented towards family planning and the use of contraception, abortion and other measures. However, family planning founders at the traditional values and prejudices especially in rural areas where young children are regarded as a cheap labour-force and simultaneously more children are understood as a form of insurance for old age. Considering these barriers, socio-economic development must be added as the second condition how to break the overpopulation constrains. A better education, income not dependant solely on the manual agricultural work, and lower infant mortality rates, all these factors contribute to removal of the motivations for a large family.

higher population growth because there are clear tendencies that poor people have a relatively higher fertility. Socioeconomic inequalities have also other negative impacts on development. Poor people have a worse access to education and thus the human capital development is undermined. Furthermore, social unrest, crime and political instability tend to rise with an increasing share of poor people in the society (KNOWLES 2005).

- *Institutions and democracy*

Contemporary, a sound institutional environment⁷ is regarded as one of the most important ingredients of development. However, many developing countries traditionally suffer not only from weak institutions but also from authoritarian, corruptive governments (*predatory states*, the politics of greed) which undermine their development potential (PETITEVILLE 1998). Narrow political elites are unwilling to jeopardize their position through a modernization process. This results in an inadequate legal system, missing monetary and fiscal institutions, undeveloped financial markets (see Box 1-3), or a weak civil society. Naturally, these conditions discourage potential investors and promote the *rent-seeking behaviour* of political elites, salient by a tunnelling of public resources to the hands of their political supporters. DOLLAR et al. (2005) point out that a good investment climate characterized by high-quality institutions (social infrastructure) leads to a higher productivity also at the firm level. They claim that the quality of the China's institutional climate is superior to that of India, Bangladesh and Pakistan and that this fact is mirrored in the economic performance of these countries.

Box 1-3: Financial markets in developing countries

Developing countries are characterized by undeveloped stock and bond markets and weak pension and insurance funds. Therefore, the banking sector plays the most important role as a source of financing of development. However, its efficiency is generally low, especially from two reasons. First, a large amount of domestic savings is not mobilized by banks. Second, only a small share of bank deposits is allocated for private investments. In 2002, the credit provided for private economic subjects was 168 % of GDP in high-income countries, 83 % of GDP in middle-income countries and

⁷ *Good governance* is another term used in this regard. The term includes not only the governments but also other actors involved in the decision-making process (e.g. lobbyist, international donors, NGOs, private firms). Note that the actors other than the government and military are labelled as the *civil society*. There are several requirements which good governance must meet. First, a direct or indirect (elections) participation by men and women in the decision making process must be assured. Furthermore, the rule of law and transparency must be ensured, including the rights of minorities. Institutions must work efficiently and as fast as possible on the basis of a consensus among various stakeholders. Finally, the accountability of all institutions must be a norm.

only 49 % of GDP in low-income countries. The main cause of this situation is not a lack of funds in the banks of developing countries but their reluctance to provide a credit for private enterprises, explained by FREEDMAN, CLICK (2006) as follows:

- There is a higher requirement on bank deposits in developing than in developed countries. This fact is caused by a higher macroeconomic instability and a missing insurance system of deposits in developing countries. Although these causes are well-founded, the requirements on deposits are often regarded as too stringent.
- The framework of creditors' protection is usually undeveloped in developing countries. Contract enforcement, the collateral law, and the bankruptcy regime tend to last very long. Moreover, tax authorities and workers are preferred to private investors during the bankruptcy regime. Naturally, banks ask for a collateral of a much higher value than the credit is (150 %). But this requirement is not accomplishable for many small enterprises. Note that a missing property rights legal system prevents owners to use their properties as a collateral in a number of developing countries (NAFZIGER 2006).
- Banks prefer to allocate their funds to the government bonds which are perceived to be relatively safe. Moreover, banks avoid the need to screen the potential borrowers in this case.

Altogether, especially small and medium enterprises are not able to gain financial means for their business in the financial market of developing countries and they must rely on relatives and friends. Therefore, the tools such as micro-credit schemes are desirable to remove the financial barriers of development.

Source: FREEDMAN, CLICK (2006), NAFZIGER (2006)

There is a broad literature now which deals with the question whether *democracy* contributes to the development of developing countries or not. One stream of scholars claims that the authoritarian regimes are more successful in the implementation of desirable reforms than democracies. RODRIK, WACZIARG (2005) even point to the comments of influential scholars that democracy produced a degree of chaos, instability, corruption, and ethnic conflicts in a number of cases. However, another stream of scholars depicts a bit more rosy view claiming that democracy reinforces the accountability of governments through the need to mobilize a sufficient number of voters for the next elections. Thus, the democratically elected governments have to distribute benefits more evenly than the authoritarian regimes which traditionally focus only on a restricted number of influential supporters (FEREE, SINGH 2006). FOWERAKER, LANDMAN (2004), RODRIK, WACZIARG (2005) point to the successful cases of Botswana or Mauritius where a positive relationship between democracy and development was created. However, FEREE, SINGH (2006) warn that it is a long-run process to achieve such a positive relationship.

Geography of Development

The World Bank (the WB hereafter) classification sorts countries according to their GNI per capita into four groups. *Low-income countries* (GNI per capita less than 905 USD in the year 2006), *lower middle-income countries* (906-3,595 USD) and *upper middle-income countries* (3,596-11,115 USD) are also labelled as developing or less developed countries or the South. *High-income countries* (more than 11,116 USD) are understood as developed countries or the North (see Box 1-4).⁸

Box 1-4: How to understand the term developing countries

This is a rather controversial issue to find an aggregate label for the countries from Africa, South Asia, East and Southeast Asia, Latin America and the Caribbean and the Middle East. Three terms are the most widespread in this way. The first term *Third World* refers not only to economically weak, underdeveloped countries but also to their relatively unimportant position in the international politics. They represent a large bloc of countries⁹ which are in their proclamations neutral from both, the First World of industrialized capitalistic countries and the Second World of socialist countries. However, the term Third World became obsolete in the 1990s, as an aftermath not only of the Soviet-bloc disintegration but also of an increasing economic diversity of the Third World countries.

The second term *South*, based on an uneven distribution of developed and underdeveloped countries between the Northern and Southern hemispheres, emerged as a reaction to the negative connotation of the word Third World in the 1980s. However, also this term hides several drawbacks because Australia and New Zealand as developed countries belong to the Southern hemisphere and the term is not able to grasp the increasing economic diversity of the South countries. And thus, though not free from problems¹⁰, the third term *developing countries* is the most frequently used one nowadays. Note that the term is favoured not only by the governments of developing countries but also by the international institutions such as the United Nations.

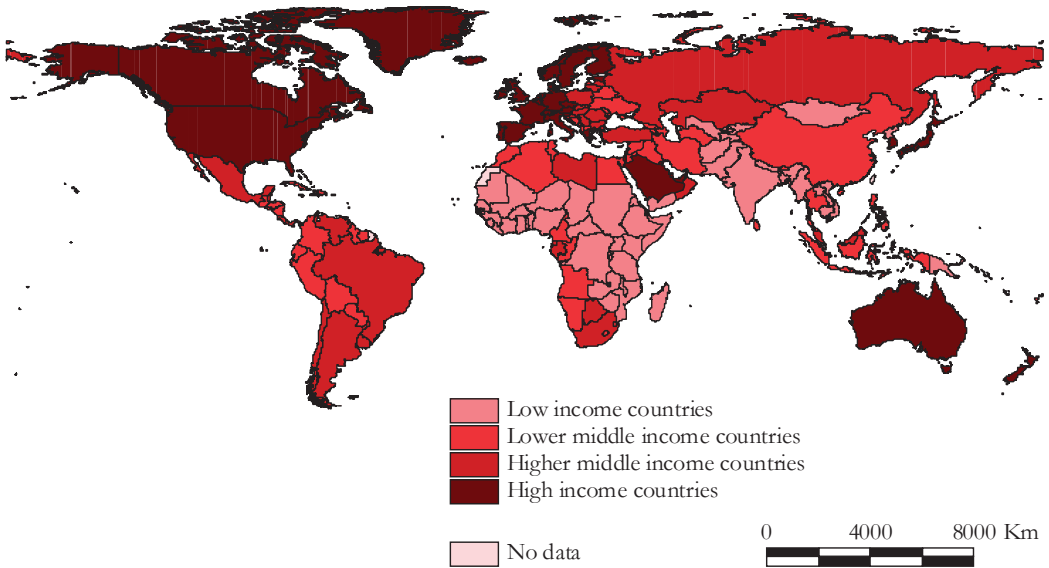
Source: HAYNES (2002), NAFZIGER (2006)

⁸ It is noteworthy that there is also another category of the so called *least developed countries*. This is a United Nations list of the countries which have a low combined score for selected indicators. These countries are expected to receive the majority of the aid provided by developed countries (NAFZIGER 2006).

⁹ The members of the United Nations Conference on Trade and Development, in particular 134 countries from Asia, Africa and Latin America, were denoted as the Third World.

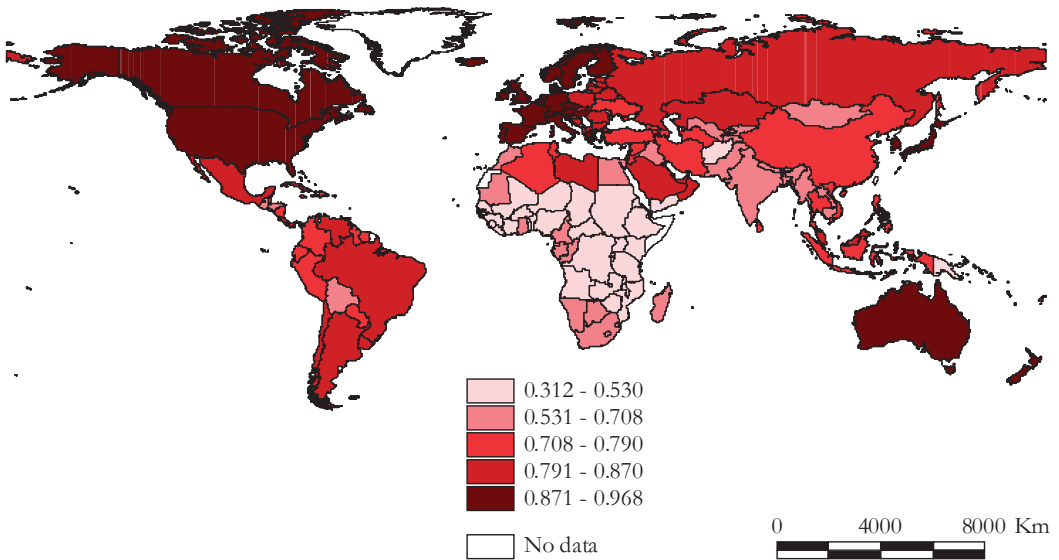
¹⁰ Similarly as the terms Third World and South, the term developing countries is not able to distinguish the increasing economic diversity of developing countries. Not all developing countries are on the way to become developed. On the contrary, there are little features of development in many of these countries, especially in Africa. Furthermore, HOESCHELE (2002) criticises the term also for some form of cultural prejudice against the “non-western” countries.

Figure 1-1: Income groups of countries according to the World Bank classification for GNI in 2006



Data source: Based on the World Bank list of economies according to income groups

Figure 1-2: Human Development Index of particular countries in 2005



Data source: OECD - Human Development Report 2007-08

Only few non-Western countries succeeded to join the club of high-income countries (see Figures 1-1 and 1-2). Besides the oil exporting countries, Japan and four *Asian Tigers* – South Korea, Taiwan, Hong Kong and Singapore, labelled also as the Gang of Four or *Newly Industrialized Countries* (the NIC hereafter) – represent the most important exception of this kind. Note that many economists thought that East Asia had a worse development potential than Latin America or Africa in the early 1950s (see e.g. EASTERLY, LEVINE 1997) because of its large surplus of labour-force and a poor natural resource endowment. However, the history drew a somewhat different picture of a volatile Latin American economic growth, an African growth disaster and an East Asian growth miracle (SAITOTI 2003, FRANKEMA, SMITS 2005). Note that the efforts to explain this fact became very important because a great hope was given to the East Asian development strategy as an opportunity to solve the problems of other developing countries as well. So what are the causes of the East Asian growth miracle and the Latin American and African growth failure?

Although nobody knows the exact mix of ingredients which initiated the economic growth miracle of Japan and Asian Tigers, KUZNETS (1988) accentuates especially five factors in this respect:

- *High investments*

Investments are generally understood as an engine of economic growth through the opportunities to expand production. In the period 1960s-1980s, the investment ratio¹¹ of Japan, South Korea and Taiwan was higher when compared with the countries on the same level of development. Note that BIRD, MILNE (1999) add the sound macroeconomic management, characterized by a low inflation and fiscal stability, as another positive feature of the East Asian countries.

- *Small public sector*

The critics claim that large public expenditures squeeze funds which could be used for more effective private (productive). Japan, South Korea and Taiwan are characterized by a relatively small public sector measured by the public expenditures. This is caused by a specific approach of the East Asian countries to the social security system. Because of the traditional cultural values, families are regarded to be responsible for social security. Note that high household savings of the East Asian countries may be partially explained by the efforts to be always prepared for unexpected expenditures of a health treatment or social security.

¹¹ Gross Domestic Investments to Gross Domestic Product

- *Export orientation*

Several internal and external factors enabled an impressive export growth of Japan, South Korea and Taiwan. The external factors include e.g. the long-term economic growth of the main trade partners or a gradual removal of trade barriers. The long-term comparative advantage of a cheap labour-force, the ability to shift this advantage to a technologically more advanced production in the later stage of development (see Table 1-1) and a proactive government policy belong to the most important internal factors.

Table 1-1: The share of primary goods in the total export (selected regions; selected years)

Region	The share of primary goods in the total export	
	1960	1999
Eastern Asia	85.4 %	7.5 %
Latin America	83.4 %	34.0 %
Africa	80.2 %	66.6 %

Source: FRANKEMA, SMITS (2005)

- *Competition in the labour market*

The labour market of Japan, South Korea and Taiwan are characterized by a weak position of labour unions, a rare strike occurrence and a specific working mentality based on the loyalty and diligence. These factors enabled to increase the efficiency of production in these countries.

- *State interventions*

A development-friendly government, the so called ***developmental state***, is another common feature of Japan, South Korea and Taiwan. In this respect, PETITEVILLE (1998) and WAI YIP SO (2006) emphasize three aspects of such a state. First, the developmental state is able to formulate a development plan and supports its realization. Such a support traditionally includes land reforms in rural areas, export-oriented trade policies, promotion of technologically more advanced sectors (e.g. scientific parks, technological transfers), management of a cooperative competition¹², and investments in education. Second, the developmental state is independent from the interests of various lobby groups and therefore it is able to

¹² In other words, competition of a limited number of cooperating firm-networks as a better solution than the pure laissez-faire. Note that this approach is completely different from the corruptive and rent-seeking behaviour typical for many countries in Sub-Saharan Africa.

assert its development plan without a substantial change. Note that this requirement was assured by a rather repressive and authoritarian government in the East Asian countries, especially in the initial stage of development. Third, the development state contributes to a high quality of its institutional environment because its bureaucrats and technocrats are able to realize the development plan without the corruptive and rent-seeking behaviour.

Box 1-5: The developmental state – semiconductor industry in Taiwan

The development of its semiconductor industry may be perceived as the definitive graduation of Taiwan into the group of technologically advanced countries. A proactive approach of the state played an important role in this way, especially in the initial stage of development. Three aspects should be highlighted:

- Private capital was not willing to bear the risk connected with the infant industry. Therefore, the state provided not only the funds used for the establishment of a first semiconductor company but also forced large domestic firms to provide an additional capital. Moreover, the state provided a matching financing for venture capital.
- The infrastructure necessary for the development of the semiconductor industry was constructed, using public funds. This included especially the *Hsinchu Science Park* founded in 1980. A vision of the park was a bit blurred in the early phase. Some high-tech industries, especially computer components, should have been attracted into the park, using the traditional tools such as financial incentives, administrative support, and others.
- The government negotiated a transfer of new technologies from the United States. Integrated circuits became the most important item in this respect, enabling a fast development of the firms engaged in this branch of the semiconductor industry.

Note that the primary goal of the whole strategy was to upgrade the Taiwan's economy and catch up Japan, South Korea and Hong Kong in their development. Foreign direct investments should have played a relevant role. The reality turned out to be a bit different although foreign firms prevailed in the 1980s. However, no giant foreign firm decided to set up its subsidiary in the newly established science park. Consequently, the share of small and medium domestic firms began increasing and their number outweighed their foreign counterparts in 1987. The return of Taiwanese students from abroad was an important factor in this way. The absence of a large firm contributed to a closer and flexible cooperation among small and medium domestic firms which enabled them to find and occupy market niches in the industry. The export oriented strategy followed by the government was another important piece of the development mosaic. At the turn of the century, over 100,000 persons were employed in the park.

Source: WAI YIP SO (2006)

Naturally, this review may not be regarded as an exhausted list of the factors which explain the East Asian economic miracle. PASHA, MITTELMAN (1995) stress the specific cultural values derived from Confucianism and the development aid from the Western countries during the Cold War as important factors as well. The

question remains whether the East Asian model of economic development may be transferred elsewhere. As usually, the answer lies somewhere in the middle of both extremes. It is not possible to replicate the initial conditions of Japan, South Korea or Taiwan and therefore the development path of any other country will inevitably differ from that of Japan or the Asian Tigers. However, a lot of partial knowledge may be drawn.

At the dawn of colonialism, the independence was perceived as a great development for Africa. Primarily, some progress was achieved, especially in the social sector (education, health care). However, this development appeared to be not sustainable and the most relevant economic indicators began to lag behind other regions, especially in the 1970s and 1980s (SINDZINGRE 2005). Note that especially Sub-Saharan Africa was seriously hit, with the causes summarized by SAITOTI (2003) as follows:

- *Excessive state interventions and an inappropriate institutional environment*

After the independence, the state became an important actor in the decision-making process about the development of Sub-Saharan Africa. However, the state interventions turned out to be excessive soon, resulting in a low return on investments. Moreover, high financial requirements to follow such a strategy led not only to a massive borrowing and debt but also to higher taxes, undermining the development potential of human capital and private sector. Note that the swings in prices of main export commodities made the economic performance of particular countries extremely volatile (SINDZINGRE 2005). Furthermore, the protectionism followed in the import substitution strategy contributed to the survival of inefficient domestic firms and sectors. Altogether, a risky economic and institutional environment prone to corruption and opportunistic behaviour was created, adversely affecting the development potential of Sub-Saharan Africa.

- *Political instability*

Political instability was an undesirable feature of Sub-Saharan Africa in the 1960s and 1970s. Not democratic elections but military coups became the main mechanism how to change the government. In many cases, civil wars and violent turmoil, often based on an ethnic cleavage, were sparked as an aftermath. Naturally, investors were reluctant to allocate their funds in such an environment, resulting in the bad economic performance of Sub-Saharan Africa. The countries which were able to sustain their political stability recorded also a better economic performance (FEREE, SINGH 2006).

As the reaction to the economic underperformance in the 1970s and 1980s, the so called *Structural Adjustment Programs* (the SAPs hereafter) financed by the WB and the International Monetary Fund (the IMF hereafter) were chosen as a suitable remedy for the economic recovery not only of Sub-Saharan Africa but also other developing countries. The emergence of the SAPs was based on the neoliberal ideas that the economic underperformance of these countries was caused by excessive state interventions and by market distortions (KONADU-AGYEMANG 2000). Thus, the SAPs were designed to increase the economic efficiency and to break the structural deficiencies of developing countries through a removal of state interventions, with all steps resulting in a larger inflow of investments. Note that a debt relief, loans and development aid were conditioned by the acceptance and implementation of the SAPs. Moreover, the SAPs became relevant for the creditworthiness of developing countries. Thus, developing countries had practically no other choice than to accept the SAPs. OWUSU (2001) points out that practically all Sub-Saharan countries initiated their SAPs in the early 1980s.

The SAPs generally have two phases with the first short-term one focused on macroeconomic stabilization and the second long-term one on structural reforms (KONADU-AGYEMANG, ADANU 2003). Altogether, the SAPs traditionally include a package of measures which aspire to (KONADU-AGYEMANG 2000, OWUSU 2001, JONAKIN, STEPHENS 2004):

- Promote trade liberalization and export industries – reduction of tariffs and other trade barriers, currency devaluation, the selection of suitable export commodities, an institutional support, and others
- Fight against inflation – an increase of interest rates, restrictions on credit, and others
- Reduce fiscal deficits – massive cuts in public expenditures, price deregulation, extension of the tax base, privatisation of state assets, and others
- Mobilize financial means for the financing of the initial phase of development (the WB and the IMF loans)
- Rehabilitate the existing infrastructure and build a new one

The overall assessment of the SAPs is rather ambiguous. Critics generally claim that the deregulatory nature of the SAPs is an ideal way how to free developed states and their transnational corporations in their exploitation of assets in developing countries. Thus, the dependency syndrome is strengthened (OWUSU 2001). Moreover, the successful East Asian countries never followed this strategy in a pure form and they kept their regulatory power especially in the initial phase of reforms (JONAKIN, STEPHENS 2004). SAITOTI (2003) mentions another three aspects of the critique. First, the SAPs were designed externally with a limited incorporation

of local actors in their preparation. Second, the SAPs had a bit generalized nature, insufficiently considering the specifics of particular countries. Third, the gains and losses of the SAPs were distributed unequally, with an adverse impact especially on poor people.

Box 1-6: The Structural Adjustment Program in Ghana

After the long-term British rule since 1844, Ghana gained the independence in 1957. Naturally, its economy was characterized by a structural underdevelopment in this time. The economy of Ghana was primarily oriented towards export of a limited number of commodities not consumed at home (cocoa, gold and timber) and import of manufactured goods not produced in Ghana. However, the economic activities were not integrated internally and therefore the domestic market was strongly underdeveloped with a limited potential of multiplier effects. Nevertheless note that Ghana was the leading country in cocoa export in 1957 (KONADU-AGYEMANG 2000) and that cocoa provided 70 % and cocoa, gold and timber in sum even 90 % of all export earnings in the period 1900-1960 (KONADU-AGYEMANG, ADANU 2003). Moreover, a relatively high economic growth (around 6 % in the late 1950s), foreign exchange reserves from export earnings, a well-developed export infrastructure and the best educated workforce in Africa positioned Ghana firmly among middle-income countries in the late 1950s, with a potential to become the development leader of the region (KONADU-AGYEMANG 2000).

However, the opportunities were not grasped at all. Between the 1960s and 1980s, economic growth dropped to the negative figures¹³, the export performance decreased substantially because of an overvalued currency and tax on export, the foreign exchange reserves were exhausted, indebtedness skyrocketed, real wages fell by almost 50 % because of a high inflation (80 % per annum in the early 1980s), socio-economic inequalities increased, political corruption became widespread, and many skilled and unskilled Ghanaians left the country (KONADU-AGYEMANG 2000, OWUSU 2001). Furthermore, the structure of export commodities remained the same, with the 70-90 % share of cocoa, gold and timber in the total export. The willingness of financial institutions to provide loans to Ghana decreased substantially. Altogether, Ghana stood at the edge of an economic chasm in the early 1980s.

In this situation, the SAP was initiated in Ghana in 1983. Public expenditures were substantially cut especially in the social sector, the tax base was extended, prices were deregulated and the state-owned enterprises privatized to reduce the excessive state interventionism as well as the fiscal deficit. Furthermore, export was promoted (e.g. currency devaluation¹⁴, an institutional support through the establishment of the *Ghana Export Promotion Council*, the permission to keep a part of export earnings in hard currencies) and anti-inflation tools (e.g. high interest rates, restrictions on credit) were applied. Other deregulation measures were used as well. Altogether, the SAP helped to recover the export-based economic growth with 5-6 % in the late 1980s and 2-4 % in the 1990s, to substantially decrease inflation and to resume the creditworthiness of Ghana for investors (KONADU-AGYEMANG 2000). Moreover, some diversification of export commodities was

¹³ GDP per capita fell from 1000 USD in the early 1960s to 750 USD in the early 1980s (KONADU-AGYEMANG 2000).

¹⁴ One USD was 2.75 *cedis* in 1983 while 7,800 *cedis* in 2001 (KONADU-AGYEMANG 2000).

recorded with an increasing share of the non-traditional products such as flowers, bananas, yams, textiles, reptiles and others in the total export earnings (KONADU-AGYEMANG, ADANU 2003).

Based on the preceding argumentation, the case of Ghana was declared as a successful implementation of the SAPs in Africa (OWUSU 2001). However, the SAP brought also some negatives to Ghana. First, the currency devaluation increased import prices and simultaneously the indebtedness of Ghana. Second, the social sector was affected by the massive cuts in public expenditures. Third, the SAP created both winners and losers of the reforms, with a limited impact on poverty reduction. The uneven distribution of benefits had also its spatial dimension, with the growth poles in the Southern part of the country attracting a larger part. Similarly, the benefits were also very limited for the peasants engaged primarily in the subsistence agriculture not producing the export crops (KONADU-AGYEMANG 2000). Fourth, despite some progress the export commodities were not diversified sufficiently because of a low share of manufactured and other higher-value added products in the total export earnings (KONADU-AGYEMANG, ADANU 2003). Finally, the SAP did not create internal linkages in the economy. Therefore, the domestic market remained weak (OSUWU 2001).

Source: KONADU-AGYEMANG (2000), KONADU-AGYEMANG, ADANU (2003), OWUSU (2001)

Altogether, pros and cons of the SAPs exist and the debate has shifted a bit further more recently. It is now widely accepted that there is not one easy solution for the development of Africa (AZAM et al. 2002). The rationale of the SAPs was recognized but the social and institutional aspects of development were newly emphasised. In this way, the WB and the IMF uphold the importance of the strategies which are prepared internally by the African leaders. Developed countries are expected to support these strategies. Note that this line of thoughts is not absolutely new and that already the Lagos Plan of Action, a document of the Organisation of African Unity from the year 1980, followed the “self-reliance and cooperation” philosophy, though with limited achievements (OWUSU 2001). Contemporary, the *New Partnership for Africa’s Development* (the NEPAD hereafter), signed in 2001 as the strategic document of the African Union¹⁵, is based on the same idea.

The main goal of the NEPAD is to give a vision and strategic framework for a new development of the African continent. In accord with the MDGs, peace, democracy, the institutional development, the human capital development, the fight against poverty, macroeconomic stability, and a high economic growth based on trade and foreign investments belong to the NEPAD priorities. The NEPAD accepts the leading role of African countries in the formulation and implementation of these goals. Therefore, the Heads of the State and Government Summit of the African Union are the highest authority of the NEPAD implementation process. Naturally,

¹⁵ The African Union is a principal organization which aspires for a greater socio-economic integration and solidarity of African countries.

the most influential African countries (South Africa, Algeria, Egypt, Nigeria, and Senegal) have the strongest voice. Furthermore, the NEPAD challenges developed countries to support Africa in the implementation of the goals. However, the question remains whether African countries are able to fulfil the ambitious goals of the strategy. The inability to solve the recent political crises in Zimbabwe or Kenya casts some doubts in this regard. The critics also claim that the NEPAD is only another document in the neoliberal spirit which follows the interests of developed countries and South Africa under the label “Made in Africa”.

The Latin American development after the Second World War had many similar features with Africa although the economic misery never reached the African level. The Latin American post-war economy was based especially on the industrialization policy made up of three fundamental pillars (ROXBOROUGH 1992):

- Protectionism and the import substitution industrialization
- Extensive state interventions (e.g. subsidized industries, state-ownership and others)
- A net inflow of foreign capital first in the form of foreign direct investments and later of borrowing

A balance of these pillars enabled a relatively good economic performance since the 1950s but the increasing dependence on foreign capital and inefficient domestic sectors created the assumptions for an immense economic problem emerging later in the 1980s. An extraordinary high indebtedness of many Latin American countries led to the inability to repay their debts and to an increasing reluctance of financial institutions to them provide new loans. Thus, one pillar of the traditional economic system collapsed with an adverse impact on the whole Latin American economy. LOVE (1999) describes the consequences as follows. The Latin American countries were forced to divert their public expenditures from education, health-care and other sectors and simultaneously to tax private investments to raise funds to cover their debts. However, such a policy inevitably led to a lack of capital for investments, resulting in a drop of GDP per capita by 8 % between 1980 and 1991, falling real wages by 50 % in the same period and hyperinflation of 1,200 % in some Latin American countries in 1989 and 1990 (ROXBOROUGH 1992). Based on these figures it is not surprising that the 1980s were labelled as the *lost development decade* of Latin America.

The failure of the traditional economic model evoked the consideration about a new development paradigm for Latin America. The paradigm was found in the neoliberal reforms as formulated in the so called Washington Consensus which generally aspire (WALTON 2004):

- To increase the economic stability through a monetary and fiscal prudence
- To ensure economic growth and efficiency through the market-based mechanisms
- To reduce inequalities through the fight against corruption and through increasing wages of unskilled labour employed in trade

Similarly to Africa, the SAPs became a widespread solution to the problems of Latin America. However, the achievements of the neoliberal reforms were rather disappointing (CASTANEDA 2006). Although economic growth was sparked in the 1990s, the economic performance of Latin America lagged far behind East Asia (WALTON 2004). Financial crises became frequent during the 1990s, first affecting Mexico in 1994-95 and subsequently Brazil, Ecuador, Uruguay, and finally Argentina in 2001 (STIGLITZ 2003b), a country which was regarded as the best neoliberal student of the IMF for a long time. It is interesting that a broad discussion on the causes of these financial crises contributed to an institutional shift of the whole neoliberal paradigm. Note that Latin America has remained a continent with very high socio-economic inequalities (CASTANEDA 2006).

Neoliberalism experienced the heyday in Latin America in the 1990s. Even the ideas on a convergence of the whole Western hemisphere emerged. However, the contemporary Latin America depicts a completely different picture. After the elections in 2006, the left governments rule in Argentina, Bolivia, Brazil, Chile, Ecuador, Nicaragua, Panama, Peru, Uruguay, Venezuela. Only Colombia and Mexico were able to keep their right governments (CASTANEDA, MORALES 2007). Why were the leftists so successful in Latin America? CASTANEDA (2006) mentions especially three reasons. First, the collapse of the USSR freed the Latin American countries from the communist stigma. Thus, any interventions from the United States have become unsubstantiated. Second, the economic situation characterized by high socio-economic disparities generally favour the leftist. Finally, the advent of democratic elections enabled to utilise the aspects of the second reason. CASTANEDA, MORALES (2007) add also the abandonment of an extreme left position as an important factor in the elections. The candidates who left the extreme left position were able to mobilize a broader spectrum of voters. CASTANEDA, MAROLAS (2007) illustrate this hypothesis on the example of the unsuccessful Mexican leftist candidate *López Obrador* who was beaten by the right-oriented candidate *Felipe Calderón* in the 2006 elections because he was not able to leave his extreme political opinions. On the contrary, the newly elected Nicaraguan president *Daniel Ortega* experienced a comeback to the presidency office because he was able to completely change his Marxian rhetoric from the 1980s.

Based on these considerations, CASTANEDA (2006) distinguishes two types of the left politicians in Latin America. The first type is represented by the modern,

reformist, internationally oriented politicians who understand economic reforms, democracy and social improvements as the development of their countries. The leaders in Chile, Uruguay, and Brazil are the best examples of this type of politicians. Note that these countries tend to have a relatively good economic performance recently. The second type is represented by the nationalist, close-minded politicians with the traditional populist (Peronist) roots. Political power is much more important for them than modernization and development therefore the rule of law is often violated. Muscle declarations are typical for these leaders with the United States, international financial institutions and transnational corporations as the most frequent targets. The Venezuelan president *Hugo Chávez* is the ideological leader of this group and simultaneously a generous donor of the allied countries (e.g. oil supplies for China, the purchase of the Argentine debt and other steps) despite a deteriorating domestic economic situation.

Development Theories

A number of theories were proposed to explain the differences in the development level of particular countries. The most relevant of them are briefly introduced in this subchapter, based especially on the excellent review provided by MARTINUSSEN (1997).

Modernization Theories

The concept of modernization is the cornerstone of the first group of theories, introduced here. In this line of reasoning, development is understood as the transition from a traditional to a modern society. Industrialization, increasing productivity of work, democracy and the rule of law are stressed as the features typical for the modernization process. In developing countries, such a transition is blocked by several negative self-reinforcing factors, known also as two *vicious circles of poverty*. According to the demand circle, low incomes do not generate a sufficient market for private investments, limited investments result in a low productivity of work, and this once again in low incomes. The supply circle is based also on low incomes, resulting in a lack of capital for savings, therefore into insufficient investments, a low productivity of work and again into low incomes. Moreover, capital accumulation (savings) is restrained by the tendencies of rich people to copy the consumption patterns of developed countries and to allocate their capital for an ostentatious consumption. Corruption, military and other expenses are widespread as well. Thus, NAFZIGER (2006) claims that there is a potential for savings and capital accumulation in developing countries.

The main question is how to break the vicious circles of poverty and spark the process of modernization. The *concepts of balanced and imbalanced growth* aspire to answer the question in two different ways. The concept of balanced growth emphasizes the need to mobilize capital allocation for private investments in a large number of industries. A sudden change, the so called *big push*, is regarded as a better solution than gradualism. NAFZIGER (2006) gives an example of this kind. It is very likely that one newly established shoe-factory will not survive because of a limited market for its products. On the other hand, it is much more likely that one hundred new firms from various branches will create a market, large enough for survival of a high number of them. Therefore, radical structural changes are a better solution than slow gradualism. The concept of imbalanced growth criticizes such an approach claiming that the human capital of developing countries is not able to ensure the development of a large number of industries. Instead, it recommends to specialize in a limited number of fast growing industries, with strong ties to other sectors of economy (the so called *growth poles*). Though several differences, the emphasize on an active role of state in the initiation of the process of modernization is common for the both concepts. The active role of state may include e.g. public large-scale investments with the use of foreign aid.

The *concept of stages of growth* belongs to the most influential modernization theories. The concept tries not only to explain the underdevelopment of developing countries and to suggest development strategies but also it tries to grasp the dynamics of development. In the 1950s and 1960s, just this concept was often used to substantiate the massive development aid from developed to developing countries. What is the essence of the concept? As its point of departure, the concept distinguishes the subsistence (traditional) and the capitalist (modern) sector in the economy of developing countries. The subsistence sector is based on the family work, characterized by a low productivity, subsistence income, and non-reproducible capital. Therefore, the subsistence sector has practically no modernization potential due to an insufficient capital accumulation for investments. The capitalist sector, characterized by wage-employment and reproducible capital, is decisive for the development of developing countries. The following mechanism describes the structural shift from the subsistence to the capitalist sector (NAFZIGER 2006):

- Incomes in the subsistence sector range around a subsistence level. All eventual changes in production are reflected in the population changes. The birth rate increases during a good harvest while the mortality rate increases during a bad harvest. Note that underemployment is widespread in the subsistence sector.
- The capitalist sector offers a higher average wage than the subsistence sector. The wage premium is attractive for employees to migrate from the subsistence (rural) to the capitalist (urban) sector and simultaneously the positive difference

between the capitalist wages and the marginal product of labour¹⁶ creates an incentive for capitalist to hire the cheap labour-force from the subsistence sector.

- The capitalists' willingness to hire a new labour-force from the subsistence sector lasts as long as the difference between the capitalist wages and the marginal product of labour is zero. Note that the capitalist wage level remains the same because of the oversupply of workforce from the subsistence sector.
- Capitalists grasp the capital-surplus which arises as the difference between the capitalist wages and the marginal product of labour. This capital is then used for investments which increase the marginal product of labour at the same level of capitalist wages. Therefore, it is possible to hire an additional labour-force from the subsistence sector and the whole cycle is repeated.
- The whole mechanism ends when the oversupply of labour-force from the subsistence sector is exhausted. Then, a further economic growth must be based on other mechanisms.

The question remains how to trigger the shift from the subsistence to the capitalist sector. The concept of stages of growth answers the question claiming that all developing countries follow the same transition path from the traditional to the modern society. This path consists of five stages (NAFZIGER 2006, MARTINUSSEN 1997, KAMBHAMPATI 2004):

- *Traditional society*
- *Conditions to take-off*

Three conditions are traditionally mentioned. First, a technological progress in agricultural production is necessary to feed the growing urban population. Second, investments in transport infrastructure follow the goals to expand the market for production and to enable specialization. Third, transfer of technologies and capital from abroad is desirable.

- *Take-off*

During the third stage, the barriers of growth are definitely removed and a sustained economic growth triggered. An increase in the total volume of investments at least at 10 % of the national income, the existence of at least one important industrial growth sector with strong forward and backward linkages to the rest of economy,

¹⁶ The output produced by each extra unit of labour (KAMBHAMPATI 2004)

and political, social and institutional background supporting modernization are highlighted as the decisive take-off conditions.

- *The drive to maturation*

The fourth stage is characterized by a stable economic growth. Skills are becoming more and more important.

- *Mass consumption*

Cars, suburbanization, consumption, welfare states are typical features of the last stage.

The take-off stage may be perceived as the main phase of development resulting in a radical change of the traditional society. Therefore, the development policies should be oriented to fulfil the conditions defined in the second and third stages. The concept of stages of growth was confronted with much criticism from several angles. First, the characteristics of the particular stages are defined very vague. It is not obvious why the conditions of the third stage are not included also in the second stage. Second, the relationship between the subsistence and capitalist sectors does not have to be as straightforward as the concept supposes. Especially, it is not assured that the wages in the subsistence sector will not rise during the transfer of labour-force between the both sectors. Furthermore, the subsistence and capitalist sector may be closely interlinked and an adverse shock in the former sector (e.g. droughts) may result in negative consequences in the latter sector (BLUNCH, VERNER 2006). Thus, a more attention towards the inter-sectoral dynamics may be desirable. However, the main criticism deals with the assumption that the fifth stage is the desirable aim of development.

The concept of modernization represents the starting point also for another group of theories, which add the emphasis on structural factors in the explanation of the underdevelopment of developing countries (the *structuralist approach*). Once again, an insufficient domestic market for private investments is taken to be one of the most important barriers for the development of developing countries. Simultaneously, the development potential is seen in the modern (capitalist) sector, which is however too small when compared with the traditional (subsistence) sector. Therefore, industrialization with the shift of workforce from the traditional to the modern industries is regarded as the engine of development. This argumentation is still the same as in the concept of stages of growth. However, the structuralist approach adds the following structural barriers of industrialization as an important part of reasoning:

- There is too limited domestic market in developing countries to trigger any form of an extensive industrialization.
- Developing countries have only limited opportunities to export products to developed countries and to trigger the industrialization process in this way because of the asymmetrical relationship between the both groups of countries.
- Developing countries are confronted with the problem how to finance the initial phase of their industrialization because of a general lack of capital.
- Developed countries are able to better integrate their economies to reduce social and regional inequalities and to produce multiplier effects than developing countries.

Because of these structural barriers, an active role of states is decisive to trigger the industrialization process of developing countries. In practice, various approaches may be used, including the import-substitution strategy, the squeezing of capital from the agrarian sector (see Box 1-7), or the promotion of strategic industries (PETITEVILLE 1998). Moreover, a substantial role is ascribed to foreign aid, foreign direct investments and advantageous loans to finance the initial phase of development.

Box 1-7: The role of the agrarian sector in the industrialization process

As already mentioned, developing countries are confronted with the problem how to finance the initial phase of the industrialization process. The squeezing of capital from the agrarian sector represents one possibility how to break this barrier. However, it is necessary to realize that the whole situation is very complex and also other factors must be considered not to squeeze the agrarian sector in a devastating manner. The industrialization process South Korea and Taiwan after the Second World War represents two successful stories unlike the failure of many Latin American countries.

In the 1940s, South Korea was characterized as a predominantly rural country with a widespread landlord-tenant system. However, this system was radically changed after the Second World War when the landownership was transferred to the tenants in a mass manner. The efforts to prevent a social conflict in a politically sensitive country are regarded as the most important stimulative factor which enabled to break an eventual resistance of landlords. The change in the ownership relations triggered a substantial increase in the efficiency of agrarian production, creating a surplus value which was grasped by the South Korean state and used for the financing of the initial industrialization phase. Several tools were applied in this regard, especially low fixed prices for selected agricultural commodities, the state monopoly over a number of expensive agricultural inputs such as fertilizers, and strict regulations on the quality of inputs (high-yielding seeds, technology). Altogether, these steps led to a limited betterment of the living conditions in rural areas. Consequently, a mass migration from rural to urban areas was triggered, further promoting the labor-intensive industrialization by a large pool of cheap workforce.

The case of Taiwan depicts a similar picture. The aspiration of the new Kuomintang government to gain the authority in rural areas led to the land reforms in the late 1940s and early 1950s, based

again on the landownership transfer from landlords to tenants. Note that the prices paid to landlords were fair and enabled them to start new businesses in other sectors (industry, finance, commerce). Similar to the South Korean example, innovations (new crop varieties, irrigation, fertilizers, credit schemes and others) became widespread in the Taiwanese agrarian sector, resulting in an increasing productivity and surplus value. The trade bias between the high prices of agrarian inputs and the low prices of agrarian outputs, taxes and other levies were the main mechanisms which squeezed the capital from the agrarian sector for the industrialization process. Moreover, agriculture became less attractive even than low-paid jobs in manufacturing. Unlike the South Korean case, a lot of industrial subjects were located in rural areas therefore they could rely on the temporary contracts with local workers, further depressing the labor-cost of production. Note that foreign aid and the expropriated Japanese capital were important to finance the initial phase of industrialization as well and that later the bias between the agrarian and industrial sector was reversed through the subsidies flowing into the agrarian sector. The cease of the cheap grain import from the United States in the 1960s played an important role in this regard.

The story of many Latin American countries is less optimistic despite their better initial conditions in the 1950s. Why was the agrarian reforms in these countries not successful when compared with South Korea and Taiwan? Two factors must be highlighted in this way. First, the ability of the Latin American states to influence their economy was much more limited than that of South Korea and Taiwan. The existence of many interest groups caused the need to search for a consensus in sensitive issues. Then, the enforcement of land reforms was very difficult because landlords, as an influential interest group in rural areas, were able to block an unacceptable proposition for them. Thus, the land reforms in Latin America were only partial. Second, the Latin American states did not succeed to ensure the diffusion of innovations and thus an increasing efficiency of both, the agrarian and industrial sector. While the South Korean and Taiwanese structure of individual peasants and smallholders in the agrarian sector promoted the diffusion of innovations, the dominance of large capitalist farmers in Latin America, focused on production of cash crops, did not create such a process. Similarly, while South Korea and Taiwan succeeded in the export oriented industrialization, this was not the case of Latin America with its reliance on protectionism.

Altogether, the real agrarian reforms in Latin America did not precede the process of industrialization. On the contrary, these reforms may be better described as an aftermath of the crisis which affected the inefficient protected industrial sector during the second half of the 20th century. The capital squeezing of the agrarian sector should have solved the crisis, nevertheless with a limited success. Four aspects different from the South Korea and Taiwan cases were of a great importance in this respect:

- The inability of states to squeeze especially landlords resulting in even larger income disparities in the society
- The inability to create a sufficiently large rural market for consumer goods because of the large income disparities
- The inability of the industrial sector in urban areas to absorb the workforce released from the agrarian sector
- A general inefficiency of the Latin American economies

To conclude, because of the specific arrangement of social relations and the incorrect development strategy, the Latin American states were not able to choose the same development path, as South Korea or Taiwan did. This is one of the reasons why a number of East Asian countries overtook the Latin American ones in the second half of the 20th century.

Source: KAY (2002)

There is also another scepticism to the modernization theories, based on an institutional weakness of developing states (PETITEVILLE 1998). Therefore, the traditional economic modernization theories were supplemented by political, social and cultural features. In this way of arguing, the political and institutional systems of developing countries are regarded as undeveloped and a transfer of the Western-like institutions¹⁷ is necessary to spark the development of developing countries. In other words, it is necessary to break not only the economic but also the social and cultural barriers of development. Note that the modernisation theories claim that the undeveloped institutions were not caused by the external factors such as colonialism. On the contrary, it was a natural state-of-the-art with respect to the modernisation process.

Dependency Theories

In the 1960s, a new development paradigm, which came to be known as the dependency theories, emerged as a reaction to a disillusion from the achievements of the modernization approaches. The pioneer work on this topic, which is not in the pure form of dependency theories, explains the underdevelopment of developing countries once again on the basis of the traditional and modern economic sectors, with the development potential hidden in the process of industrialization. However, the barriers of development are viewed in an absolutely different manner than by the modernization theories. The different interests of particular social classes represent the cornerstone of this idea. Note that it is possible to distinguish four social classes - landowners (land rent), moneylenders (credit), merchants (profit from trade) and new capitalists (surplus from capital production) - which are able to grasp the economic surplus and thus to contribute to a capital accumulation. Nevertheless, no one of these groups is interested in the use of the accumulated capital for industrialization which could jeopardize their own position. Therefore, the social relations represent the most important development barrier of developing countries.

The traditional dependency theories apply the idea of different interests of particular actors as well, nevertheless, with an emphasize on the external factors and the world economic order. In this view, developing countries are a part of the so called *international division of labour* (the IDL hereafter; see Box 1-8). The inferior position of developing countries (periphery, satellites) in this division is the main

¹⁷ E.g. political parties, Western education and legal system, interest organisation, modern bureaucracy

reason of their underdevelopment because developed countries (core, metropolises) try to maintain their dominance. In other words, the underdevelopment means the dependence of developing countries on foreign power and capital, not their traditional economic, political or social structures¹⁸ (NAFZIGER 2006). The underdevelopment of one group of countries arises as a direct consequence of the development of other group. Thus, development is inevitably an unequal process because when rich nations get richer the rest gets poorer. The explanation of these assertions is based on the argumentation as follows.

Box 1-8: The international division of labour

In the traditional form of the IDL, workers' specialization in the production process enabled a substantial increase of efficiency. A reduction of lags in the production process and a reinforcement of the innovative spirit are generally regarded as the main reasons of the success of the traditional IDL. From the spatial viewpoint, the traditional IDL was connected with export of raw materials from developing and import of processed goods from developed countries. However, important changes emerged in the 1960s when manufacturing firms began to relocate a part of their production to developing countries with subsequent export of manufactured goods. These changes were enabled especially by three factors:

- Increasing labour-costs in developed countries during the Golden Age of Economic Growth
- Technological innovations which enabled a fragmentation of the whole production process into a number of discrete activities
- The development of transportation and communication systems

Altogether, the relocation of low-skilled economic activities to developing countries became a firm strategy how to maximize profits. The attractiveness of developing countries rested on their abundant cheap workforce, less stringent environmental and labour regulations, financial incentives, and other factors. Altogether, developing countries became not more dependent solely on the export of raw materials and the new IDL (NIDL hereafter) was created.

In the 1980s and 1990s, the debate on the IDL shifted again with the processes of globalisation and regionalisation as the cornerstones of this debate. Nowadays, not only low-skilled economic activities are relocated to developing countries but firms search the ways how to maximize their profits across the national borders. The developing countries which offer skilled and cheap workforce and an adequate infrastructure are able to attract investments in dynamic industries now. Financial liberalization and the development of IT technologies represent important triggers in this regard. Furthermore, a cooperation of states in one region represents another more and more characteristic feature of the contemporary *global division of labour*, the term used e.g. by MITTELMAN (1995). The so called *Borderless Asian Economy* (the BAE hereafter) represents a nice example of this kind. In the BAE, the decision making process is concentrated in Japan where headquarters, financial institutions, and information hubs are located. Japan transnational corporations also provide the most significant portion of foreign direct investments in the BAE. Research activities and technologically

¹⁸ These structures are denoted as undeveloped.

more advanced industries are located in the NIC, especially in South Korea and Taiwan. Finally, the ASEAN Four countries (Indonesia, Malaysia, the Philippines, and Thailand) are the most typical location of labour intensive industries. Altogether, the BAE development is also labelled as the *Flying Geese Model* (e.g. RADELET, SACHS 1997) where Japan is a head, the NIC wings and the ASEAN Four countries a tail of a goose. Technological upgrading and different labour costs add the dynamic feature (flying) to the model. Thus, Japan proceeded from the labour intensive via the technologically advanced to the decision making oriented economic activities. The NIC followed the same path but only from the labour intensive to the technologically advanced activities. Finally, the ASEAN Four countries are still on the labour intensive level of economic activities with some signs of technological upgrading. Note that the spatial compactness is not a necessary condition for such considerations which may be successfully applied also for a hub and spoke model.

The Asian *growth triangles* are an example of the IDL on the regional level. The basic idea of the growth triangles is simple – to create a cooperative arrangement between sub-regions which differ in their characteristics. It is expected that such a cooperation will strengthen the position of involved sub-regions in their efforts to attract investments. Note that preferential bilateral or regional trade agreements between the involved countries help to augment the benefits from a cooperation. The oldest growth triangle, which consists of Singapore, Riau Islands in Indonesia and Johor in Malaysia, illustrates the essence of the growth triangles. For investors, Singapore is a source of capital, technologies and skilled human capital while Riau Islands and Johor provide a cheap land and workforce. Thus, the regional division of labour creates a rather comprehensive package of incentives for potential investors from various branches. LANDINGIN, WADLEY (2005) describe another growth triangle in Asia, the so called *Brunei-Indonesia-Malaysia-Philippines East Asian Growth Area* (the BIMP-EAGA hereafter). The BIMP-EAGA was formally established in 1994 with the aim to attract foreign direct investments and to stimulate export from the East Asian peripheral region in this way. The cooperation is based on regular meetings of the representatives from all four countries and on an exchange of information about existing domestic resources and exporting opportunities abroad. Furthermore, common marketing products and web pages are used. Other areas of a potential cooperation may include a support to a cooperation of actors in the region, common lobbying for infrastructural upgrading, or a coordinated approach to the export processing zones establishment.

Source: MITTELMAN (1995), MARTINUSSEN (1997), NAFZIGER (2006), LANDINGIN, WADLEY (2005)

First, it is necessary to once again uphold the economic differences between developed and developing countries. Developed countries are characterized not only by the mass production for consumption but also by the production of capital goods with close relations to other sectors of economy. These both segments of production create multiplier effects. On the contrary, the traditional sector maintains a strong position in developing countries, with an underrepresented production of both mass consumed goods and capital goods. Furthermore, a specialized export sector (e.g. raw commodities) is often overdeveloped in developing countries, creating their strong dependence on the international exchange of goods and thus on developed countries. Moreover, developing countries suffer from a disadvantageous trade structure with export of less sophisticated industries and from an increasing pool

of unskilled workforce employed on plantations, in mines or in TNC branches. Overall, developed countries are able through international trade and foreign direct investments to grasp the surplus value arising in developing countries. According to the dependency theory, there are little efforts to change this situation in a positive manner for the development of developing countries because developed countries do not want to threaten their dominance.

The dependency theories claim that the countries which were weakly integrated to the IDL tended or tend to be more developed than the countries with strong ties to developed countries. Similarly, the periods of the weak economic ties between developing and developed countries (e.g. World Wars, the Great Depression of the 1930s) are connected with the fastest development of developing countries. Therefore, the dependency theories claim that the independence from developed countries is the best development path for developing countries. However, the strategies how to gain independence are not formulated persuasively. Generally, a very strong role is ascribed to states¹⁹, including the considerations about revolutions and socialism. But the comparison of Cuba on one hand and Taiwan or South Korea on the other one shows that the reality is much more complicated than proclaimed by the dependency theories. It is also a bit paradox that the dependency theorists see the political modernization of developing countries as practically not possible but they support the same in the direction of socialism.

Neoliberalism and Institutional Shift

Since the 1980s, another shift in the development paradigm may be observed. The crisis of the Keynesian welfare state connected with the emergence of a new generation of political leaders (Ronald Reagan in the United States, Margaret Thatcher in the United Kingdom, and Helmut Kohl in Germany) gave way to a recovery of the liberal ideas about development (neoliberalism). A stable economic growth in the 1990s and the U.S. victory in the Cold War stimulated the faith in neoliberalism (BEESON, ISLAM 2005).

The neoliberal theories generally prefer the free market mechanisms to state interventions which cause an inefficient allocation of financial resources with negative impacts on development. Therefore, the internal problems of developing countries are the major cause of their economic underperformance, not the external

¹⁹ Note that the corruptive, authoritarian governments of developing countries are understood as another consequence of dependency. In this respect, the core countries are willing to sacrifice a part of their profit to ensure a stability of their interests through the corruptive and authoritarian governments of developing countries (PETITEVILLE 1998).

factors as claimed by the dependency theories. This line of reasoning asserted oneself in the 1980s when a number of developing countries experienced a severe debt crisis caused by extensive state interventions (WILLIAMSON 2005). As RODRIK (2006) claims to stabilize, privatize and liberalize became the mantra of the technocrats engaged in the development of developing countries. The essence of this mantra is summarized in the so called *Washington Consensus*, a basic agreement of the Washington-based institutions (the WB, the IMF, and the U.S. Treasury), as formulated by the economist John Williamson in the late 1980s. The consensus includes the following components (WILLIAMSON 2005, KROGSTAD 2007, NAFZIGER 2006):

- Financial liberalization with the objective to determine interest rates by market forces
- Fiscal discipline with the objective to prevent financing of debts through increasing taxes
- Public expenditure priorities with the objective to spur the development of infrastructure, primary health and education
- Tax reform with the objective to create a well-performing tax system, to broaden the tax-base and to cut marginal taxes
- Exchange rates with the objective to create a unified and export competitive exchange rate
- Trade liberalization with the objective to remove trade barriers
- Foreign direct investment with the objective to remove foreign direct investment barriers and to ensure an equal position of domestic and foreign firms
- Privatization of state enterprises
- Deregulation with the objective to abolish the regulations which violate the free market mechanisms
- Property rights with the objective to increase the investment security

Note that the SAPs which became the traditional strategy how to implement the neoliberal ideas in developing countries. It is interesting that the structural aspect of the SAPs represent a new emphasis on the modernization ideas (KONADU-AGYEMANG 2000), though with a dominant role of market in this case.

The application of the Washington Consensus principles in practice attracted a rather wide criticism.²⁰ CHANG, GRABEL (2005) speak about a failure in

²⁰ Nevertheless, it is necessary to note that the term Washington Consensus was a bit diverted from its original meaning (NOMAN 2005). WILLIAMSON (2005) stresses that the rule of a competitive, not overvalued exchange rate was violated by the IMF and the WB policies of a floating or a fixed exchange rate in many cases. According to WILLIAMSON (2005), the unrealistic exchange rate policy and a fiscal indiscipline were the main reasons of the Argentine financial crisis in 2001.

the goal achievements and about high socio-economic costs connected with the implementation of the principles in developing countries. They and RODRIK (2006) alike point to:

- A lower economic growth of developing countries during the neoliberal period 1980-2000 than during the interventionist period 1960-1980
- A higher propensity of developing countries to an unexpected financial crisis in the 1990s and early 2000s
- The inability to spark a high and sustainable economic growth in most African countries despite the generous official development assistance and political reforms
- An unexpected economic growth of China and India which do not follow the Washington Consensus principles
- An inappropriate nature of the efforts to implement the Anglo-American economic model in the institutional environment of developing countries

Box 1-9: The financial crisis in East Asia

The East Asian economic miracle was challenged in 1997 when the region was hit by an unexpected financial crisis. Thailand was the first country affected, with a subsequent spread of the crisis to Indonesia, Malaysia, South Korea, and other East Asian countries (TOMIOKA 2001). Currency devaluation, bankruptcy of firms, and unemployment were some consequences of this financial turmoil. Why was the crisis unexpected? Easy said, there was no clear sign of any problems. Inflation was minimal, GDP growth and domestic savings high, fiscal balance positive (BIRD, MILNE 1999). So where was hidden a problem?

Contemporary, there is a rather wide consensus on the causes of the Asian financial crisis. Financial liberalization was underway in East Asia in the early 1990s. Thailand, for example, established an international banking facility in 1993 which guaranteed the borrowing of domestic banks abroad (BIRD, MILNE 1999). Furthermore, a number of countries pegged their currencies to the U.S. dollar²¹ which appreciated in the mid 1990s (RADELET, SACHS 1997). Thus, the East Asian countries became attractive for the inflow of a short-term capital and the domestic banking sector began to borrow extensively. Simultaneously, the creditors from developed countries were willing to lend because of high interest rates and a low risk of transactions (e.g. pegged currencies). And this is the cornerstone of the problem. The banking sector of the East Asian countries was not institutionally prepared for the large inflows of capital because of its corrupt practices²², outdated banking rules, and a weak supervision (WONG 1999). Moreover, bankers were not skilled to allocate loans on the basis of the market efficiency.

²¹ A fixed exchange rate increased the credibility of the countries for potential investors.

²² Note that such practices were not perceived as corruptive (WONG 1999). On the contrary, they were regarded as some form of trust because there is traditionally a strong relationship between the East Asian firms and banks.

Problems emerged in 1997, when the inability of many private borrowers to pay their loans was revealed. Moreover, the export competitiveness of the East Asian countries was weakened by their overvalued currencies and an increasing competition from China. In this environment, Malaysia took the decision to impose a comprehensive control on the capital outflows. These factors triggered the fears from currency devaluation, followed by an outflow of capital from the East Asian countries. Consequently, a lack of foreign exchange forced Thailand to announce this problem, triggering a massive run on banks by Thai people (WONG 1999). A baht devaluation became necessary and this step triggered a spiral of devaluations in other East Asian countries. Some aspects should be stressed in this regard. First, financial liberalization restricted the regulative power of national states which became more prone to the speculative capital inflows and outflows. Second, the baht devaluation created an advantage for Thai export and undermined the export competitiveness of other countries, thus contributing to the devaluation spiral (BIRD, MILNE 1999). Finally, STIGLITZ (2001) claims that the traditional IMF prescription to increase the interest rates turned out to be a bad treatment which undermined demand and trade and worsened the whole situation in the region. WONG (1999) adds that the financial support of the IMF came too late and was insufficient. However, it is necessary to mention that e.g. HALE (1998) does not agree with this argumentation. He claims that the IMF tempered the Asian financial crisis, providing enough credit to prevent a formal government default.

Altogether, KROGSTAD (2007) regards the steps in the Washington Consensus spirit as the path which aggravated the whole crisis. The states which did not follow this path (Malaysia, South Korea) were able to better cope with the problems. Malaysia, for example, restricted foreign exchange, preventing capital outflows. This step enabled to lower interest rates and stimulate demand. This decision attracted a strong criticism from the IMF and the Malaysia's rating was lowered. However, the Malaysia's economy recovered faster than the economies of other countries which strictly followed the IMF recommendations. Note that regulations may be applied also on capital inflows, e.g. through a ban on short-term loans or though obligatory reserve deposits in the Central Bank (NAFZIGER 2006). It is noteworthy that even John Williamson agrees with the interpretation of the East Asian financial crisis given above (WILLIAMSON 2005). However, he claims that the unfettered financial liberalization is not in accord with the original propositions of the Washington Consensus. The IMF traditionally found an error in an insufficient transparency of the East Asian financial markets not in own policy (e.g. STIGLITZ 2001, BEESON, ISLAM 2005). We may conclude with the contention that financial liberalization must be gradual in accord with the creation of an institutional framework.

Source: BIRD, MILNE (1999), TOMIOKA (2001), RADELET, SACHS (1997), KROGSTAD (2007), NAFZIGER (2006), WILLIAMSON (2005), BEESON, ISLAM (2005), WONG (1999), STIGLITZ (2001), HALE (1998)

Also KROGSTAD (2007) does not evaluate the implementation of the Washington Consensus principles in developing countries as a success. From the political viewpoint, he speaks about the emergence of the anti-globalization movement and about the left turn in Latin America, as only some consequences of the neoliberal development strategies. RODRIK (2006) goes even further claiming that practically nobody believes in the Washington Consensus principles now. However, the question remains what instead of the Washington Consensus.

The disillusion from the neoliberal achievements in developing countries was interpreted in different ways by the two most important protagonists, the IMF and the WB. The WB's publication entitled *Economic growth in the 1990s: Learning from a decade of reform* brought an important evidence how the WB argumentation shifted away from the traditional understanding of the Washington Consensus principles. According to RODRIK (2006), the WB admits the failure of the Washington Consensus approach, especially in the undue emphasis on the only best solution. All countries have their unique conditions and development constrains which must be reflected in their development strategies. This argumentation is in accord with the contention by STIGLITZ (2003a) that the Washington Consensus principles were incorrectly understood in the meaning "the more deregulation or privatization the better for development". The new WB argumentation admits the existence of more development paths to achieve the Washington Consensus principles which may be naturally desirable from the long-term developmental perspective. RODRIK (2006) gives a comparison of China and Russia in the 1990s, when China was able to attract a large amount of private investments in the form of the quasi-public township and village enterprises (TVEs hereafter) and Russia failed despite its Western-style private ownership. A simple explanation is connected with the inadequate legal protection of private owners in Russia. Thus, the cooperation with local governments in China turned out to be less risky for private investors than the corruptive privatization in Russia. It is noteworthy, that the further development of China showed the need to transform the ownership structure but only when an adequate institutional environment was created. However, the authors like RODRIK (2006), STIGLITZ (2003a) and others point to the tremendous problems how to really change the thinking of the IMF and WB economists.

Box 1-10: The World Bank

The WB represents one of the world's largest sources of funding and knowledge for developing. The WB supports projects in health and education, in economic growth and poverty alleviation, in infrastructure construction, in agricultural production, in environmental protection, and in other areas. Over 23 billion USD were approved in loans and grants by the WB only in 2006. The WB works as a shareholder institution with over 180 member countries. The Board of Governors represented by the ministers from member countries is the most important decision making body. Note that the shares of particular countries are distributed according to their economic strength. Therefore, The United States is the largest single shareholder (16.41 percent of votes), followed by Japan, Germany, the United Kingdom, and France. The day-to-day decision making process is realized by 24 Executive Directors. The WB Group consists of five agencies:

- The International Bank for Reconstruction and Development (IBRD) - loans and development assistance to the middle-income countries in Latin America, Asia, Africa and Eastern Europe
- The International Development Association (IDA) - interest-free loans and grants to the poorest countries

- The International Finance Corporation (IFC) – loans and equity finance for business ventures in developing countries.
- The Multilateral Investment Guarantee Agency (MIGA) - guarantees to foreign investors against the loss caused by non-commercial risks
- The International Centre for the Settlement of Investment Disputes (ICSID) - facilities for settling investment disputes between foreign investors and their host countries

The WB was established in 1944 at the conference in Bretton Woods. Its original mission was to provide relatively small loans for a reconstruction of the war-damaged European countries and their colonies. Thus, the WB was a conservative financial institution in the 1950s and 1960s. However, the mission of the WB changed substantially in the late 1960s. GOLDMAN (2007) highlights the following preconditions of this change. First, the colonial system was definitively dead in this time resulting in the calls from developing countries for some form of financial assistance to spur development. Second, developing countries with rich mineral resources became an attractive target for investors. Altogether, the WB became a global financial player and an important source of loans for financing of various projects in developing countries. Note that the WB financed also the training of professionals in developing countries, thus strengthening the thinking in the WB direction.

The system of generous loans foundered at complications in the 1980s when it turned out that many developing countries were not able to smoothly service their debts. Therefore, the WB mission shifted once again. However, the WB did not admit the failure of its loan concept. On the contrary, the WB in close cooperation with the IMF found its new position as the arbiter of global debts. Moreover, new loans for developing countries became conditioned by the SAPs which were perceived as desirable from the Washington Consensus viewpoint. The disappointing results of the neoliberal period caused the more recent shift in the WB mission. Contemporary, the WB emphasizes the dialogue with its borrowers, social and environmental aspects of development, and the fight against corruption. In addition, the eradication of poverty was once again highlighted as the top priority. NGOs have become a partner of the WB, a step which enabled to extend the WB activities to the afore-inconceivable areas, such as slums, tropical rain forests, and public services. Thus new fields for the WB loans were opened (GOLDMAN 2007).

Nevertheless, the WB activities are confronted with an adverse political change in the contemporary world. The Latin American left turn is connected with a hostile attitude to the IMF/WTO duet. Furthermore, more middle-income developing countries are able to mobilize sources for financing of large projects abroad. The Chinese investments in Africa represent a good illustration of this kind. In addition, the WB needs to maintain the confidence in its AAA-rating bonds, the main source of funds. Facing all these problems, the WB vision may be another step in its changing mission. The idea is to start negotiations directly with regional and local governments. The problems of overpopulated developing cities require a financial support for their solution and the WB is ready to provide such a support (GOLDMAN 2007).

GOLDMAN (2007) illustrates the whole idea with the Indian city of Bangalore as an example. Bangalore experienced a rapid development in the last twenty years or so. The population of the city increased three-fold in this time and income disparities rose substantially. Thus, Bangalore faces many problems how to shape its development. The WB is ready to help with financing of ambitious development plans, including the construction of a new airport two times larger than the Heathrow airport in London, of a new elevated highway, of new satellite cities in the suburbs, and of a large IT corridor. Naturally, this type of development is nothing bad. However, GOLDMAN (2007) claims that some questions remain. Loans are still conditioned by the work of foreign consultants, undermining

the power of local and regional authorities. When will be developing countries developed enough to really decide about their future? Furthermore, the poor people in Bangalore will have a better access to WiFi than to basic sanitation and prices of housing will increase. Where is the fight against poverty?

Source: GOLDMAN (2007)

The preceding text illustrates the background of the most recent change in the development paradigm which may be labelled as the institutional shift. As SINDZINGRE (2005) points out the motto “getting institutions right” replaced the motto “getting prices right”. It is noteworthy that even the IMF emphasizes the importance of institutions for development though its explanation is completely different from that of the WB. The IMF claims that the failure of the Washington Consensus was caused by the insufficient depth of reforms in the institutional sector – a weak rule of law, corruption, inflexible labour markets and others. This stance is in accord with the Williamson’s idea that the Washington Consensus principles are still the most suitable strategy how to shape the development of developing countries (WILLIAMSON 2005), but new items must be added. They include especially improvements in the quality of institutions, a more equal distribution of benefits from economic growth and massive government expenditures during the recession periods. KROGSTAD (2007) alike summarizes the cornerstones of what he calls the *Post-Washington Consensus* as follows:

- Institutional improvements
- A gradual implementation of reforms accompanied by the creation of regulatory mechanisms
- Consideration of all country specifics
- Emphasis on the Human Development concept

Altogether, the institutional, social and environmental aspects are highlighted in the most recent development strategies. Note that this evolution may be understood as a shift somewhere between the strong state interventionism from the 1950-1970s and the belief in unfettered markets from the 1980s and 1990s.



CHAPTER TWO

DEVELOPMENT STRATEGIES

The preceding chapter illustrated which factors are essential for the development of developing countries and which recommendations may be drawn from the most relevant development theories. However, the question how to finance development was not answered. The aim of this chapter is to fill the gap.

Official Development Assistance, Loans and Debt-Relief

Although *official development assistance* (ODA hereafter) may be understood in various ways the definition coined by the Development Assistance Committee (the DAC hereafter, see Box 2-1) is the most widely accepted and used one. According to this definition, ODA includes the “*flows of official financing (as grants, loans²³, or contributions to multilateral institutions) administered with the promotion of the economic development and welfare of developing countries as the main objective which are concessional in character*”. The term concessional is understood as the financing with at least 25 % grant element which is calculated on the basis of interest rate, length of grace period²⁴, length of repayment period, and possibilities to repay the loan in national currencies. The grant element is equalled to nil for commercial loans while to 100 % for grants. Developing countries are defined in the World Bank’s way as low and middle-income countries, excluding the G8 and EU members. Finally, military grants or loans are not included in ODA while the technical cooperation focused on implementation of ODA projects (e.g. costs of education or consultancies) is. Note that the official financial flows which do not meet the ODA criteria are labelled as *other official flows* and that aid may have also an unofficial form e.g. via foundations or other private donors (private aid), importance of which tends to rise.²⁵ There are even some secret ODA flows, such as the funds used by the Saudi Arabian royal family (NEUMAYER 2004).

²³ Note that the repayment of principal is deducted from the ODA statistics in the applicative year.

²⁴ The interest charges and repayments of principal are not required in this period.

²⁵ The Bill and Melinda Gates Foundation declared allocation of about 3 billion USD for development projects in the year 2008 (MARTENS 2007).

Table 2-1: Total volume of various types of ODA and their share in total volume of ODA in 2006

Type of ODA	Total volume	Share in total volume of ODA
Bilateral grants and grant-like flows	79.5 billion USD	76 %
Bilateral loans	-2.5 billion USD	- 2 %
Contributions to multilateral institutions	27.5 billion USD	26 %
Total ODA	104.5 billion USD	100 %

Source: OECD-DAC Statistics

ODA may be classified according to various perspectives. With respect to the relations between particular countries, it is possible to distinguish (see Table 2-1):

- The bilateral ODA provided directly by a donor country to an recipient country
- The multilateral ODA provided via an international organisation (see Box 2-1)

It is noteworthy that the total volume of the bilateral is much higher than the multilateral ODA. There may be several reasons for this fact, including the opportunity to better consider own national interests just through the bilateral ODA. On the contrary, the multilateral ODA enables to reduce the political costs from failures and to better concentrate financial means.

With respect to its purpose ODA, may be categorized as:

- Development aid (development cooperation)²⁶ provided with a long-term development goal
- Humanitarian aid provided as the reaction to a sudden unpredictable event

ODA may be designed in various forms, including development projects, food aid, debt forgiveness, debt conversions, a support to NGOs and international private organisations, a support to refugees in donor countries, contributions to PPP projects or a promotion of development awareness.

Box 2-1: The Development Assistance Committee and multilateral institutions

The Organisation for Economic Co-operation and Development (OECD) is an intergovernmental organisation of 30 countries which is especially engaged in helping governments to compare policy

²⁶ Note that the term cooperation is in accord with the institutional stream of development theories which stresses the self-reliance development of developing countries with an external support of developed countries.

experiences, to identify good practices, and to co-ordinate domestic and international policies. Collection of statistical data, analyses, projections and publishing are the decisive activities to fulfil these goals. The OECD interest is oriented towards several topics, including employment; entrepreneurship; education and social welfare; tax policy and financial affairs; trade; science and technology; public governance; environment. Since its establishment in 1961, the OECD has also given a great attention to international relations in the framework of development cooperation.

The DAC is the key forum through which the OECD deals with the issues related to the development cooperation with developing countries. The main goals of the DAC may be described as follows:

- To coordinate development cooperation through a dialogue, exchange of experiences and evaluation of current ODA policies
- To mobilise more ODA funds
- To increase the effectiveness of ODA (the rules harmonisation, result-orientation, untied character²⁷, coherence with other policies)
- To provide the statistics about ODA

It is noteworthy that the DAC recommendations may be regarded as very influential because of the dominant position of the DAC member countries as ODA donors. Moreover, the DAC has the power to make recommendations binding for its member countries. Note that the DAC often played the decisive role in the formulation of strategic documents related to the development of developing countries.²⁸ Contemporary, the DAC includes 22 countries (EU15 countries, Norway, Switzerland, the United States, Canada, Japan, Australia and New Zealand) and the European Commission. The remaining OECD countries are not the formal members of the DAC but their delegates may take part in the DAC councils. Furthermore, the IMF, the UNDP and the World Bank have the observer status.

There are several multilateral organisations which are engaged in the ODA provision. The European Commission, the World Bank Group represented especially by its International Development Association, and the United Nations Agencies (especially the United Nation Development Programme - UNDP, the United Nations Children's Emergency Fund - UNICEF, and the United Nations High Commissioner for Refugees – UNHCR) are far the most important of them. Furthermore, regional development banks (the African Development Bank, the Asian Development Bank, and the Inter-American Development Bank), as well as the IMF, through its soft loan window, provide concessional loans. Note that ODA multilateral institutions exist also in the Arab world. The Islamic Development Bank which provides concessional loans to the member countries of the Organisation of the Islamic Conference is the most important of them.

Source: OECD (2007), NEUMAYER (2004), NAFZIGER (2006)

The roots of ODA may be found in the success of the post-war Marshall Plan, the goal of which was to promote the economic reconstruction of war-torn Europe. Thus,

²⁷ The so called tied ODA is conditioned by the purchase of goods and services from firms located in the donor country. In this way, a large part of ODA is diverted back to the donor countries.

²⁸ E.g. the breakthrough document *Shaping the 21st Century: The Contribution of Development Cooperation* issued in the year 1996 or Millennium Development Goals formulated at the UN Summit in 2000.

a great optimism was sparked that ODA would help to trigger also the development of developing countries (THÉRIEN, LLOYD 2000). Furthermore, the emergence of new postcolonial states in the developing world strengthened the efforts to create or maintain bilateral economic relations through ODA and simultaneously the emerging bipolar division of world led to the ODA motivated by the efforts to spread capitalism and communism in developing countries. In accord with the ideas of modernization theories, the ODA flows were especially allocated for large infrastructural and industrial projects (THÉRIEN, LLOYD 2000). However, this orientation of ODA was challenged by the extended definition of development in the 1970s when the social dimension of ODA was emphasised. Note that this period was substantially influenced by dependency theories which regarded ODA as a tool how to maintain the dependency of developing countries. Therefore, ODA was perceived rather sceptically from the theoretical point of view. However, with respect to the total ODA provided in sum by the DAC countries²⁹ and divided by their GNP in the applicative years, a decrease may be followed only in the early 1970s with the swing of the pendulum since 1973 (see Table 2-2). An oscillation of this indicator may be observed also in the 1980s. However, a decreasing trend, further reinforced in the 1990s, is rather obvious in this period.

Table 2-2: The ODA/GNP rate for the DAC countries (selected years)

Year	1970	1973	1975	1980	1985	1986	1988	1991
ODA/GNP (%)	0.34	0.30	0.33	0.37	0.35	0.39	0.34	0.33

Source: NAFZIGER (2006)

In the 1970s, indebtedness became a serious problem of many developing countries as a consequence of the global financial shocks which led a substantial price increase, including oil as one of the most important trade commodities. Developing countries solved the problem of more expensive imports by borrowing in the commercial market which offered a surplus of petrodollars not demanded in the saturated markets of developed countries. This trend may be documented on the changes in the ODA/Loans ratio which was 1.40 in 1970 but dropped to 0.55 in 1975 and 0.23 in 1984 (NAFZIGER 2006). Commercial banks welcomed the potential of higher

²⁹ In a long-term perspective, the DAC countries are the most important donor of ODA. Therefore, it is possible to use the DAC countries as a proxy of changes in the ODA statistics. However, there are also other ODA donors, especially the Arab countries Saudi Arabia, the United Arab Emirates and Kuwait, the OECD Non-DAC countries, and the emerging donors China and India. Note that the total volume of Arab ODA was very high in the 1970s and 1980s (petrodollars), but substantially dropped in the 1990s. In the period 1980-84, the Arab countries provided 35 % of the total ODA provided by the DAC countries but the figure decreased at 1 % in the period 1995-99 (NEUMAYER 2004).

profits from the loans allocated in middle-income developing countries, regarding these loans as low-risky because of government assurances. Simultaneously, these loans were attractive for many governments in developing countries as a source of necessary funds. However, the governments were usually not able to use the funds for productive investments what is the main assumption of a successful repayment of both, principal and interests. On the contrary, consumption and public expenditures³⁰ rose substantially, little contributing to development. Overall, the ability of developing countries to repay their debt decreased. This trend was further worsened by several other factors (NAFZIGER 2006):

- The tendency of loans to become more expensive during the 1970s and 1980s, as the interest rates grew and maturity and grace periods shortened
- A volatility of raw material prices, the dominant source of income to service the debt of many developing countries
- An overvalued foreign exchange rate of many developing countries with a negative impact on their trade competitiveness
- The uncertainty connected with foreign exchange rates
- The states' collaterals for defaulted private loans
- Capital flight understood as an outflow of residents' capital³¹

Not surprisingly, the inability of developing countries to repay their debts³² undermined the willingness of banks to provide new loans.³³ Thus, developing countries were forced to divert their public expenditures from education, health-care and other sectors and simultaneously to tax private investments to cover costs of their debt. However, such a policy inevitably led to a lack of capital for investments and human development and many countries in Latin America and Africa experienced a low and even a negative economic growth in the 1980s. In accord with a frequent

³⁰ In Nigeria, public expenditures rose from 9 % of GDP in 1962 to 44 % in 1979 (NAFZIGER 2006).

³¹ NAFZIGER (2006) gives the secret bank accounts of the former Zairian president Mobutu Sese Seko in Switzerland as an example of this kind. He claims that the total volume of these funds would have been able to free Zaire from its debt problems.

³² Note that the debt crisis in 1980 created threads to several U.S. large banks, which had a high share of bad loans in Latin American countries. Therefore, the U.S. Secretary of the Treasury James Baker persuaded the IMF, the World Bank, the American Development Bank and other creditors to accumulate funds which enabled to reduce the debt burden of selected countries. These funds, provision of which was conditioned by structural reforms in recipient countries, gave the U.S. banks time to decrease their dependence on bad loans and thus the Baker plan was terminated in the late 1980s (NAFZIGER 2006).

³³ The ODA/Loans ratio may be once again used for confirmation of this trend with its increase from 0.23 in 1984 to 0.43 in 1994 and 0.95 in 2002 (NAFZIGER 2006). Note that changes in the ODA total volume played an inferior role in this respect.

default on the debt burden, calls for a new solution of the indebtedness of developing countries emerged (see Box 2-2). Simultaneously, in accord with the political recovery of neoliberal thoughts the ODA provision was newly conditioned by the acceptance of the structural adjustment programs (LOVE 1999).

A substantial drop in the total volume of ODA provided by the DAC countries was recorded in the 1990s (see Table 2-3). THÉRIEN, LLOYD (2000), NAFZIGER (2006), OVASKA (2003) summarize the causes of this drop as follows:

- A donors' disillusion from ODA achievements in developing countries (the so called *ODA fatigue*)
- The preference of alternative development paths to achieve donors' goals (e.g. the Washington Consensus)
- The geopolitical changes connected with the collapse of the former Soviet bloc which led not only to the disappearance of the communist ODA donors but also to the disappearance of one of the most important political motives of ODA
- Stringent fiscal policies applied in developed countries
- The failure of the efforts to find an alternative financial source of ODA, including the best known Tobin's proposal to tax international financial transactions (the so called Tobin tax).

At the turn of the Millennium, a last shift in the DAC countries' ODA/GNI rate trend may be observed with an extraordinarily high increase especially in 2005 and 2006. This rise was caused especially by large debt-relief operations, especially with respect to the indebtedness of Iraq and Nigeria³⁴. Lower figures of debt-relief in 2006, compared with the preceding year, led to a drop of the ODA/GNI ratio in 2006 and this tendency is expected to continue. Therefore, there are fears whether the donors' commitments from the G-8 and Millennium+5 Summit held in 2005 will be fulfilled. Note that ODA has an important role in the fulfilment of the Millennium Development Goals through some form of the big-push effect as coined in the concept of stages of growth. The commitments include (DAC 2007):

- To increase the total volume of ODA by 50 billion USD in real terms and between the period 2004-2010

³⁴ It is noteworthy that the debt-relief to Nigeria, but also to Iraq, is not based on the HIPC Initiative. Nigeria is labelled as a blend country which is eligible for the IDA loans on the basis of per capita income but has a limited creditworthiness to borrow from the IBRD. Thus, Nigeria is not included on the list of the HIPC countries. The debt-relief to Nigeria is therefore provided on the case-by-case negotiations with the DAC countries (the so called Evian Approach). Its total volume is 60 % of the initial debt, absolutely about 18 billion USD. Note that the replacement of the Nigerian military regime in 1999 was a necessary precondition of the debt-relief (DEBT MANAGEMENT OFFICE 2005).

- To double the total volume of ODA provided for African countries in real terms and between the period 2004-2010

Table 2-3: The ODA/GNP rate for the DAC countries (selected years)

Year	1991	1997	2001	2002	2003	2004	2005	2006
ODA/GNI (%)	0.33	0.22	0.22	0.23	0.25	0.26	0.33	0.31

Note: Net disbursements at current prices and exchange rates

Source: OECD-DAC Statistics

Furthermore, the DAC-EU countries agreed to increase their summed ODA/GNI rate at 0.56 % and at 0.51 % for all particular countries by the year 2010. Commitments were made also by other DAC countries. However, it is rather a tradition that the ODA targets are infringed. Already in 1970, the United Nations proposed the target that the ODA/GNI (GNP) rate of donor countries would have reached 0.7 %. Although this target was mentioned also in the documents signed later (e.g. DAC 1996, UNITED NATIONS 2003) only five countries were able to fulfil this target in 2006.³⁵ On the contrary, the United States as the largest world economy lagged far behind this target in 2006 (0.18 %) and there was a declining trend in the U.S. ODA/GNI rate during the second half of the 20th century³⁶ (OSBORNE 2002). Thus, THÉRIEN, LLOYD (2000) point to the absence of a natural leader in the donor community.

The drop in the total volume was not the only change related to ODA after the end of the Cold War. Other changes were related to the strategies how to provide ODA, with the DAC document entitled “*Shaping the 21st century: The contribution of development co-operation*” understood as a milestone in this regard (THÉRIEN, LLOYD 2000). This document stressed the need to solve the threads arising from poverty of a large part of population in developing countries, and from the Earth’s capacity to feed an increasing number of inhabitants. Furthermore, an excessive proliferation of aid projects was mentioned as an important barrier for a more effective use of ODA because of different strategies followed by particular donors creating high requirements on local institutions. The document claims that just this was one of the causes which strengthened the aid-dependency syndrome of developing countries. Based on these considerations, the document recommended especially (DAC 1996):

- *To tangibly formulate a limited number of objectives as the monitoring indicators of achievements in the development of developing countries*

³⁵ Denmark, Luxembourg, the Netherlands, Norway, Sweden

³⁶ The U.S. ODA/GNP rate was 0.5 % in 1967 (OSBORNE 2002).

Three key areas were formulated with a limited number of specific objectives. The first key area, *economic well-being*, included one specific objective (poverty reduction), the second key area, *social development*, four specific objectives (increasing gender equality, decreasing infant and maternal mortality rates, improvements in access to health care and primary education) and the third key area, *environmental sustainability and regeneration*, one specific objective (implementation of national sustainable development strategies).

- *To promote partnerships of actors with the aim to increase ODA efficiency*

The document stressed a key position of partnerships to efficiently use ODA. The leading role was ascribed to the actors from developing countries. Therefore, national development strategies prepared by them were recommended as the cornerstone of this type of partnership with a supportive and consultative role of ODA donors. The rules of transparency, monitoring and evaluation were denoted as an inseparable part of the strategies and partnerships.

- *To at least maintain but better to increase the total volume of ODA*

The document stressed the importance of ODA especially in the countries (Africa, island and landlocked states³⁷) and sectors (e.g. education, health-care) which were not able to attract a larger volume of private investments for development. The emphasis on low-income countries is also reflected in the distribution of ODA as depicted in Table 2-4).

Table 2-4: ODA according to the income groups of countries and top-regions in 2006

Category of countries	Least developed	Low-income	Low middle-income	Upper middle-income
Share	32.7 %	24.2 %	39.2 %	3.9 %

Region	Sub-Saharan Africa	Middle East and North Africa
Share	36.8 %	26.1 %

Source: OECD-DAC Statistics

³⁷ The ODA/GNI rate was 60.6 % in the Solomon Islands, 54.4 % in Liberia, 52.8 % in Burundi, 41.4 % in the Federative States of Micronesia, 35.7 in Afghanistan and 34.6 % in Palestinian Administrative Areas in 2006. Regionally, Oceania had the highest ODA/GNI ratio slightly more than 11 % followed by Africa. Note that JAYARMAN (2006) summarizes the main causes of the underdevelopment of the Pacific Island states as follows:

- Spatial remoteness and isolation resulting in high transportation costs
- An insufficient domestic market to create economies of scale or to diversify economy
- The frequency of natural disasters

Also the conclusions from the *United Nations Millennium Summit* upheld the multidisciplinary and multi-actor nature of development (AMIN 2006) and the same argumentation was maintained during the *United Nations Conference on Financing for Development*, held in 2002 in Monterrey (UNITED NATIONS 2003). Note that the importance of good governance to increase the efficiency of ODA was repeatedly stressed. This ODA philosophy was further strengthened in the *Paris Declaration on Aid effectiveness*, signed at the High Level Summit of the Ministers of developed and developing countries responsible for promoting development and the Heads of multilateral and bilateral development institutions. The new commitments³⁸ in the Declaration may be perceived as an extension of the preceding documents.

To summarize, changes in the evolution of the ODA provision may be summarized as follows. LEWIS (2003) accentuates especially the transition from security concerns to free trade and economic liberalization. THÉRIEN, LLOYD (2000) add the shift towards an increasing role of social and environmental features of ODA. Thus, sustainable development became one of the ODA leitmotifs. Furthermore, QUINN, SIMON (2006) point out to some diversion from the donor interest led development towards a greater emphasis on the interest of recipient countries after the Cold War. Moreover, they add the conditionality of good governance imposed on the ODA provision as a rather new feature of ODA. Finally, NOMAN (2005) mentions other conditions on the ODA provision, notably the requirements of a transparent administrative system and democracy in recipient countries.

Box 2-2: Debt relief

Since the 1970s, a debt of developing countries in the value of several billion USD was relieved on the basis of bilateral or multilateral agreements. However, it became obvious that some global approach was necessary to provide a large-scale debt relief because of the free-rider problem. This problem rests on the unwillingness to provide a debt relief by a larger number of creditors if some creditor is reluctant to do so expecting own benefits. The following text briefly summarizes the most important collective debt-relief initiatives.

The *Brady Plan* may be denoted as the first large-scale initiative to reduce the debt of developing countries. The plan was launched in 1989 when Mexico gained 5 billion USD from the World Bank and the Inter-American Development Bank to issue conversion bonds. Consequently, Mexico

³⁸ The commitments include the donors' commitment to use solely financial management and procurement systems of developing countries, preventing the existence of parallel administrative systems of ODA in developing countries, to provide ODA in a more reliable manner according to the preceding promises, to increase the share of untied ODA, to follow own strategic planning aligned to the strategic plans of developing countries, or to generally apply environmental impact assessment.

purchased its 10 billion debt in the secondary market with debts³⁹, using the newly issued bonds. In this way, the debt was halved and transferred to the World Bank. Note that this debt was due first from all debts of the borrower country. Consequently, agreements with other 15 countries were signed in the 1990s, eleven of which were middle-income countries from Latin America. Note that the agreements were conditioned by the structural adjustment programs. The Brady Plan helped the debtor to remove the disadvantages from the *debt overhang*,⁴⁰ or other said to free funds for investments, and to increase countries' creditworthiness. After the implementation of the Brady Plan, capital inflows to the involved countries exceeded capital outflows and economic growth was triggered (NAFZIGER 2006).

In the 1990s, the calls to relieve the debts of the so called *highly indebted poor countries* (the HIPC hereafter) strengthened. As a reaction, the World Bank and the IMF launched their *HIPC Initiative* in 1996, with the goal to reduce the unsustainable indebtedness of the HIPC as an important barrier to their economic development. If meeting the criteria of GDP per capita and debt sustainability⁴¹ the HIPC may have benefited from a debt relief after the successful structural adjustment process. However, these conditions appeared to be too strong because only six countries were able to fulfil them. Therefore, they were eased in 1999 in the so called enhanced HIPC initiative. On the contrary, the requirement on the elaboration of the so called *Poverty Reduction Strategy* was added. However, the impacts of the debt relief on the development of the HIPC was rather inconclusive, evoking the ideas on some much more generous form. And just this path is followed in the *Multilateral Debt Relief Initiative* (the MDRI hereafter) proposed at the G8 Gleneagles Summit in 2005 and launched in the same year. In the framework of the MDRI, three multilateral organisations, the International Development Association, the IMF and the African Development Fund, committed to provide 100 % debt relief for the countries which completed the HIPC Initiative process. In 2007, also the Inter-American Development Bank joined the MDRI and a debt relief is provided also by the DAC countries. Note that 22 of the 41 HIPC-eligible countries fulfilled all conditions in this respect and 10 countries completed the decisive point of the HIPC procedure (structural adjustment process). Also the remaining 10 countries gained some debt-relief commitments under the HIPC Initiative. Altogether the debt relief commitments to the countries which met the HIPC decisive point was nearly 60 billion USD by the mid 2006 (UNITED NATIONS 2007).

Despite the aforementioned scenario seems to be big-hearted, ARSLANALP, HENRY (2006) give several objections. First, the total debt service⁴² annually represents a marginal share (0.01 %) of GNI of developed countries. Thus, the idea on generosity is not well-founded. Second, the relationship between the debt-relief and ODA is not wholly obvious. Is the debt-relief a substitute of or a supplement to ODA? Third and especially, the development problems of the HIPC and "Brady" countries are totally different. The "Brady" countries experienced negative net resource transfers⁴³ for several years because of their debt overhang. When the overhang was removed the sign of this transfer was reversed. However, this is not the case of the HIPC where net resource transfers

³⁹ Note that the risk of default decreased the real price of debts, thus creating the secondary market with debts.

⁴⁰ A debt overhang arises when country owes more money to creditors than is able to pay (ARSLANALP, HENRY 2006).

⁴¹ Debt sustainability was measured by the net debt/export ratio.

⁴² Debt service is a ratio of interest of principal and interest payments due in a given year to year's export of goods and services.

⁴³ The sum of foreign direct investments, loans, grants and portfolio equity less debt service

are positive, because of ODA. Thus the debt overhang can not be the major cause of the slow economic growth. Finally ARSLANALP, HENRY (2006) conclude that not the debt but the missing economic and institutional infrastructure is the main development barrier of the HIPC and that the Gleneagles Proposal seems to be a good political calculus of developed countries to gain cheap political points.

Source: NAFZIGER (2006), ARSLANALP, HENRY (2006), UNITED NATIONS (2007)

The question remains whether ODA really contributes to the development of developing countries. Naturally, to answer this question is not easy because it is difficult to isolate the ODA impacts on development from other factors (THÉRIEN, LLOYD 2000). The ODA proponents will highlight the successes of ODA which THÉRIEN, LLOYD (2000), OSBORNE (2002), QUINN, SIMON (2006), DAC (1996) summarize as follows:

- The success of a large number of infrastructure projects and programmes (construction of new dams, roads, airports or irrigation systems), a control over a number of dangerous diseases (e.g. smallpox, polio, measles and others), the development of new crops and others
- ODA as an important ingredient of development in the newly-industrialized countries such as South Korea or Taiwan
- ODA as an important source of foreign capital for investments in many, especially the least developed, countries
- The graduation of several countries to the donor status (e.g. Spain, the Czech Republic)
- An increasing public support to ODA in developed countries and an increasing awareness of the topic with the rock concerts LIVE 8 in 2005 as the “cherry on the cake”
- Implementation of new approaches in the donor community (e.g. partnership of actors in the direction of sustainable development⁴⁴, improvements in monitoring and others)
- The opportunities to influence the ODA allocation on the basis of strategic planning

However, ODA is confronted also with a strong criticism from various perspectives (NAFZIGER 2006). In the traditional sense, the motives of ODA are to promote

⁴⁴ Note that that convergence of World Bank’s and United Nations’ attitudes towards ODA may be observed. Contemporary, World Bank accentuates also social and environmental features of ODA while UN agencies supplemented their stance with emphasis on economic efficiency and market relations.

a broad-based economic development, social justice, peace, democracy, clear environment, the fight against diseases, to provide humanitarian aid or assistance for refugees and overall to increase the world stability through development. But the first stream of criticism claims something different, notably that the ODA donors follow their own interests not the interest of developing countries. The economic motives such as access to natural resources, preferential bilateral trade relations or tied ODA and the political motives such as alliances in the international institutions may be some examples of this kind (see Box 2-3). Also LEWIS (2003) claims that the Global Environmental Fund as a multilateral donor tend to allocate ODA for the projects oriented rather to the global problems such as the biodiversity loss than to the local problems such as water pollution. Finally note that the bilateral ODA traditionally exceeds the multilateral ODA, including the period 2000-06 as given in Table 2-5.

Table 2-5: The bilateral ODA share in the total ODA provided by the DAC countries (selected years)

Year	2000	2002	2004	2006
Bilateral ODA	66.2 %	69.3 %	68.5 %	73.6 %

Note: Net disbursements at the current prices and exchange rates

Source: OECD-DAC Statistics

Box 2-3: France, Japan and their motivation to provide ODA

France traditionally belongs to the most generous ODA donors in the absolute figures. Moreover, France has been always regarded as a country which the ODA provision with its political and economic interests. The causes of this strategy are explained e.g. by QUINN, SIMON (2006). They claim that France aspired to resume their “great power” position between the two superpowers, the United States and Soviet Union, during the Cold War. ODA represented an important tool how to fulfil this goal because it helped the recipient countries to resist their incorporation into one of the two power blocs led by the United States or Soviet Union. Simultaneously, France represented something like a third choice in this way. Furthermore, France tried to reproduce the French culture abroad and therefore its ODA flows were oriented especially to the Francophone countries especially in Africa. Besides these goals, the France’s ODA was motivated to harness some economic and political benefits as the donor country. Therefore, the bilateral and tied ODA was typical for France during the Cold War. Moreover, France strengthened its trade relations with the recipient countries through ODA. It was very important in the military sector, for example. France gave a great emphasis on the military self-sufficiency but its domestic market was not large enough to create economies of scale. Trade relations with the ODA recipient countries enabled to increase the number of consumers. Also import of raw materials and political coalitions are noteworthy.

Altogether, QUINN, SIMON (2006) point out that the French language, the presence of French troops, strong trade relations and the total amount of ODA provided in the preceding year were statistically significant to explain the geographical distribution of French ODA during the period 1980-1990. Note that French ODA had also some humanitarian aspect because there was a statistically

significant negative relationship between GDP of recipient countries and the total amount of ODA provided and that political freedom was not statistically significant. After the end of the Cold War, some changes were noticed by the two authors. Although all variables, except the presence of French troops, remained statistically significant their strength to explain the geographical distribution of French ODA decreased in the period 1990-2000. There was only one exception, the total amount of ODA provided in the preceding year. The authors explained these changes by more recipient countries of French ODA and by a high bureaucratic inertia. Political freedom remained statistically insignificant despite the proclamations of French politics. QUINN, SIMON (2006) concluded that the French ODA was still strongly motivated by the donor interests and the existence of bureaucratic inertia lowered its potential to contribute to the development of recipient countries.

As France, also Japan belongs to the most generous ODA donors in the absolute figures, with even the first place in the ranking during the 1990s. For three last decades, China received a substantial share of ODA from Japan, with the concessional loans as the dominant type of ODA. However, in 2005, Japan decided to stop this concessive loan programme by 2008 and without the usual guidelines. Why did Japan choose just China for its ODA allocation? And what is behind the termination of the ODA loan programme? The answers document the intricate relationship between these two countries in an illustrative manner.

There were several reasons in Japan to launch the ODA programme directed at China. First, the efforts to support its modernisation and to create a peaceful and Western-oriented China were followed. Second, Japan used ODA as a political leverage how to influence the development of China. This leverage was applied e.g. in 1989 when Japan temporary suspended its ODA provision as the reaction at the Tiananmen events. Third, Because of ODA, Japanese firms gained a better access to large contracts in China and therefore these firms welcomed and actively promoted the ODA programme. Finally, there was also a moral aspect of the ODA programme. In 1972, China announced its renouncement of any war repatriation paid by Japan and this argument was revived in 1978 when Japan considered the initiation of the ODA programme directed at China. ODA was denoted as a substitution of war repatriation by the proponents of this programme. Altogether, Japan became the largest ODA donor of China for many years.

However, the situation completely changed at the turn of the century, when China not only initiated its own ODA programme but especially launched its expensive space programme, something not existing in Japan. China increased also its military expenditures, thus triggering the fears in Japan that its ODA supported China just in this way. Furthermore, Japan experienced an economic recession in the late 1990s because of its high indebtedness and problems to maintain its economic strength in the increasing global competition. Finally, Japan lost the opportunities to influence the development of China through ODA because of its increasing self-confidence and possibilities to gain foreign exchange from various sources including commercial loans. Consequently, Japan decided in 2005 to stop its concessive loan programme directed at China by 2008 though China was still classified as a eligible low-income country. From this reason, this decision may be understood as politically motivated.

Source: QUINN, SIMON (2006), DRIFTE (2006)

The second stream of criticism is based on the contention that ODA increases the dependency syndrome of recipient countries. In this respect, ODA may postpone political and economic reforms which are desirable to increase the economic

efficiency of recipient countries. Furthermore, JAYARMAN, CHOONG (2006) point to the threads of currency exchange appreciation caused by an increasing amount of money in economy (the so called *Dutch disease*). Then, the export competitiveness of affected countries may be endangered. Furthermore, ODA projects tend to heavily rely on foreign managers. Thus, the development of domestic management skills may be suppressed. Moreover, the ODA provision may be conditioned by other, usually neoliberal, reform measures which do not have to be beneficial for the development of recipient countries. Finally, the ODA flows may be sensitive to political changes and therefore be a very uncertain source of financing. LOVE (1999) gives an example of the South Africa's transition to democracy in the early 1990s when some ODA flows were diverted from other countries in the region just to South Africa. Simultaneously, many offices of ODA agencies were relocated to South Africa as well.

The third stream of criticism points to the inefficiency of ODA projects which may be caused by several reasons. Governments as the main distributor of ODA in developing countries tend to be more interested in their short-term political interests than in the long-term development objectives. Then, ODA is often diverted to political friends or to the inefficient projects for the rich part of population. Aid bureaucracy and corruption represent an important unofficial item of the ODA project budgets, as described e.g. by JAYARMAN, CHOONG (2006). Moreover, a continuation of inefficient projects may drain scarce domestic resources which are necessary for the development of other sectors (OSBORNE 2002). Furthermore, the abilities of especially the least developed countries to absorb ODA are limited because of their undeveloped infrastructure and a lack of skilled professionals (LOVE 1999). Finally, there is often an incoherence between particular policies of developed countries. In this way, trade policies may follow different aims than ODA policies and similarly, humanitarian aid may paradoxically solve aftermaths of violent conflicts caused by the sale of weapons to the affected regions (THÉRIEN, LLOYD 2000).

After this short review, we return to the question on the relationship between ODA and development. Naturally, it is not possible to formulate an unambiguous conclusion in this way. Intuitively, successful but even also unsuccessful ODA projects helped many people in developing countries to improve their quality of life (LOVE 1999). However, the empirical studies which surveyed the relationship between ODA and development were rather sceptical to the positive impacts of ODA on economic growth and other development indicators. Thus, the fungibility argument against ODA, claiming that ODA is not transformed into the improvement of macroeconomic figures, arises. The studies mentioned in the next paragraph confirm this argument.

Based on a literature review, THÉRIEN, LLOYD (2000) did not record any example of a statistically relevant relationship between the total amount of ODA and economic growth or reduction of poverty in developing countries. Similarly, OSBORNE (2002) and OVASKA (2003) claim that there was even a negative relationship between the total amount of ODA and economic growth in developing countries in the periods 1987-95 and 1975-1998. It is noteworthy that OSBORNE (2002) concludes that trade had a better growth potential than ODA in the period 1987-1995 and OVASKA (2003) claims that good governance was a good explanatory variable of economic growth in developing countries in 1975-1998 but not if combined with ODA. Thus, the potential of good governance for development was undermined by the inefficiency of ODA. This is in accord with the conclusions given in DALGARD, HANSEN (2001) that good governance substitutes ODA or in JAYARMAN, CHOONG (2006) that, after reaching some level, there are diminishing returns from ODA, including a negative impact of ODA on growth. OVASKA (2003) concludes that it may be desirable to orient the development efforts towards a sound institutional environment which serves as an important incentive for private investors (LOVE 1999).

International Trade and Foreign Direct Investments

Trade between nations is nothing new in the long human history. However, the total volume of trade skyrocketed after the Second World War (see Table 2-6 for the merchandise trade) because of technological changes, open trade policies, changes in economic organization, and other factors (WTO 2007). Similarly, the regional trade structure changed markedly (see Table 2-7 for the merchandise trade). A stronger position of Asia is the most striking feature in this way, with the share of seven East Asian countries, four Asian Tigers, Malaysia, Thailand, and China in the total world merchandise export increasing from 3.7 % in 1963 to 17.2 % in 2005 (WTO 2007). Nevertheless, developed countries are still the most important actors on the world trade scene.

There are also other typical features of the contemporary trade (DICKEN 2003, WTO 2007):

- A strong tendency to trade within one region (almost 200 regional trade agreements)
- A relatively weak export performance of most Latin American and African countries
- The still dominant position of manufactured products in trade but with an increasing trade in services

- The total world trade growth higher than the total world output in a long-term perspective, as an evidence of an increasing economic integration of the contemporary world

Table 2-6: The total world merchandise exports (selected years, billion USD)

Year	1948	1973	1993	2005
World	59	579	3,675	10,159

Source: WTO (2007)

Table 2-7: Regional shares of the world merchandise export and import (selected years)

	1948		1973		1993		2005	
	Export	Import	Export	Import	Export	Import	Export	Import
Europe	35.1 %	45.3 %	50.9 %	53.3 %	45.4 %	44.8 %	43.0 %	43.2 %
North America	28.1 %	18.5 %	17.3 %	17.2 %	18.0 %	21.5 %	14.5 %	21.7 %
South and Central America	11.3 %	10.4 %	4.3 %	4.4 %	3.0 %	3.3 %	3.5 %	2.8 %
Africa	7.3 %	8.1 %	4.8 %	3.9 %	2.5 %	2.6 %	2.9 %	2.4 %
Middle East	2.0 %	1.8 %	4.1 %	2.7 %	3.5 %	3.4 %	5.3 %	3.1 %
Asia	14.0 %	13.9 %	15.2 %	15.1 %	26.1 %	23.3 %	27.4 %	24.7 %

Source: WTO (2007)

Naturally, trade substantially influences also the development of developing countries. However, to answer the question whether trade stimulates the development of developing countries is not straightforward (e.g. CUADROS et al. 2004) though FOSTER (2006) claims that there is a positive relationship between export growth and output growth even in Africa. The proponents of the idea claim that international trade increases the global economic efficiency (NAFZIGER 2006, PERNIA, QUISING 2003) in accord with the concepts of comparative advantages and consumer preferences. On the contrary, the dependency theorists emphasize international trade as a way how developed countries may exploit their developing counterparts. This argumentation is based on the traditional pattern of international trade when manufacturing products are exported from developed to developing countries and primary products in the opposite direction. Thus, economic development of developing countries is, in this line of arguing, confined to few primary industries with volatile export prices⁴⁵ (OLOFIN 2002). Moreover, NAFZIGER (2006) points to the falling ratio of primary product prices to manufactured product prices in a long-term perspective (the so called *Prebisch-*

⁴⁵ E.g. cotton in Sudan, cocoa in Ghana, tea and coffee in Uganda, or copper in Zambia

Singer thesis), because of an increasing demand on manufactured goods (SEN 2005) and the development of substitutes for primary products. Then, to keep the trade balance, developing countries are forced to increase their export of primary products, with adverse impacts on environmental sustainability.⁴⁶ Note that the underdevelopment of other sectors blocks the emergence of other export activities.

However, the traditional trade pattern experienced an unprecedented shift after the Second World War when the share of manufacturers in the total export from developing countries increased substantially from 20 % in 1981 to 80 % in 2001 (CHARLTON, STIGLITZ 2005). Contemporary, substantially less developing countries are dependant on a limited number of primary products (NAFZIGER 2006). Following these changes, the static idea of comparative advantages was supplemented by some dynamic features. In this argumentation, developing countries may shift their export from primary products to labour-intensive and later to skill- or capital-intensive products through learning (OLOFIN 2002). Nevertheless, only few developing countries were able to reach such a development level that would have enabled them to join the inter-industry trade typical for developed countries and based on the model, brand or image differentiation of products (NAFZIGER 2006).

The relationship between industrialization and international trade was an important ingredient in the development strategies of many developing countries. DICKEN (2003) distinguishes three fundamental types these strategies:

- Export of processed indigenous commodities
- ***Import substitution industrialization (the ISI hereafter)***
- ***Export oriented industrialization (the EOI hereafter)***

The choice of a suitable strategy depends on several factors such as resource endowment, size of domestic market, government preferences and others. However, the processing of indigenous commodities is the most common for an early phase of development in accord with the idea of comparative advantages. The subsequent stage of industrialization is traditionally based on the ISI, the essence of which rests on the protection of infant domestic industries which are confronted with a harsh global competition. Protectionism from foreign importers provides the industries

⁴⁶ Note that there are also other ways how to keep the prices of primary products stable. Let us mention only the Organization of the Petroleum Exporting Countries (OPEC) as an example. In 2006, the OPEC members decided to decrease their output quotas by million barrels as a reaction to the expected economic slowdown and to the search for the oil substitutes such as natural gas and ethanol (UNITED NATIONS 2007a).

an extra-time to increase their competitiveness, e.g. through the purchase of new technologies, training, or the creation of consumer markets. *Tariffs*, or in other words taxes on import, and *non-tariff barriers*⁴⁷ are used as the traditional ISI tools (DICKEN 2003).⁴⁸ Note that protectionism is expected not only to reduce import of the goods newly produced domestically but also to contribute to a diversification of economic activities. In the initial stage of the ISI, developing countries traditionally focus on consumer goods, import of which is burdened by high tariffs and other non-tariff barriers. Protectionism against intermediate and capital goods is much lower. In the subsequent stages of industrialization, domestic production of intermediate and capital goods is expected to be developed.

However, the ISI brought only a limited success with respect to the development of developing countries (e.g. OLOFIN 2002). MARTINUSSEN (1997) understands the most relevant causes of this failure as follows:

- An insufficient competitiveness of artificially protected consumer industries not able to expand in foreign markets
- Indebtness arising from the import of intermediate and capital goods and from high government expenditures
- A lack of capital, know-how and foreign exchange from trade which undermines a gradual shift towards more sophisticated products

NAFZIGER (2006) adds another problems with the ISI. He claims that import restrictions increase the demand on and simultaneously prices of domestic goods. Furthermore, insufficient contacts with world markets lead to a currency overvaluation. These two factors further undermine the export competitiveness of “ISI countries”. The ISI may also lead to a widespread rent seeking behaviour and corruption.

The rather modest achievements of the ISI gave way for the EOI strategies, primarily in smaller developing countries in the 1980s or so. The emergence of this strategy was facilitated by a gradual removal of trade barriers in developed countries after the Second World War (see Box 2-4). WTO (2007) estimates that the average trade tariffs in developed countries decreased from 20-30 % immediately after the Second World War to around 4 % in the late 1990s. Furthermore, practically all tariffs were

⁴⁷ Import quotas, import licenses, foreign exchange control, obligatory deposits, antidumping measures, special labelling and packaging requirements, health and safety requirements, subsidies to domestic producers and others

⁴⁸ Note that trade barriers are also used to keep influence on too high import to prevent balance of payments crises.

bound what means that tariff ceilings were determined. Many developing countries gained also a preferential access to the markets of developed countries on the basis of regional agreements (e.g. Mexico as the member state of NAFTA) or of a special preferential scheme (e.g. some African, Caribbean, and Pacific countries as the signatories of the *Lomé Convention* with the European Community). The shift from the ISI to the EOI strategies changed also the attitudes of developing countries towards free trade. In the 1980s and 1990s, trade barriers imposed by developing countries were substantially reduced and the binding coverage increased markedly. Note that Asian and African countries were less eager than Latin American countries in this respect (WTO 2007).

Box 2-4: Trade liberalization under the WTO umbrella

Is free trade a better development strategy than protectionism? Naturally, to find an unambiguous answer is not easy, with pros and cons for the both strategies. It is noteworthy that protectionism gained grounds especially during the economic crises, such as the Great Depression in the 1930s or the economic slowdown in the 1970s (COLLIER 2006, DICKEN 2003). However, the access to the markets of developed countries is the most important feature in the trade discussion on the development of developing countries. The history of trade liberalization under the WTO umbrella depicts the most relevant trends and problems in this regard. WTO (2007) distinguishes four periods of multilateral trade liberalization:

- *The emergence of the General Agreements on Tariffs and Trade (1947-1963)*

After the Second World War, the United States as the economic and political power number one accepted the commitment to create a world trade system which would have prevented the dysfunctional protectionist battles of the 1930s. But as COLLIER (2006) claims, a unilateral trade liberalisation was not possible because of the fears from a balance of payment⁴⁹ deficit. On this background, multilateral negotiations about trade were initiated with the *Charter for an International Trade Organization* (ITO) signed by 53 countries in 1948 as the most relevant output. However, the United States did not sign the document because of too many non-trade issues in the document (e.g. labour standards). Thus, the idea of the ITO was dead in the 1950s but one by-product survived, the General Agreements on Tariffs and Trade (the GATT hereafter) primarily signed by 23 countries.

The main goal of the GATT was to reduce trade barriers on a non-discriminatory basis. Simultaneously, some exceptions were allowed, such as trade restrictions explained by anti-dumping measures, by a balance of payments crisis, by the protection against a damaging import increase, or by a historical relationship between countries. Under the GATT umbrella negotiations proceeded on the bilateral and product-by-product basis. Nevertheless, the *Most Favoured Nation rule* assured that the trade

⁴⁹ According to the IMF definition, the balance of payments summarizes the economic transactions between the residents of a country and non-residents during a specific period. The balance of payments includes trade in goods and services, payments of income (current account) and capital transfers, financial assets and liabilities (capital and financial account).

concessions granted to one country were automatically transferred also to other GATT members.⁵⁰ In this way, tariffs were substantially decreased for many manufactured products. However, two aspects need to be highlighted with respect to developing countries. First, developing countries were generally treated under specific rules with a well-understood goal to exclude them from negotiations (COLLIER 2006) and to enable the non-reciprocity measures of the ISI or EOI strategies. Second, agricultural products were not included in the GATT and a special agreement was introduced with respect to cotton products.

- ***Consolidating the GATT (1963-1979)***

The second period of the trade liberalization was characterized by an increasing weight given to developing countries in the negotiating process, in accord with their calls for a better access to the markets of developed countries.⁵¹ Nevertheless, the main results of this period were driven especially by the interests of the three most prominent actors, the United States, ECC and Japan. They saw a further trade liberalization in manufacturers as beneficial for their specialized inter-industry trade (economies of scale). Thus, the tariffs on manufacturers fell substantially, except of some skilled-intensive branches important for developing countries. A special agreement, the so called ***Multi-Fibre Agreement***, defined the rules of trade with textiles.⁵² In this agreement, developed countries were allowed to impose quotas on the textile import from developing countries as an obvious discriminatory tool. Similarly, agricultural trade remained strongly regulated not only by tariffs but also by subsidies granted to farmers in developed countries. Only some tropical crops (cocoa, coffee, tea) were an exception in this respect. Moreover, the economic recession in the 1970s led to a more frequent application of non-trade barriers. Overall, the benefits of developing countries were very limited in this period, despite the adoption of a Generalized System of Preferences which assured a privileged access to the markets of developed countries for all GATT developing countries but only in selected products. Moreover, this system limited the negotiation power of developing countries.

- ***From the GATT to the World Trade Organisation (1980-1995)***

The most important feature of the third period was the establishment of the World Trade Organization (the WTO hereafter) in 1994 as a successful result of the so called Uruguay Round of negotiations (1986-1994). Compared with the GATT, the WTO substantially extended the number of sectors covered by trade agreements and the number of participating developing countries. An increasing interest of developing countries to participate in the GATT negotiations was caused by the reorientation of their trade strategies from the ISI to the EOI. Thus, the perception of free trade was changed dramatically and trade liberalization became desirable for a number of developing countries.⁵³ In the Uruguay Round, developing countries definitively abandoned their unified block

⁵⁰ The MFN is still the leading WTO principle though some exceptions exist.

⁵¹ E.g. the establishment of a loose coalition of developing countries, called the Group of 77, with the aim to lobby for their interests at the United Nations meeting

⁵² The Multi-Fibre Agreement was an extension of the previous agreements on cotton products. This extension was motivated by an increasing export of other textile products (e.g. artificial fibres) from developing countries.

⁵³ Note that there were also other causes in this regard. First, the advantages from the Generalized System of Preferences were eroded by tariff cuts. Second, especially smaller developing countries expressed fears from a trade isolation without the WTO. Finally, the ideas of neoliberalism supported trade liberalization (WTO 2007a).

and began to follow the strategies based on their own interest. Thus, negotiations became more complex and complicated.

The final result of the Uruguay round, the *Marrakesh Agreement*, included:

- The WTO Charter which defined the mission and structure of the organisation
- The GATT
- *The General Agreements on Trade in Services (the GATS)*
- *The Agreement on Trade-Related Intellectual Property Rights (the TRIPS)*
- A clarification and tightening of the Dispute Settlement mechanisms

Some aspects of the WTO establishment should be highlighted. First, the GATS became a part of the WTO, with the goal to create a regulative framework for the trade in services which is traditionally connected with a higher level of protectionism than the trade in goods. GATS included four types of services, in particular cross-border trade (Mode 1) such as banking services, consumption abroad (Mode 2) such as tourism, commercial presence (Mode 3) such as subsidiaries⁵⁴, and presence of natural persons (Mode 4) or labour migration in other words. Note that the GATS posed less stringent requirements on particular countries than the GATT. Second, tariffs but also non-tariff barriers were cut once again during the third period and agricultural subsidies were partially removed as well. Moreover, it was decided to phase out the Multi-Fibre Agreement by 2005. However, the tariffs on agricultural products and on labour-intensive goods remained higher than on other manufacturers and raw materials. Textiles and clothing were still burdened by around 15 % tariff compared with the average rate around 4 % for all manufactured goods. Third, the preferential treatment with developing countries was sustained but an emphasis on the least developed countries was added.

- *Trade liberalization under the WTO (after 1995)*

The WTO period is characterized by more complex and difficult negotiations than each of the preceding periods. This is reflected in the Doha Round of negotiations which started in 2001 but which was not completed by the early 2008. COLLIER (2006) mentions two fundamental problems in this way. First, the WTO includes more member states compared with the GATT. Naturally, developing countries want to be heard more than they are. In addition, there are different groups of developing countries. While China or India see trade liberalization as an opportunity for their economic development, the potential benefits for poor African countries are rather blurred. They fear that their trade deficits will increase, that their preferential trade agreements will be eroded, that they will have nothing to offer in reciprocal agreements, and that the benefits from free trade will be grasped by their rivals. Simultaneously they perceive that outside the WTO they would be even more economically marginalized. Overall, the problem to find a consensus among so various countries arises. Second, the WTO covers more sectors than the GATT, including agriculture and services. Therefore, it is necessary to accept new rules for the trade with agricultural products and services, acceptable for all WTO members. Moreover, FRANCOIS et al. (2005) mention some supplementary topics in negotiations such as environment and trade, labour market and trade (e.g. child work), or competition and trade. These are the reasons why the Doha Round negotiations are so complicated.

⁵⁴ Under the Mode 3, the local content requirements (a minimal share of local products in the total production) or the trade balance requirements (the requirement to export production) are not welcomed by the WTO rules.

In the Doha Round of negotiations, the importance of developing countries was positioned very high, at least rhetorically. CHARLTON, STIGLITZ (2005) pose an important question: “What should developing countries expect from the Doha Round?” Their answer is rather interesting claiming that the liberalization of labour migration (Mode 4 in the GATS) is the most promising area for the development of developing countries. Despite some progress in intra-corporate labour movement, the current regulations remain strong, including economic needs tests, administration costs and others. The liberalization of trade in manufactures took the second place in the ranking created by CHARLTON, STIGLITZ (2005). They admit that trade tariffs are relatively low but especially in the trade with manufacturers between developed countries. Barriers in the trade between developed and developing countries, as well as among developing countries, are still high. This is true also for the trade in services where developing countries may benefit especially from offshore outsourcing (e.g. business services, ICT, health service, education services and others), tourism, and foreign subsidiaries. Surprisingly, the top-priority of developing countries, the liberalization of agricultural trade, has the least development potential from the four areas mentioned by CHARLTON, STIGLITZ (2005). The rationale is simple. Developing countries are not only exporters of agricultural products but also importers of temperate products. A removal of protectionism in developed countries will inevitably lead to rising prices of these products also for developing countries. Thus, the benefits will be not evenly distributed. There are especially two influential countries which may benefit from liberalization in agricultural trade, Brasilia and Argentina. And just these two countries belong to the most loudly advocates of free agricultural trade.

Overall, trade liberalization is a very sensitive political issue. NAFZIGER (2006) describes a conflict between economists and politicians in the United States. While economists saw the liberalization of trade in services as beneficial for both, developed and developing countries politicians emphasized the loss of domestic jobs because of outsourcing. Similarly, the TRIPS agreement is generally welcomed in developed countries but opposed by developing countries because of its impact on the access to technologies. The question remains how to shape a consensus in the WTO. COLLIER (2006) proposes a strategy based on the following arguments:

- The WTO should maintain its bargaining function. Otherwise, developed countries will close bilateral agreements regardless of other developing countries.
- The WTO should create some transfer mechanism which would offer specific benefits for developing countries. The costs of this mechanism should be shared by all developed countries according to a predefined quantification. The transfer mechanism should work as a “bribe” in the negotiations with the least developed countries to offer them some benefits from trade liberalization.
- The WTO should follow the plurilateral approach. It means that when the WTO gives a proposal of rules it depends on the members whether they will accept the rule. This approach is suitable because it is very unlikely that a unanimous consensus may be found by all WTO members. However, some core principles are desirable to be accepted by all member countries. stimulate participation of all actors at least in basic rules. Note that environmental or labour market issues cannot belong to these core principles because of an absolute disagreement from developing countries.
- The WTO should offer something “special” to the least developed countries to stimulate their interest in trade liberalization. An exemption from the Most Favoured Nation rule may be this “special”. Then it is possible e.g. to substantially lower tariffs imposed on the import from the least developed countries. However, it is necessary to strictly apply the rule of origin. Otherwise, the threads of re-labelling of Asian or Latin American export in Africa arise.

- There are also another tools how to contribute to the development of developing countries through trade, such as the extension of the Most Favoured Nation rule to the Most Favoured Developing Nation rule or the *Aid for Trade* idea which aspires to build an export infrastructure using ODA.

Source: WTO (2007), COLLIER (2006), FRANCOIS et al. (2005), NAFZIGER (2006), DICKEN (2003), CHARLTON, STIGLITZ (2005)

The essence of the EOI rests on an active promotion of export industries. The tools such as currency devaluation, financial and tax incentives for exporting firms, the establishment of institutional support overseas (export promotion offices) and domestic export processing zones are traditionally applied in this regard. The rationale of the EOI is based on an increasing efficiency of the economic subjects incorporated in the world trade networks. First, access to foreign markets enables the economic subjects to increase their production and create economies of scale. Second, the incorporation of economic subjects into the world trade networks forces them to increase their efficiency in the harsh global competition and simultaneously it gives them the opportunities to draw new knowledge and technologies from close contacts with customers and trading partners (NAFZIGER 2006). Moreover, foreign exchange from export is grasped for the financing of import and some multiplier effects may be created as well (CUADROS 2004). Taiwan represents an example of a country which successfully graduated from an underdeveloped, agriculturally dependent, war-devastated economy to the position of an important exporter of capital and technology intensive products. This transition was rather gradual, initiated by the ISI in the 1950s. Already in the 1960s, this strategy was replaced by the EOI, first focused on low-cost (textiles, electronics) and later on capital and technology intensive (general machinery, automobile parts, computers and related electronics and others) products (LIN et al. 2003).

Foreign direct investments (FDI hereafter) represent an important piece in the EOI, though the importance of FDI for the development of developing countries is naturally much wider. FDI are generally understood as the investments abroad connected with a takeover of some degree of control over an existing (acquiring or merging with some domestic firm) or a newly established (green-field investments) firm.⁵⁵ The FDI flows experienced an unprecedented surge after the Second World

⁵⁵ Note that the control assumption (the share of at least 10 % in the firm according to the United Nations) differs direct from portfolio investments. The portfolio investments are oriented purely towards financial gains and therefore they represent a form of a more volatile capital than FDI. Capital flight is much more typical for the portfolio investment than for FDI (TARZI 2005). Therefore, FDI are regarded as a better form of investment (CUADROS 2002). Furthermore note that mergers are connected with the establishment of a new economic subject while acquisition means that one firm becomes a subsidiary of another firm.

War, accelerating especially in the 1990s (DICKEN 2003). The fact that the world FDI growth has far exceeded the world trade and GDP growth substantiates the idea of an increasing qualitative economic integration in the recent era of globalization.⁵⁶ *Transnational corporations* (TNCs hereafter) as the most important source of FDI may be labelled as a symbol of this integration. And just TNCs play an important role in the EOI because they create not only export platforms in developing countries and links to international trade networks but also because they generate an intra-firm trade not depended on external prices. Note that it is estimated that about one third of the world trade is realized in the intra-firm manner (DICKEN 2003).

The geographical distribution of FDI is rather uneven. Developed countries are naturally not only the main source but also the main recipient of FDI (see Table 2-8). The FDI flows to developing countries tend to increase in the last three centuries or so (CHOWDHURY, MAVROTAS 2006), though the share of developing countries in the total inward stocks and inflows fluctuated in the period 1980-2005 (see Table 2-8). Nevertheless, there are huge disparities in the FDI statistics among particular developing countries. Large countries in Asia (e.g. China, India), Latin America (e.g. Brasilia, Mexico), and Africa (e.g. South Africa) are naturally a more attractive destination for foreign investors than politically and economically unstable countries in Sub-Saharan Africa. This fact is reflected in the regional structure of the FDI inward stocks and inflows as illustrated in the Table 2-8.

Several developing countries especially from East Asia, but also Russia, Brazil or South Africa have strengthened their position as a source country of FDI (DICKEN 2003). As UNCTAD (2006) mentions there is an increasing interest of Asian firms to invest even in Africa. Firms from India, Malaysia, Republic of Korea, China and Taiwan belong to the most agile in this way. Mineral resources represent a natural magnet for these firms (e.g. the acquisition of the Egyptian oil firm *Egyptian LNG* by *Petronas* from Malaysia in 2003).⁵⁷

⁵⁶ DICKEN (2003) upholds the functional integration of economic activities (transnational corporations, transnational entrepreneurs, or transnational diplomacy) in the contemporary era of globalization, compared with the spread of rather loosely integrated economic activities across national boundaries in the previous era of internationalization.

⁵⁷ However, firms from developing countries invest also in developed countries (e.g. the purchase of the Canadian oil firm EnCana's by China National Petroleum Corporation and Sinopec in 2005 or the Indonesian BT Burni Modern acquisition of the U.S. oil firm Gallo Oil Ltd in 2000).

Table 2-8: FDI stocks and flows – regional shares (selected years, in %)

Stocks	1980		1990		2000		2005	
	Inward	Outward	Inward	Outward	Inward	Outward	Inward	Outward
European Union	42.5	37.2	42.9	45.2	37.6	47.1	44.4	51.3
Japan	0.6	3.4	0.6	11.2	0.9	4.3	1.0	3.6
United States	14.8	37.7	22.1	24.0	21.7	20.3	16.0	19.2
Africa	6.9	1.3	3.3	1.1	2.6	0.7	2.6	0.5
Latin America	7.1	8.5	6.6	3.4	9.3	3.3	9.3	3.2
Asia and Oceania	10.5	2.9	10.8	3.8	18.4	9.5	15.4	8.2

Flows	1978-80		1988-90		1998-2000		2003-05	
	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow
European Union	39.1	44.8	40.3	50.6	46.0	64.4	40.7	54.6
Japan	0.4	4.9	0.04	19.7	0.8	2.6	0.8	4.9
United States	23.8	39.7	31.5	13.6	24.0	15.9	12.6	15.7
Africa	2.0	1.0	1.9	0.4	1.0	0.2	3.0	0.2
Latin America	13.0	1.1	5.0	1.0	9.7	4.1	11.5	3.5
Asia and Oceania	5.3	0.9	10.5	5.6	11.0	5.1	21.4	8.6

Source: UNCTAD (2006)

However, the access to mineral resources is not the only motivation for firms from developing countries to invest abroad. UNCTAD (2006) adds also:

- The efforts to use a competitive advantage in the global market (e.g. the Taiwanese *Acer's* and Indian *Infosys Technologies'* FDI in North America and Europe)
- The efforts to minimize costs through relocation of some activities to low-income countries or to the countries with a preferential trade relationship with the most important trade markets (e.g. the investments of Taiwanese TNCs in the Lesotho's apparel industry motivated by its cheap workforce and a preferential trade relationship with the EU during the *Lomé Convention*⁵⁸)
- The efforts to gain an access to new technologies or other assets through an acquisition of a firm in developed countries (e.g. the acquisition of the *IBM's* PC business by the PC firm *Lenovo* from China to gain not only new markets but also the *IBM's* brand and distributional networks)

⁵⁸ Note that after the removal of the Multi-Fibre Arrangement in 2005, the apparel industry in Lesotho experienced a sharp slowdown.

Thus, the outward FDI represent another opportunity how to stimulate the development of developing countries.

Why are some developing countries more successful in the attraction of FDI? The answer is naturally based on the motivations of TNCs to invest in developing countries. These may include their efforts to extend the utilization of competitive advantages (e.g. brand, technology, management and others) with the aim to create economies of scale. Furthermore, TNCs may aspire to maximize their efficiency through cost reduction (e.g. low labour costs, cheap land, cheap raw material, lax environmental and labour standards and others), or to secure an access either to markets avoiding import barriers or to raw materials avoiding transportation and other costs. The *OLI concept* integrates these various approaches in a unified theory which claims that a firm will be engaged in an international production when three conditions are met. First, the firm owns some competitive advantage which equalizes the disadvantages of its limited knowledge of a new territory. Second, a host country offers location advantages such as cheap labour force, large market and others. Third, it is beneficial for the firm to use its advantage internally because of e.g. a high risk of supply failures, or know-how protection. And just the location advantages explain the disparities of the FDI distribution in developing countries. TARZI (2005) mentions five of them as decisive:

- A large domestic market with respect to population and purchasing power (GDP per capita)
- A sustainable high or moderate economic growth as an indicator of good institutions, human capital quality, technological progress, rule of law, and work habits
- Macroeconomic stability
- Political stability including a proactive FDI policy
- The quality of infrastructure

The countries which are able to offer these location advantages generally attract more FDI than the countries that are not. However, one missing piece in this mosaic may substantially decreased the potential of FDI inflows. In this respect, TARZI (2005) points to the differences between the proactive FDI policy of China and the restrictive FDI policy of India which resulted in a large difference in the FDI inflows to China and India in the last twenty years or so. A proactive FDI policy usually contains:

- Tax incentives, exemptions from duties on import of initial equipment, and other financial incentives offered to foreign investors
- Liberalization of trade and financial policies (e.g. removal of import and export restrictions, of restrictions on capital export and others)

- Removal of the requirements on local equity ownership
- Stringent laws towards labour union and environmental standards
- Legal assurances not to nationalize FDI
- Simplification of administrative procedures
- **Export Processing Zones** designed to attract FDI to selected sites⁵⁹ through a package of incentives which may include all the items given above

The question remains whether and how FDI stimulate the development of developing countries. The answer is once again not straightforward. While TARZI (2005) claims that there is a widely recognized positive impact of FDI on economic growth, SYLWESTER (2005) is much more cautious in this regard, pointing at the studies which supported but also questioned the hypothesis. Nevertheless, his own analysis concludes that there is a positive impact of FDI on economic growth, without worsening socioeconomic disparities. CHOWDHURY, MAVROTAS (2006) contend that the relationship between FDI and economic growth is not unidirectional, claiming that economic growth stimulated FDI in Chile and the relationship was bidirectional in Malaysia and Thailand. HERMEN, LENSINK (2003) uphold the needs of specific conditions, in particular the development of financial systems, to realize a positive impact of FDI on economic growth. Other conditions may also include an adequate human capital, trade policies, or rule of law. The conclusions of the latter two studies are rather important for FDI policies in the least developed countries. Based on these conclusions, it is necessary to first improve socio-economic environment and only then FDI may have a positive impact on development.

What is the rationale of the preceding debate? NAFZIGER (2006) summarizes the positive impacts of FDI on the development of developing countries as follows:

- A source of capital to cover the balance of payments
- An access to new technologies, management and working skills, and products through imitation, competition, linkages, and training
- Creation of new jobs for skilled (management) but also unskilled workers
- Multiplier effects for domestic suppliers
- Tax revenues

However, all these benefits have also their counterarguments. **Transfer prices** and financial incentives provided by governments reduce the amount of new capital

⁵⁹ Note that the selection process of sites may be based on the efforts to reduce regional disparities or to spark development. The location of export processing zones into less developed regions is preferred in the former case while into regions with the best development potential in the latter case.

and tax revenues from FDI. Moreover, TNCs generally prefer to use the local credit not their own financial resources and then a higher demand restricts the access to capital for local firms. Furthermore, TNCs are often unwilling to diffuse their know-how and technologies, relying on their traditional subcontractors. Then it is doubtful whether multiplier effects may be created. There are also objections against the security, social and environmental quality of jobs created by TNCs. Finally, the dependence of developing countries on foreign resources increases with FDI. IROGBE (2005) gives several examples when TNCs affected developing countries in the dependency theory spirit. This includes the case of the Swiss *Nestle Corporation* which distributed its powdered dry formula as a modern nutrition for children in Africa. However, a poor quality of local water seriously threatened health of children exposed to the formula.

International trade and FDI may be promoted also by preferential bilateral or regional agreements. Although such agreements are against the MFN principles the WTO rules enable an exception for these agreements, traditionally explained by historical reasons and the efforts to find a preferential agreement for developing countries (WTO 2007). Regional cooperation may be of different intensity. DICKEN (2003) distinguishes four basic forms of regional cooperation in this respect:

- **Free Trade Area** – removal of trade barriers between member states which maintain their own trade policy towards third countries (e.g. the *North American Free Trade Area* - NAFTA; the *ASEAN Free Trade Area* - AFTA)
- **Customs Union** – a common trade policy towards third countries added
- **Common Market** – free movement of production factors (labour, capital) added (e.g. *Mercado Común del Sur* - MERCOSUR)
- **Economic Union** – a harmonization of common policies and supranational control added (e.g. European Union - EU)

Nowadays, the number of preferential regional and bilateral trade agreements and the intensity of regional cooperation tend to be increasing. There are several ambitious projects of this kind. These include for example the project of the *American Free Trade Area* which would cover the whole Western hemisphere or the plan to create the *ASEAN Economic Community*, akin to the European Union, by 2020 (LANDINGIN, WADLEY 2005).

Macroeconomic Policies

Macroeconomic policies belong to the traditional approaches how states may influence economic growth, unemployment and inflation. They include the monetary

policy, which is focused on the supply of money in economy through interest rates, state bonds and obligatory bank reserves, and the fiscal policy, which is focused on a redistribution of money through tax collection and government spending. The traditional idea of the policies is simple.⁶⁰ During an economic recession, states try to increase the supply of money in their economies and so stimulate investments to solve the problem of an increasing unemployment. Lower interest rates to make money cheaper, and purchase of state bonds, lower obligatory bank reserves, lower tax rates and increasing public investments are the tools generally applied to meet the goal. The opposite strategy is applied during a period of economic growth when states try to fight against *inflation*. Inflation is understood as the rate of increase in general price level measured by the consumer price index or GDP deflator.⁶¹ NAFZIGER (2006) distinguishes the following types of inflation according to the most important triggers:

- The demand-pull inflation stimulated by an increase in demand which is not covered by the same increase in supply
- The cost-push inflation arising as a reaction to some market imperfection (e.g. a limited number of suppliers, a strong position of labour unions⁶², and others)
- The structural inflation arising from some structural problem such as the disaccord between export and import structures in developing countries or survival of uncompetitive protected industries⁶³
- The expectational inflation arising as a reaction to expected currency devaluation when people prefer the purchase of goods to savings

⁶⁰ NAFZIGER (2006) points out that the application of the monetary and fiscal policies in developing countries is confronted with several problems. First, there is little interest of financial institutions to make transactions in national currencies. Thus, central banks have only limited opportunities to influence their activities. Second, central banks are not able to control a large informal financial sector in developing countries. Finally, the share of taxes to GDP is generally low undermining the opportunities of the fiscal policy.

⁶¹ The consumer price index is an average price of a basket of goods and services consumed by a representative household. The GDP deflator compares the average price of a GDP basket today and in a base period (NAFZIGER 2006).

⁶² Labour unions may be able to negotiate a higher average wage when prices increase. However, the increase in the labour costs (wages) is then reflected also in higher prices.

⁶³ The share of raw material in the export structure of developing countries is generally high compared with developed countries. However, the relative value of raw material as an export commodity tends to decrease. Then, a shortage of foreign exchange may arise, resulting in the cuts on import (supply) but not on local demand. Thus inflation, similar to the demand-pull type, may emerge. The ISI may also trigger an undesirable inflation because it is not assured that the ISI limits import. On the contrary, other types of goods (especially machinery) must be imported to enable a development of selected industries and the mechanism described in the preceding case arises once again. Second, the protected industries tend to be less efficient with higher costs and higher prices.

- The political inflation triggered by the efforts to prevent a political conflict through increasing wages of selected interest groups

As NAFZIGER (2006) points out, inflation may cause some positive development effects. He stresses the fact that prices tend to increase faster than wages and therefore the value from depreciated wages may be grasped in profits of firms or in taxes. Then, an opportunity to improve the efficiency of capital allocation arises. However, the negative consequences implying from inflation seem to be more important in a long-term perspective. Inflation generally depreciates the value of money (savings, investments, wages) and increases the market uncertainty. Then, economic subjects look for an alternative opportunity to keep the value of their financial means than long-term investments or savings are. The purchase of consumer goods may represent one of these opportunities, but such a step further reinforces the inflation spiral. Moreover, spatially unrestrained capital tends to flee from the inflation-hit countries, resulting in a lack of money for investments. Note that the depreciation of savings through inflation represents a serious threat also for various funds, from which e.g. health-care or pensions are financed. Finally, a social conflict may arise as a consequence of inflation impacts.

Having the negative consequences in mind, the question arises how to fight against inflation. There are several tools which may be applied in this regard. First, a stringent monetary and fiscal policy is followed to decrease the amount of money in economy. However, such a policy is suitable especially in the case of the demand-pull inflation. With respect to other types of inflation, such an approach may be even counterproductive because it does not solve the causes of inflation. Therefore, other tools are recommended which include antimonopoly measures, freezing of wages and costs for a certain period, or structural changes of economy. Furthermore, external borrowing may increase the financial credibility of states and prevent capital outflows. Finally, it is possible to peg the national currency to other currencies (e.g. U.S. dollar) with the aim to control the rise of import prices. However, such a step reduces the export competitiveness of a country. The crawling peg, which enables a fluctuation of exchange rates in some interval, may be a solution of this problem. NAFZIGER (2006) mentions this opportunity with respect to the financial crisis in Argentina in 2001 (see Box 2-5).

The macroeconomic stability and prevention of financial crises represent the leitmotifs of the International Monetary Fund (the IMF hereafter). Three main tools are used by the IMF in this regard. Surveillance includes a policy advice prepared by the IMF for its member countries on the basis of an in-depth assessment of their economic situation and of a regular dialogue with their authorities. Technical assistance is offered by the IMF to its member countries with the aim to increase their capacity to design and implement effective policies. Finally, lending should

help the countries which have serious balance of payments problems to give them an extra-time for a recovery. These loans are conditioned by the implementation of policy programs designed by the IMF in cooperation with national authorities. In addition, the IMF provides the concessional loans focused on poverty reduction⁶⁴ and is involved in the debt relief initiatives (see Box 2-2).

The IMF was founded at the United Nations conference in 1944 as one of the Bretton Woods institutions, with the original goal to reduce the worries that the economic downturn of the Great Depression period may have occurred once again. John Maynard Keynes, one of the IMF architects, claimed that it was necessary to prevent the policies which had led to the economic crisis in the 1930s. Therefore, he recommended instead of the import cuts in economically stagnant countries which had led to a spatial spread of the crisis elsewhere, to pursue an expansionary fiscal policy as a prerequisite of economic recovery. And just the IMF was to have two important functions in this regard (STIGLITZ 2003a):

- To provide funds for the expansionary fiscal policy
- To pressure on states to follow the expansionary fiscal policy

However, as STIGLITZ (2003b) contends the more recent policy applied by the IMF was completely different, recommending a prudent fiscal discipline and a neoliberal package of market-oriented adjustment reforms during an economic slowdown. However, such a policy worsens the whole situation. Similar to the import cuts from the 1930s, the fiscal contractionary policy undermines import to economically stagnant countries and, in addition, the domestic aggregate demand is undermined. This argumentation was used by many critiques of the IMF during the frequent financial crises in the 1990s and early 2000s. Moreover, the IMF was criticized also for other reasons (STIGLITZ 2003a, STIGLITZ 2001):

- The IMF interventions to keep stable exchange rates created a time-span for capital flight.
- The IMF pressure on the capital-account liberalization led to an inflow of speculative capital and break of traditional financial ties in developing countries which were not institutionally prepared.
- The IMF did not consider social aspects of reforms because it protects preferentially creditors. The riots in Argentina or Indonesia were a logical aftermath of an increasing social hardship especially of poor people.

⁶⁴ The IMF poverty program is also called the *Poverty Reduction and Growth Facility*. The concessional loans are financed by borrowing from central banks, governments, and official institutions. The differences between commercial and concessional interests are covered by a contribution from bilateral donors and by the IMF own resources.

Note that STIGLITZ (2003b) goes with his critique even further claiming that the whole global financial system does not work well. This critique is based on the contention that:

- Private finances flow only into selected developing countries. Simultaneously, a large amount of financial means flow in the direction from developing to developed countries as a consequence of e.g. the global reserve⁶⁵ and trade system⁶⁶ arrangements, or market imperfections in developing countries.
- Private finances flow only into selected sectors in developing countries which usually do not create a large number of jobs.
- Private finance flows to developing countries are often of a speculative nature, leaving these countries when matters do not go well.

Box 2-2: Financial crisis in Argentina (2001)

Argentina was seriously hit by hyperinflation in the late 1980s, with the inflation rate of 3,080 % in 1989. To solve the problems two measures were adopted in 1991 in accord with the International Monetary Fund guidelines (GALLO et al. 2006):

- Under the *Convertibility Plan*, the Argentine peso was pegged to the U.S. dollar based on parity.
- Structural reforms were initiated, focused on the reduction of state interventionism.

The success in the fight against inflation was tremendous because the inflation rate decreased at only 4 % in 1994 (NAFZIGER 2006). Furthermore, Argentina experienced a relatively high GDP growth in the first half of the 1990s because of its increasing creditworthiness for investors. Note that the IMF declared Argentina as one of its success stories (SETSER, GELPERN 2006). However, the situation changed dramatically in the second half of the 1990s. The *Convertibility Plan* turned out to be inflexible and the overvalued⁶⁷ peso undermined the export competitiveness

⁶⁵ States traditionally keep a large amount of financial means as reserves to prevent an eventual insolvency problem. In this way, states try to maintain their creditworthiness as a prevention of a capital flight. The reserves are often held in the low-interest U.S. Treasury Bills and then the paradox arises because developing countries provide financial means to cover U.S. consumption, practically in the ODA form. The lost opportunity costs of developing countries may even exceed the total volume of ODA (STIGLITZ 2003b).

⁶⁶ Naturally, the sum of the world export and import is equal to zero. Thus, export from one country is inevitably connected with import to another country. Why does the whole trade system work? Easy said the U.S. economy is able to absorb import from other countries, often through issuing new bonds or in other words through an increasing U.S. indebtedness. Question is how long developing countries will be willing to finance the U.S. debt (STIGLITZ 2003b).

⁶⁷ The foreign exchange rate is influenced by supply and demand for both domestic and foreign currency. Then, an increasing demand for U.S. products in Argentina (dollar flight) as well as a decreasing demand for Argentine products in the United States (lack of dollar injections) lead to a devaluation of peso. However, peso was hardly pegged to the dollar in this time and therefore it was not possible to reflect the changes in financial markets through a floating exchange rate. The trade deficit of Argentina clearly indicates an overvaluation of peso which was further reinforced by the dollar appreciation in the late 1990s.

of Argentina. Furthermore, the export competitiveness of Argentina was hit also by the Brazilian financial crisis in 1999 because of a reduced market access and a competitive challenge from Brazil after its currency devaluation (SETSER, GELPERN 2006). More extensive structural reforms were blocked by conflicting views of the national and provincial governments of Argentina. Note that strong provincial voice in the Congress enabled to oppose many decisions of the Argentine government which were in conflict with the provincial interests. Therefore, a bulk of money from privatization and economic growth was ineffectively allocated to buy a support for at least partial reforms (GALLO et al. 2006).

Because of the reasons given above, Argentina suffered from a stagnant economy in the second half of the 1990s. Moreover, the cool economy of Argentina was unattractive for investors who lost also their interest in buying the government bonds. The political elections in 1999, won by the President Fernando de la Rúa, did not enable to solve the economic problems because too many influential actors had their stakes in the fixed exchange rate and different political parties had majority in the national and provincial governments. New sources of financing were searched in domestic banks and the IMF to finance high government expenditures and to maintain the creditworthiness of the fixed exchange rate. Note that the IMF assurances helped to attract a short-term retail capital which bought the government bonds. However, this was only a short-term solution (SETSER, GELPERN 2006).

At the turn of the century, the creditworthiness of the *Convertibility Plan* began decreasing, as the fears from a currency devaluation emerged. Capital flight was sparked. Moreover, depositors began withdrawing their money from financial institutions in 2001. The IMF helped once more to prevent a devaluation through a financial injection in the summer 2001. However, also the IMF representatives were sceptical to the success of this step which was driven politically.⁶⁸ In August 2001, international financial institutions definitely refused further financing of the Argentine debt. In this severe situation, the Argentine government decided to freeze bank deposits in December 2001. However, this step was not approved by the IMF which consequently stopped its support to Argentina. Riots affected the whole country. Mass demonstrations, looting of supermarkets and shops, attacks to public buildings and banks, roadblocks, and struggle with police became a typical picture in Argentina of these days (CARRERA, COTARELO 2003). Confronted with such a situation, de la Rúa was forced to resign and the new government, led by Eduardo Duhalde, practically immediately after its appointment devalued peso. Moreover, the new government decided to convert the loans and deposits denominated in the U.S. dollars to peso because of an absolute lack of foreign exchange. Many Argentines became cheated in this way. Naturally, a lot of lawsuits followed this decision. However, a political pressure finally led to the approval of this “*pesification*”, resulting in a scepticism about rule of law in Argentina (GALLO et al. 2006). The socioeconomic impacts of the financial crisis were harsh (GALLO et al. 2006). The real GDP fell by 11 %, with increasing poverty figures and with the depreciation of deposits in banks and pension funds. Indebtness of Argentina rose from 54 % of GDP in 2001 to 140 % in 2004.

The financial crisis in Argentina peaked in the Spring of 2002. The Duhalde’s government achieved to renew the macroeconomic stability even without the IMF. Strict restrictions on capital flows and foreign exchange, a tight fiscal policy, and Central Bank interventions played an important role in

⁶⁸ The political motives include the IMF efforts not to be blamed from the anticipated Argentine failure or the U.S. effort to show a good will with respect to the Latin American ally (SETSER, GELPERN 2006).

this way (SETSER, GELPERN 2006). Thus, economic growth in Argentina was sparked in 2002, fuelled especially by the domestic import-competing industries benefiting from the peso devaluation. In 2003, new elections were held in Argentina with two candidates competing for the presidency office, the former president Carlos Menem and the leftist Santa Cruz Governor Néstor Kirchner. The former called for a repayment of all debts, the latter stressed the preference of Argentine people to foreign creditors. Néstor Kirchner won and became a new president of the country. To find a way from the debt crisis was naturally one of the most important challenges before him. The opportunities to solve the problem were perceived rather sceptically because of the usually strong coalition of creditors led by the IMF. However, Kirchner surprised by his strategy of tough actions against private creditors (foreign banks, bondholders, portfolio investors) and a much more cooperative behaviour towards the IMF. In this way, Kirchner succeeded to separate the negotiations with the IMF and private creditors. After the agreement on a debt rescheduling with the IMF, Argentina offered a debt rescheduling to private creditors which was extremely disadvantageous for them (e.g. the 75 % face value cut, default on interests, or extension of bond's maturity). Naturally, private creditors were anxious about this step. However, Kirchner did not retreat claiming that it was not moral hazard but support to Argentine people. In 2005, 76 % of private creditors accepted the disadvantageous conditions and a year later Argentina repaid its debt to the IMF in one single payment.

Source: GALLO et al. (2006), SETSER, GELPERN (2006), COOPER, MOMANI (2005), CARRERA, COTARELO (2003), NAFZIGER (2006)

The question remains why the IMF has retreated so far from its original goals. STIGLITZ (2003a) sees the most important problem in the IMF governance structure and its direct accountability to the finance ministers and central bankers of particular countries. Thus, the economic interests far outweigh the social and even political interests. STIGLITZ (2003a) describes a comic situation when the U.S. president Bill Clinton criticized the IMF for its decision, not considering the extraordinary strong position of the U.S. Treasury in the IMF decision structures. Note that the G7 countries have most votes in the IMF because the economic strength is the criterion how to distribute votes among member countries. Altogether, it is not surprising that the financial interests of developed countries play the most relevant role in the IMF decisions.

The failure of the IMF interventions evoked the ideas about some reforms of this institution. The first strategy of this kind claims that it is best to abolish the IMF, the second strategy that it is necessary to extend the IMF role as the central bank of central banks, and the third strategy that it is necessary to change the orientation of the IMF interventions. According to STIGLITZ (2003a), the first strategy is not realistic because politicians will always want to have an argument that somebody tries to fight against crises though in a wrong direction. The idea of the second strategy is very simple. The IMF as the global central bank should reduce speculative runs on banks because depositors will be assured that their money will be safe. However, STIGLITZ (2003a) contends that the central banks do not guarantee the financial

stability without a regulated deposit insurance system and he asks whether there is a willingness of national states to create such a mechanism in the environment of floating exchange rates. And therefore, STIGLITZ (2003a) claims that the third strategy seems to be the most appropriate one. A return to the expansive expenditure policies and financial regulations during crises, an incorporation of the social factors to the decision-making process, independent evaluation, and even a change of the existing governance structure may be necessary in this regard.

Conclusion

Our journey where we met a lot of interesting facets of the term development and landed in several ports in developing countries to hear about their instructive stories is close to its end. Each return from a long-term trip is connected with an evaluation of experiences and new knowledge acquired. So what are the most relevant lessons which may be drawn from our adventure? It is really not easy to answer this question. However, we would like to emphasize especially one point in this regard. Simply said, there is no universal, all problems encompassing solution which would trigger the development of developing countries. It was shown that ODA, international trade, FDI, or prudent macroeconomic policies, these all have their pros and cons with respect to the development potential of developing countries. Moreover, what works in one country does not have to work in another one. These facts naturally make the considerations about what should be changed in developing countries to spark development very difficult.

Reading the preceding paragraph, cynics could say that then it is not important to think so much about the development of developing countries. Who knows what the correct development strategy is. But our stance is completely different. It is necessary to learn as much as possible because the real tragedy is when decisions are made without a robust argumentation based on a theoretical underpinning, on empirical evidences and on a variety of applied methods. And just in this way, we would like to appeal to our readers. Do not be bound by the only neoliberal truth how to solve the development of developing countries. Do not be bound by the pessimism of dependency theorists that there is no solution. A number of examples show that neither of these attitudes is correct. Be unbound and innovative. Let us conclude with an illustration of an unbound, innovative thinking about the development of developing countries.

In one of their papers, HAUSMANN et al. (2005a) are interested in the determinants of the so called *growth accelerations*. They define the growth acceleration as a period when a country experienced a post-acceleration GDP per capita growth more than

3.5 % which was sustained for at least 8 years at the level of more than 2.0 %. In addition, the post-acceleration output was expected to exceed the pre-acceleration one to exclude a pure economic recovery of countries. The authors' interest in the growth accelerations is motivated by the idea that it may be useful to focus on the determinants to draw some policy lessons. The traditional econometric studies deal especially with the determinants of long-term growth changes which do not address such turning points of economic growth. HAUSMANN et al. (2005a) point to several interesting results from their research on the growth accelerations. They claim that a large increase in the trade volume and a political change made the growth accelerations more likely, with a higher impact of the shift to autocracy than to democracy. It is noteworthy that economic reforms had only a limited impact on the growth accelerations. However, the picture changed when HAUSMANN et al. (2005a) surveyed the determinants of the sustained growth accelerations defined by the 2 % GDP growth requirement for further 10 years. In this respect, the relevance of economic reforms and the shift to democracy increased while the relevance of trade shocks and of the shift to autocracy disappeared. However, the most important conclusion was that the determinants had only a limited ability to predict the growth accelerations, resulting in the calls for a case-by-case approach to the development strategies in developing countries.

Based on the last conclusion, HAUSMANN et al. (2005b) propose a methodology how to operationalise the case-by-case approach to development. Their initial idea claims that it is not possible to realize the best solution, all necessary reforms, at once. Furthermore, the strategy "*Do as Many Reforms as Possible*" founders at the existing negative linkages. The capital account liberalization in East Asia had negative impacts on economic growth because of undeveloped financial markets. Instead, HAUSMANN et al. (2005b) recommend the orientation of development strategies towards the most binding constraints of economic growth, using the **growth diagnostics** approach which is based on a review of factors which influence economic growth. HAUSMANN et al. (2005b) illustrate this approach on examples of two Latin American countries, El Salvador and Brasilia, which experienced a slow economic growth in the 1990s and early 2000s despite rather extensive reforms. The aim of the growth diagnostics is to reveal the most binding constraints of economic growth which differed in the both cases.

El Salvador was characterized by a relatively low indebtedness, low interest rates and remittances allocated for consumption, the evidences that El Salvador did not suffer from a lack of capital in the surveyed period. There were also the opportunities to borrow abroad and to mobilize domestic savings through higher interest rates. Thus, not high costs of financing but a low return to capital explained the lack of private investments in El Salvador. But what was the major cause of the low return

to economic activities? El Salvador was a relatively open economy with a low inflation and fiscal deficit, with a stable exchange rate, a relatively good institutional environment (a low corruption and tax evasion, secure property rights, flexible labour-market), a moderate tax system, and improvements in the infrastructure construction in the surveyed period. Thus, these characteristics cannot be regarded as the main problem of the slow El Salvador's economic growth. The main problem rested in the inability to find products which would attract investors.⁶⁹ Based on this growth diagnostics, HAUSMANN et al. (2005b) claim that e.g. the FDI liberalization is not a suitable growth strategy for El Salvador because there is nothing attractive for foreign investors. And thus El Salvador should search for the products at which it is good, an approach labelled as self-discovery by HAUSMANN, RODRIK (2002). Which tools can El Salvador apply? Export subsidies promote the efficiency but they do not differentiate between innovators and imitators. Moreover, they give only little incentives for the former when the protection of intellectual is not assured. Thus, HAUSMANN, RODRIK (2002) recommend a direct support to innovators, e.g. through an advantageous credit. It is noteworthy that there is a large amount of potential export commodities when the wide terms such as labour-intensive goods or textile industries are disaggregated. Then, it is possible to find out that Bangladesh is specialized in the hat production while Pakistan in bed-sheets.

Brazil was in a totally different position in the surveyed period, characterized by a high indebtedness and interest rates, an inadequate business environment, insecure property rights, high taxes, high social transfers, and a lack of infrastructure. However, the return to investments was relatively high indicating that a lack of capital was the most important binding constraint of economic growth. Thus, lowering of taxes or infrastructure investments could not remove the constraint. HAUSMANN et al. (2005b) recommend the fiscal stabilization of the country e.g. through higher taxes, cuts in social transfers and other wasteful public expenditures. Naturally, the growth accelerations should be used for further reforms. We think that these two examples illustrate the complexity of all questions related to the development of developing countries but also the opportunities to search and find an innovative solution.

⁶⁹ Note that the El Salvador's traditional coffee, sugar, and cotton production was unattractive for investors and that a low return to education may be regarded as an indicator of this kind. This is not valid for Brasilia.

CHAPTER THREE

CAUSES OF MIGRATION – FOCUSED ON DEVELOPMENT

In the course of the third quarter of the 20th Century, rapid and sustained economic growth, the increasing internationalization of economic activity, decolonization, and emergent processes of economic development in the developing world, all brought about an intensification of migration (ARANGO 2000). Global communications and transportation have made it possible for people to enjoy more freedom of movement than ever before. But people should not be compelled to migrate because of inequality, exclusion and limited alternatives in their home countries. While governments and experts discuss how best to manage migration, at the centre is the fact that migrants are first and foremost human beings vested with human rights. The equitable management of migration means that measures adopted should not further penalize the most vulnerable, who already face systemic inequality, first of all, lower-income and female migrants (UNFPA 2006).

What are the reasons for human migration flows during the last decades that “dictate international migration” (DRBOHLAV 2001)? Following parts of the chapter are addressed to theoretical views on the causes of migration from three perspectives. First of them deals with brief review of the best known migration theories from the economic causes perspective based on classical papers of Douglas S. Massey and other authors that have principal impact on many social sciences. Traditional paradigm of development studies in relation to causes of migration in terms of critical works by Arjan de Haan and other scholars is contained in second part of the chapter. Final third section deals with short review of three another approaches to the causes of migration issue within the frame of relations between developed and developing regions.

The essential purpose of the chapter is not to bring comprehensive interpretation of particular theories dealing with causes of migration, but tries to offer sententious introduction to fundamental causes and motives of migration processes leading to better understanding of the following chapters.

Structural Forces Supporting International Labour Migration

Why do people move? In the contemporary globalized world is no single, coherent theory of international migration, only fragmented set of theories that have developed largely in isolation from another, sometimes but not always segmented by disciplinary boundaries. A variety of theoretical models has been proposed to explain why international migration begins, and although each ultimately seeks to explain the same thing, they employ radically different concepts, assumptions, and frames of reference (MASSEY et al. 1993, MASSEY et al. 1997).

Social scientists have theorized about four basic aspects of human migration in their efforts to explain it (MASSEY 2001):

- The structural forces that promote ‘out-migration’ from sending regions
- The structural forces that attract ‘in-migrants’ to receiving societies
- The motivations, goals, and aspirations of people who respond to these structural forces by becoming migrants
- The social and economic structures that arise to connect areas of out- and in-migration

Drink mixed from four aspects creates uniqueness of particular migration theories that are briefly characterized in following parts of the chapter.

Push-Pull Model and Neoclassical Economic Approaches

One of the most commonly known theoretical concepts in migration research is *push-pull model*. This concept in general terms describes causes of migration within the frame of number of negative (push) factors in the country of origin cause people to move away, combined with a number of positive (pull) factors that attract migrants to new destination. Lists of push factors at large include such elements as economic, social, and political difficulties in the developing countries, while the pull factors include the comparative advantages in the richer developed countries as the higher wages, social and health insurance, high quality education, etc. The general criticism is that such model does not explain why some regions supply migrants while others do not, or not to the same extent, or why within regions some people move and others stay, nor can they explain the direction of flows (compare with SCHOORL et al. 2000). This simple model has become basis for neoclassical theories at migration studies.

The neoclassical approach to migration analysis came from classical works Adam Smith from 18th century (BAUER, ZIMMERMANN 1999) and from 19th century by RAVENSTEIN (1885). MASSEY (2001) notes that the best-known theoretical model, *neoclassical economics*, offered from the macroeconomics view has strongly shaped public thinking and has provided the intellectual basis for much immigration policy. MASSEY et al. (1993) summarized the theory to several implicit propositions and assumptions:

- *The international migration of workers is caused by differences in wage rates between countries.*
- *The elimination of wage differentials will end the movement of labor, and migration will not occur in the absence of such differentials.*
- *International flows of human capital - that is, highly skilled workers - respond to differences in the rate of return to human capital, which may be different from the overall wage rate, yielding a distinct pattern of migration that may be opposite that of unskilled workers.*
- *Labor markets are the primary mechanisms by which international flows of labor are induced; other kinds of markets do not have important effects on international migration.*
- *The way for governments to control migration flows is to regulate or influence labor markets in sending and/or receiving countries.*

Neoclassical micro-economic models focus on labour markets as well, but assume that individuals make rational cost-benefit calculations, not only about the decision whether to migrate or not, but also when considering alternative destinations. Against the benefits of expected higher wages there are various costs such as travel and adaptation expenses (learning a new languages, cultural differentials) and the psychological cost of leaving the family and friends (SCHOORL et al. 2000). It means that a potential migrant goes to where the expected net returns to migration are greatest, leading to several important conclusions that differ slightly from the earlier macroeconomic formulations (MASSEY et al. 1998):

- *International movement stems from international differentials in both earnings and employment rates.*
- *Individual human capital characteristics that increase the likely rate of remuneration or the probability of employment in the destination relative to the sending country (e.g., education, experience, training, language skills) will increase the likelihood of international movement, other things being equal.*
- *Individual characteristics, social conditions, or technologies that lower migration costs increase the net returns to migration and, hence, raise the probability of international movement.*

- *Because of 2 and 3, individuals within the same country can display very different predispositions to migrate.*
- *Aggregate migration flows between countries are simple sums of individual moves undertaken on the basis of individual cost-benefit calculations.*
- *International movement does not occur in the absence of differences in earnings and/or employment rates between countries. Migration occurs until expected earnings (the product of earnings and employment rates) have been equalized internationally (net of the costs of movement), and movement does not stop until this product has been equalized.*
- *The size of the differential in expected returns determines the size of the international flow of migrants between countries.*
- *Migration decisions stem from imbalance or discontinuities between labor markets only.*
- *If conditions in receiving countries are psychologically attractive to prospective migrants, migration costs may be negative. In this case, a negative earnings differential may be necessary to halt migration between countries.*
- *Governments control immigration primarily through policies that affect expected earnings in sending and/or receiving countries—for example, those that attempt to lower the likelihood of employment or raise the risk of underemployment in the destination area (through employer sanctions), those that seek to raise incomes at the origin (through long-term development programs), or those that aim to increase the costs (both psychological and material) of migration.*

Nevertheless, ARANGO (2000) recognizes a few critical points towards the neoclassical economic approaches that originate from their difficulties to come to terms with reality. The first of them Arango calls as ‘Achilles heel of neo-classical theory’, runs from question ‘why so few people move, given the huge differences in income, wages and levels of welfare that exist among countries?’“. In fact, international migrants make approximately 3 per cent share of the world population and it argues, that majority of the world population does not migrate. The second problem, connected with the theory, is its inability to explain why some countries have relatively high outmigration rates and others, structurally similar, do not (ARANGO 2000).

Furthermore, governments control of immigration through long-term development programs seems to be very interesting hypothesis, but in fact, it is definitely useless. Developed countries have provided official development assistance (ODA) for six decades, approximately, and without any significant global effect on international migration flows to the advanced economic regions.

The New Economics of Labour Migration

In recent last decades, *the new economics of labor migration* has arisen to challenge the assumptions and conclusions of neoclassical theory associated primarily with the name of Oded Stark, however ARANGO (2000) indicates doubts whether the disparate ingredients that make up the theory are sufficiently woven and logically integrated as to constitute a coherent theory, or whether it is no more than a critical, sophisticated variant of neo-classical theory. MASSEY (2001) points out that key insight of this approach is that migration decisions are not made by isolated individuals, but within larger units of interrelated people - typically families, households or entire communities - and that people act collectively not only to maximize expected income, but also maximize status within an embedded hierarchy, to overcome barriers to capital and credit, and to minimize risk and diversify the incomes.

From the development studies perspective is crucial issue that in most developed countries, risks to household income are generally minimized through institutional mechanisms as a private insurance markets or governmental programs, but in developing countries these institutional mechanisms for managing risk are imperfect, absent, or inaccessible to poor families, giving them incentives to diversify risks through migration. In developed countries, moreover, credit markets are relatively well-developed to enable families to finance new projects, such as the adoption of new technologies. In most developing areas, in contrast, credit is usually not available or is procurable only at high cost. In the absence of accessible public or affordable private insurance and credit programs, market failures create, according to the theory, strong pressures for international movement (MASSEY et al. 1993). In the context the migrant's remittances seem to be important element of finance accumulation to invest in development, as well as for old-age pension.

Some researchers (e.g. Piore, 1979 in SCHOORL et al. 2000) argue that labour market factors in receiving countries rather than in sending countries determine migration and intrinsic labour demands in modern industrial societies create a constant need for new workers at the bottom of the social hierarchy, who will accept low wages and a lack of social mobility perspectives, motivated by a desire to increase status in their community of origin rather than at destination.

The theoretical models growing out of 'the new economics of labour migration' yield a set of propositions and hypotheses that are quite different from those emanating from neoclassical theory, and they lead to a very different set of policy prescriptions (MASSEY et al. 1997):

- *Families, households, or other culturally defined units of production and consumption are the appropriate units of analysis for migration research, not the autonomous individual.*
- *A wage differential is not a necessary condition for international migration to occur; households may have strong incentives to diversify risks through transnational movement even in the absence of wage differentials.*
- *International migration and local employment or local production are not mutually exclusive possibilities. Indeed, there are strong incentives for households to engage in both migration and local activities. In fact, an increase in the returns to local economic activities may heighten the attractiveness of migration as a means of overcoming capital and risk constraints on investing in those activities. Thus, economic development within sending regions need not reduce the pressures for international migration.*
- *International movement does not necessarily stop when wage differentials have been eliminated across national boundaries. Incentives for migration may continue to exist if other markets within sending countries are absent, imperfect, or in imbalance.*
- *The same expected gain in income will not have the same effect on the probability of migration for households located at different points in the income distribution, or among those located in communities with different income distributions.*
- *Governments can influence migration rates not only through policies that influence labor markets, but also through those that shape insurance markets, capital markets, and futures markets. Government insurance programs, particularly unemployment insurance, can significantly affect the incentives for international movement.*
- *Government policies and economic changes that shape income distributions will change the relative deprivation of some households and thus alter their incentives to migrate.*
- *Government policies and economic changes that affect the distribution of income will influence international migration independent of their effects on mean income. In fact, government policies that produce a higher mean income in migrant-sending areas may increase migration if relatively poor households do not share in the income gain. Conversely, policies may reduce migration if relatively rich households do not share in the income gain.*

Nevertheless, ARANGO (2000) points out that the new economics of migration has problem with its limited applicability and it seems to draw its inspiration from a small number of rural villages in Mexico. He notes that the theory concerns itself only with the causes of migration at the sending side. Furthermore, DE HAAS (2005) claims, that social and economic development enables more people to migrate and

tends to increase their aspirations which means that economic development within sending regions probably does not reduce the pressures of international migration directly.

Segmented Labor Market Theory (Dual Labor Market Theory)

Author of the *dual labour market theory*, Michael Piore, pays attention only to the receiving end of migration and places its explanation at the macro level of structural determinants. According to him, international migration is caused by a permanent demand for foreign labour that stems from certain intrinsic characteristics of advanced industrial societies, which in turn result in the segmentation of their labour markets. For a number of reasons, highly developed economies require foreign workers to fill jobs that native workers refuse (ARANGO 2000).

The *segmented labor market theory*, as well as the world systems theory, perceive international labour migration as the natural effect of economic globalization and trade liberalization across the borders. According to Piore (1979 in MASSEY et al. 1993) international migration is not caused by push factors in sending regions (low wages or high unemployment), but by pull factors in receiving areas (a chronic and unavoidable need for migrant workers). The built-in demand for inexpensive and flexible workers stems from three basic features of developed countries economies: structural inflation (people generally believe that wages should reflect social status and a variety of mechanisms ensure that wages correspond to the hierarchies of prestige and status that people perceive and expect); social constraints on motivation (employers need workers who view bottom-level jobs simply as a means to the end of earning money, and for whom employment is reduced solely to income, with no implications for status or prestige - for a variety of reasons, migrants satisfy this need), economic dualism (low wages, unstable conditions, and the lack of reasonable prospects for mobility in the secondary sector make it difficult to attract local workers, who are instead drawn into the primary, capital-intensive sector, where wages are higher, jobs are more secure, and there is a possibility of occupational improvement - to fill the shortfall in demand within the secondary sector, employers turn to migrants) (MASSEY 2001).

The dual labor market theory understands contemporary realities better than above mentioned theories, claims ARANGO (2000) because its fundamentals are well-known empirical observations. According to him the value of the theory does not lie principally in providing a general explanation of the causes of international migration, it rather lies in highlighting an important factor for the occurrence of international migration, namely the structural demand for foreign labour in the

economic structure of developed countries. The dual labor market theory also provides cogent explanations for such demand which help to understand the apparently anomalous coexistence of a chronic demand for foreign labour with significant rates of structural unemployment in a number of receiving countries. Another merit is its contribution to the idea that immigrant workers affect the latter's level of wages and employment prospects (ARANGO 2000).

Segmented labor market theory does carry implications and consequences that are quite different from those outgoing from micro-level decision models (MASSEY 1997):

- *International labor migration is largely demand-based and is initiated by recruitment on the part of employers in developed societies, or by governments acting on their behalf.*
- *Since the demand for immigrant workers grows out of the structural needs of the economy and is expressed through recruitment practices rather than wage offers, international wage differentials are neither a necessary nor a sufficient condition for labor migration to occur. Indeed, employers have incentives to recruit workers while holding wages constant.*
- *Low-level wages in immigrant-receiving societies do not rise in response to a decrease in the supply of immigrant workers; they are held down by social and institutional mechanisms and are not free to respond to shifts in supply and demand.*
- *Low-level wages may fall, however, as a result of an increase in the supply of immigrant workers, since the social and institutional checks that keep low-level wages from rising do not prevent them from falling.*
- *Governments are unlikely to influence international migration through policies that produce small changes in wages or employment rates; immigrants fill a demand for labor that is structurally built into modern, post-industrial economies, and influencing this demand requires major changes in economic organization.*

However, ARANGO (2000) has two critical points towards the dual labor market theory. Firstly, any theory that posits that all international migration is demand-driven and excludes altogether 'push' factors, cannot aspire to explain but a part of reality. On the second place, today's immigration flows do not seem to result primarily from recruitment practices, especially in the economies of developed countries that the theory envisages, such as those of North America or Western Europe.

World Systems Theory

Growing out of the historical–structural tradition in social science, *world-systems theory* argues that migration stems from the penetration of capitalist economic relations into non-capitalist or pre-capitalist areas to create a mobile population (Fligstein 1979 and Sassen 1988 in MASSEY 2001). The theory is based on unbalanced world order and ideas that highly developed economies need foreign labour from developing countries to work for low wages in certain sectors focusing on macro-social processes only. However, its explanation of international migration does not so much rest on this demand, but rather in the dislocations brought about by capitalist penetration in less developed countries, claims ARANGO (2000).

The conceptual cornerstone of world systems theory is the notion of a ‘modern world system’ coined in the mid-1970s by historian-sociologist Immanuel Wallerstein (ARANGO 2000), but the roots of the theory can be found in (neo)marxist doctrine. What does theory simply say? In order to achieve the greatest profit from existing agrarian resources, and to compete within global commodity markets, capitalist farmers seek to consolidate landholding, mechanize production, introduce cash crops, and apply industrially produced inputs such as fertilizer, insecticides, and high-yield seeds. Furthermore, land consolidation destroys traditional systems of land tenure based on inheritance and common ownership and mechanization using decreases the need for manual labor and makes agrarian workers redundant on the one hand, and creates many lackland from small land owners on the other hand. These forces drive peasant farmers out of local markets and create a mobile labor force of people displaced from the land. This uprooted population is prone to rural-urban and international migration, which creates necessary supply of labour force for working on plantations or for industrial production, such as extraction of raw materials and goods manufacturing. The workers on the plantations and factories are exploited by their owners firstly and “thrown aside” later, when the production is finished or managers find new cheaper labour. At the same time, capitalist firms enter developing regions to establish assembly plants, often within special export-processing zones created by sympathetic governments (compare with MASSEY 2001). In the past this penetration was assisted by colonial regimes and in the present it is assured by neo-colonial regimes with their “special” relations to the former colonial powers, and multinational corporations, and foreign direct investments play a crucial role in it (ARANGO 2005). MASSEY (1993) notes on feminizing the workforce and socializing women for industrial work and modern consumption without providing a lifetime income capable of meeting their needs within the system.

MASSEY (2001) mentions two additional dimensions of world systems theory. The first of them deals with international security issue and military attendance of

advanced economic states in developing regions. Core capitalist nations also have the military interest of preserving their geopolitical order, and leading powers thus maintain relatively large armed forces to deploy as needed to preserve the integrity of the global capitalist system. Each military base and armed intervention, however, creates a range of social and political connections that promote the subsequent movement of migrants (compare also with MASSEY et al. 1994).

The second dimension relates to ideological or cultural links between core capitalist regions and their peripheries. In many cases, these cultural links are longstanding, reflecting a colonial past in which core countries established administrative and educational systems that mirrored their own in order to govern and exploit a peripheral region. Ideological connections are presently reinforced by mass communications, modern consumption and advertising campaigns directed from the core centers. It interacts with the emergence of a transportation-communication infrastructure to channel migrants disproportionately to global cities (MASSEY 2001).

World systems theory thus argues that international migration follows the political and economic organization of an expanding global market, a view that yields six distinct hypotheses (MASSEY et al. 1997):

- *International migration is a natural consequence of capitalist market formation in the developing world. The global economy infiltration into peripheral regions is the catalyst for international movement.*
- *The international flow of labor follows the international flow of goods and capital, but in the opposite direction.*
- *International migration is especially likely between past colonial powers and their former colonies, because cultural, linguistic, administrative, investment, transportation, and communication links leading to the formation of specific transnational markets and cultural systems.*
- *Since international migration stems from the globalization of the market economy, the way for governments to influence immigration rates is by regulating the overseas investment activities of corporations and controlling international flows of capital and goods. Such policies tend to incite international trade disputes, risk economic recession, and antagonize multinational firms with substantial political resources that can be mobilized to block them. However, it is unlikely that policies are to be implemented because they are difficult to enforce.*
- *Political and military interventions by governments of capitalist countries to protect investments abroad and to support foreign governments sympathetic to the expansion of the global market, when they fail, produce refugee movements directed to particular core countries, constituting another form of international migration.*

- *International migration ultimately has little to do with wage rates or employment differentials between countries; it follows from the dynamics of market creation and the structure of the global economy which are under control of advanced industrial countries.*

Even if the world systems theory may shed light on the importance of past and present linkages between countries at different stages of development, claims ARANGO (2000), some mechanisms of development which cause uprootedness and explains the common-sense empirical observation that migration often connects countries that were linked in the past by colonial bonds. According to him the theory represents a grand historical generalisation, a product of reductionist and sense-loaded interpretation of history in which all countries pass through similar processes.

The world systems theory focuses on negative aspects of economic and social processes of (global) capitalist market and understands migration as negative consequence of the processes. The theory does not consider any positive relations, for instance possible “pull” factors in the form of positive challenges for the migrants in the receiving regions which can improve quality of their life.

Papademetriou and Martin (1991 in ARANGO 2000) emphasize that the world systems theory is only applicable at the global level, and migrants are passive players in the play of big powers. This explanation of the specific migration relationships between countries is formulated in a way that cannot be subject to empirical test.

Cumulative Causation Theory

The expansion of migration networks⁷⁰, organizations⁷¹ and migrant supporting institutions sustain international migration in other ways that make additional movement progressively more likely over time, which MASSEY (1990) calls *cumulative causation theory*, and it was first processed by Gunnar Myrdal in 1957 in his concept of circular and cumulative causation in the context of the ‘backwash effects’ put in motion by uneven development in underdeveloped areas (MASSEY 1990, ARANGO 2000). The theory basically argues that human migration changes

⁷⁰ The theory tries to explain “how” people migrate, in particular, and for that reason is not included in the list of theories dealing with the causes of migration (for details about the theory see e.g. MASSEY et al. 1993, ARANGO 2000, BARŠOVÁ, BARŠA 2005, SCHOORL et al. 2000, BAUER, ZIMMERMANN 1999, FAWCETT 1989).

⁷¹ See BARŠOVÁ, BARŠA (2005) for controversial comment of the human rights organizations that need increasing anti-immigration policy due to greater propagation of their work, their existence justification, and grants activities.

individual motivations and social structures in ways that make additional movement progressively likely. Causation is cumulative in the sense that each act of migration alters the social context within which subsequent migration decisions are made to make additional trips of longer duration more likely (MASSEY 2001). Additionally, DRBOHLAV (2001) notes, that once migration processes have been started, after that they have ‘self-sustaining tendency’ through personal motivation and social networks, where individuals are embodied.

SCHOORL et al. (2000) talk about creating a true ‘culture of migration’ in some societies where migration becomes part of the value system of the community caused by change of tastes and motivations due to the experience of migrants gained in the countries they have moved. The authors argue that at receiving countries migration tends to change circumstances. For instance, the social acceptability of work is altered as people start to view certain jobs as low-status immigrant jobs, and refuse to enter those occupations any longer. Therefore, despite high unemployment rates, there may be a structural demand for immigrant labour. Immigrants may perceive status differently, at least as long as their primary goal is to earn money and improve their status in their community of origin, or if the fact that by earning an income they have gained independence provides them with a sense of status improvement (SCHOORL et al. 2000).

MASSEY (2001) mentions eight ways that migration has cumulatively caused: the expansion of networks, the distribution of income, the distribution of land, the organization of agriculture, culture, the regional distribution of human capital, the social meaning of work, and the structure of production. Feedbacks through other variables are also possible, but have not been systematically treated yet (compare with older version within six socio-economic factors MASSEY et al. 1993; see distribution of incomes in detail in TAYLOR, 1992). However, MASSEY et al. (1993) view international migration in dynamic terms as a cumulative social process yields a set of three following propositions:

- *Social, economic, and cultural changes brought about in sending and receiving countries by international migration give the movement of people a powerful internal momentum resistant to easy control or regulation, since the feedback mechanisms of cumulative causation largely lie outside the reach of government.*
- *During times of domestic unemployment and joblessness, governments find it difficult to curtail labor migration and to recruit natives back into jobs formerly held by immigrants. A value shift has occurred among native workers, who refuse the "immigrant" jobs, making it necessary to retain or recruit more immigrants.*

- *The social labelling of a job as "immigrant" follows from the concentration of immigrants within it; once immigrants have entered a job in significant numbers, whatever its characteristics, it will be difficult to recruit native workers back into that occupational category.*

Migration Systems Theory

Migration systems theory incorporates many of the theoretical models and elements briefly described above such as world systems theory, and the theory of cumulative causation. Migration flows acquire a measure of stability and structure over space and time, allowing for the identification of stable, international migration systems. A migration system may be seen as a set of places linked by flows and counter flows of people, capital, goods, services, and information between certain countries and less intense exchanges between others. An international migration system generally includes a core receiving region, which may be a country or group of countries, and a set of specific sending countries (peripheries) linked to it by unusually large flows of immigrants (MASSEY et al. 1993, SCHOORL et al. 2000, compare with FAWCETT 1989).

SCHOORL et al. (2000) note that international migration as taking place within a system where countries and regions are connected by several types of linkages, as well as viewing it as a dynamic process rather than a static phenomenon, inevitably calls for the integration of micro- and macro-level processes (compare with FAWCETT 1989). Therefore, research on the causes of migration has to consider both individuals and households (including their migration-related behaviour, motivations, perceptions, etc.) and the economic, social, environmental and political circumstances which create the context for migration and influence individual behaviour. Within a systems framework, individuals and households are regarded as active decision-makers about migration or alternatives to it. Questions posed by systems-oriented studies include the reasons for migration versus non-migration, the role of states in controlling migration, and the role of networks and information, etc. (SCHOORL et al. 2000)

MASSEY et al. (1997) see at migration systems theory perspective yields in several interesting hypotheses and propositions:

- *Countries within a system need not be geographically close since flows reflect political and economic relationships rather than physical ones. Although proximity obviously facilitates the formation of exchange relationships, it does not guarantee them nor does distance preclude them.*

- *Multipolar systems are possible, whereby a set of dispersed core countries receive immigrants from a set of overlapping sending nations.*
- *Nations may belong to more than one migration system, but multiple membership is more common among sending than receiving nations.*
- *As political and economic conditions change, systems evolve, so that stability does not imply a fixed structure. Countries may join or drop out of a system in response to social change, economic fluctuations, or political upheaval.*

The main advantages of migration systems theory were outlined by Fawcett and Arnold in 1987 (FAWCETT 1989, compare with SCHOORL et al. 2000):

- *It directs attention to both ends of a migration flow, with a corresponding necessity to explain stability and mobility in each location.*
- *It examines one flow in the context of other flows, or one destination in relation to alternative destinations.*
- *It highlights the diverse linkages between places, including flows of information, goods, services and ideas, as well as people.*
- *It suggests comparisons between places, thus calling attention to the disparities and imbalances that are a source of energy in the system.*
- *It brings into focus the interconnectedness of the system, in which one part is sensitive to changes in other parts.*
- *It reinforces the view of migration as a dynamic process, a sequence of events occurring over time.*

ARANGO (2000) considers the potential of the migration systems approach to international migration has never been fulfilled and still remains at the stage of promise.

Gap in Linkages Between Development Studies and Migration

DE HAAN (1999) in his paper, reviewing of empirical studies, shows that may not be possible to generalise the characteristics of migrants, or the effects of migration on broader development, inequality or poverty. His review concludes that, given the importance of migration for rural livelihoods of many, policies should be supportive rather than trying to limit population mobility, and possibilities should be explored to enhance the positive effects of migration. One of the key idea of the paper is that labour migration, between and within urban and rural areas, has to be seen as a natural central element in the livelihoods of many households in developing countries for a long time. Much of the literature focuses on movements of people as a result of crises – environmental, natural, economic, political or

demographic. Yet migration is also a normal element of most, if not all societies⁷², and DE HAAN (1999) addresses itself to scholars of development studies, with a offer to integrate the analyses of migration within those of agricultural and rural development issue.

Whereas standard economic theories emphasise the advantages of a free flow of labour, development studies tends to look at migration as the population movements which are happening at an unprecedented scale. Despite increasingly tough measures and restrictions against illegal immigration to developed regions, international migration is thought to be at an 'all-time high' (MARTIN, WIDGREN 1996) and international migration issue is perceived as a 'global challenge' (see e.g. MARTIN, WIDGREN 1996, MARTIN, WIDGREN 2002). DE HAAN (1999) indicates that in contemporary studies of migration in developing countries, there is much emphasis on migration as an option of last choice for impoverished peasants. According to him, literature that usually departs critically from neo-classical models, sees migration not as a choice for poor people, but as the only option for survival after alienation from the land, and highlights the exploitation of migrants in both destination and source areas.

Further, DE HAAN (1999) argues that development studies often ignore migration as a significant factor in agricultural or rural development due to their focus on rural-urban migration in developing countries where poverty and bad crops (hazard) play main reasons for this form of migration. This focus follows a perception of historical developments in Europe, where migration has often been perceived as the result of the uprooting of the peasantry in the process of industrialisation and the transition from a rural to an urban society, however, migration was a common part of the European economy before industrialisation. According to him this is an example of the hand downed assumption common in development studies. Additionally, DEMUTH (2000) mentions that European population is generally resident since their ancient forebearers stopped being nomads, excluding the emigration flows to colonies, and migrants for a long time have been regarded as something extraordinary and resident 'deeply rooted' population was the norm. In fact, in developing countries, the largest proportion of migrants moves between rural areas (DE HAAN 1999), perhaps with the exception of the Latin America (DE HAAN 2000).

DE HAAN (1999) calls attention to ambivalent relations between development strategies and human migration. Development policies often pay little attention

⁷² For example, it is commonly argued that the history of Africa is a history of migration and similarly, Asia has been a continent of a mobile population (DE HAAN 1999).

to migration and development assistance programmes are designed to promote strategy ‘stay-at-home’ and at the same time reduce emigration pressure.⁷³ Policy makers perceive population movements as a threat to stability and the rural-urban movement in developing countries, and the consequent urbanisation, is regularly portrayed as undesirable.

In this respect, the example of double-faced Chinese government policy in the case of internal migration, seems to be interesting. Chinese national government, officially supports “stay-at-home” strategy (hukou system) and slightly persecutes the informal migrants in Chinese cities by social pressure (does not provide the social support or other generally free of charge social services as the health care or education for children and other members of immigrants families⁷⁴). On the other hand, first of all coastal economic zones have huge demand for cheap and flexible labour force which is necessary for economic growth of the country. However, Chinese national government relieved emigration policy during the 1990s and it seems that supports the brain circulation strategy.

A central point of DE HAAN’s paper (1999) is argument that population movements are not economic reactions to push and pull factors only, but the *patterns of migration are determined by social and cultural institutions* (highlighted by author of the chapter), incorporated in local customs and ideologies. According to him, *migration processes are usually not a isolation from society’s histories and they are usually part of populations’ survival strategies* to obtain livelihoods (highlighted by author of the chapter). Socio-cultural structures also give migration particular forms. Further, migration options are not open to all, and people’s networks, preceding migrations and various social institutions determine, to a large extent, who migrates, and from which areas. This also means that the gains from migration are not distributed equally (DE HAAN 1999).

Alternative Approaches

Following parts deal with three briefly described approaches frequently cited in the migration literature – voluntary/forced migration, circular migration and transnationalism (transnational social spaces) – they have direct links to development in economically poor countries.

⁷³ In fact, nobody still defines what is „(e)migration pressure“, if any exists.

⁷⁴ But the situation is slowly getting better.

Voluntary and Forced Migration

One of the classic and well-known migration concept divides migration flows into *voluntary* or *forced (involuntary)*. Migration processes are based on circumstances of leaving the country (region) of origin and a possibilities to choose to migrate or not. Voluntary migration is generally action of peoples who have left their homes of their own volition (study or intership, new position in career, etc.). DEMUTH (2000) simply classifies voluntary migration on labour migration, non-immigration, chain migration and betterment migration, even if there are another possible typologies. But at the same time he advices of a fact, that many forms of labour migration are not quite as voluntary, the people move and try to find job abroad because their opportunities inside the countries of origin are limited and many of them have to support their families. The sending remittances can be only or basic finance source for survival. At similar cases the migration can be called a mixed voluntary and involuntary migration (in the context see also UNFPA 2006).

Involuntary (forced) migration is one that circumstances cause which directly or indirectly do not allow the potential migrants to remain at their home, but forces them to leave. Here are two main distinctions: man-made causes (such as poverty, angst and political persecution or the brutality of wars) included in Geneva Convention, and natural causes such as natural disasters or catastrophes (e.g. famine caused by drought, flooding, volcano eruptions, etc.) (DEMUTH 2000). It is apparent that some of the fundamental factors - man-made or natural reasons fro migration - can blend together as in the case of poverty or climate change. Similarly, the environmental reasons for migration (such as the desertification and land degradation) are examples of cumulative, slowly-onset economic and environmental causes on the voluntary and forced base.

Circular Migration

The *circular migration* generally mentions the temporary or permanent return of migrants to their countries of origin. The migrants are not just passive participants but active agents of their own mobility (AGUNIAS, NEWLAND 2007). The theory presents relatively new research phenomenon (HUGO 2003; compare with DE HAAN 1999), first processed by Graeme Hugo in 1982 in his paper dealing with circular aspects of migration in Indonesia, and has started to be new challenge for both politicians and scholars.

Graeme HUGO (2003) argues that from a research perspective, we are confronted with the situation that the bulk of our international migration data collection, much

of our empirical knowledge and theories are rooted in a permanent settlement migration paradigm. For this reason migration experts have to rethink our data collection systems regarding migration flows or limit the amount of detail sought regarding them. Most conventional collections of information regarding stocks of migrants such as population censuses either exclude temporary residents altogether, or if they collect information from them, it is not processed or tabulated.

The paradigm of development studies was not be able to absorb the circular migration approach for a long time (whether on international or on internal level), when in the international literature of the 1960s and 1970s the idea of one-way, permanent rural-urban migration dominated, argues DE HAAN (1999). But in the 1970s analyses that emphasize the circular nature of migration started to appear, challenging unilinear models assuming rapid urban transformation. The studies of international migration stress the cultural aspects that this circular movement entails.

Recent papers dealing with circulation migration issue on general level, (e.g. AGUNIAS, NEWLAND 2007, AGUNIAS 2006, HUGO 2003) say that is impossible to receive the information about global scope of the phenomenon. As AGUNIAS, NEWLAND (2007) note, the nature of the transnational movement of people requires data to be collected from countries of origin and countries of destination, which in turn calls for coordination of such data from various sources. While many countries of destination have registration procedures in place that allow assessment of the number of incoming immigrants, estimation of outflows of immigrants is less straightforward. As was mentioned above, the permanent settlement migration paradigm still defines most data collection systems. There are typically no procedures in place that register emigration (AGUNIAS, NEWLAND 2007). However, numeric data are available from limited number of countries and the data are based on inequitable methodology and that is why, they are comparable with difficulty (e.g. quantity of gained work permissions, quantity of granted long-term visas, etc.).

The impact of such circular migration on the development of migrants' countries of origin is complex. Scholar studies are just beginning to accumulate the information and data and mixed results from these studies, although still few and mostly preliminary in nature, suggest the promise as well as the perils of circular migration (AGUNIAS, NEWLAND 2007). The present knowledge of particular research works dealing with the issue in China and India shows positive as well as negative results. For instance, China recently has experienced a significant rise of returnees with advanced technical knowledge since 1999. A survey in 2002 of 154 returnees and locals in high-tech zones in six Chinese cities found that 48 per cent returnees

in the private sector brought back foreign technology as compared to only 21 per cent of locals (AGUNIAS 2006). Further, about 30-40 percent of higher level employees in Indian software firms had relevant work experience in a developed country (COMMANDER et al. 2004). However, there is an example of study of Kerala, South-West India (NAIR 1999), found that returned migrants are, in general, middle-aged persons with low-levels of education, skills, and experience. And not surprisingly, half of them were found to be unemployed upon return (NAIR 1999). Even if, this conclusion does not have to be just unambiguous, it is true that circular migration is not any 'heal-all' on long-term and complex development challenges.

According to AGUNIAS, NEWLAND (2007) circular migration's impact on development tends to be positive when:

- The socio-economic conditions in countries of origin have improved or are strongly expected to do so.
- The return, whether on a temporary or permanent basis, has been voluntary and planned.
- The returnees have gained skills and savings while abroad.

In cases that fail to meet any of these conditions, circular migration's impact on development may be very limited. The goal of policy therefore, is to create circular migration arrangements that allow for positive circularity (AGUNIAS, NEWLAND 2007, compare with NAIR 1999).

Transnational Social Spaces (Transnationalism)

However the concept of *transnational social spaces (transnationalism, transnational social formations, transnational communities*⁷⁵) hit the migration studies scene in the late 1980s (VERTOVEC 2004), it is still beyond the main stream of political discussions, analogous to circular migration theory, dealing with international migration issues. FAIST (2000) describes the concept as combinations of ties, positions in networks and organizations, and networks of organizations that reach across the borders of multiple states (compare with more general definitions in FAIST 2004 or VERTOVEC 2004). Withal the definition does not cover any occasional and fleeting contacts between migrants and relatively immobile people in the countries of immigration and the countries of emigration (FAIST 2000).

⁷⁵ FAIST (2000) describes mentioned concepts in more detail. But for the purpose of the of the chapter we do not recognize his another diversifications using the term of transnational social spaces and transnationalism uniformly.

Transnational social spaces are populated not only by global corporations, media and communications networks, social movements, criminal and terrorist groups (VERTOVEC 2004), but also by political parties and diverse entities such as transnational families, religious communities, or issue networks of non-governmental organizations and some of which are politically active (FAIST 2004). These spaces denote dynamic social processes, not static notions of ties and positions. Cultural, political and economic processes in transnational social spaces involve the accumulation, use and effects of various sorts of capital, their volume and convertibility: economic capital, human capital, such as educational credentials, skills and know-how, and social capital, mainly resources inherent in or transmitted through social and symbolic ties (FAIST 2000). Moreover, transnational social formations in international migration systems range from little to highly institutionalized forms (FAIST 2000).

Basch et al. (1994 in LEVITT, SØRENSEN 2004) indicates that transnational theorizing began its development in the early 1990s, when a group of US-based anthropologists found that the migrants with whom they worked had developed transnational practices that conventional migration theories did not adequately capture (compare with FAIST 2004). They argued that traditional migration theory treated migrants as individuals who either departed (emigrants) or arrived (immigrants). To overcome this false dichotomy, the transnational theoretical concepts started to develop and the researchers proposed that migrants be understood as forming part of two or more dynamically intertwined worlds and transnational migration as the processes by which immigrants forge and sustain multi-stranded social relations that link together their societies of origin and settlement (Basch et al. 1994 in LEVITT, SØRENSEN 2004). Thus, sending and receiving societies became understood as constituting one single, transnational social, space for following analysis (compare with LEVITT, SØRENSEN 2004).

FAIST (2000) includes factors that are conducive to the formation and maintenance of transnational social spaces in their border-crossing expansion such as modern technologies of contemporary globalized world (e.g. communication, transport), incomplete nation-state formation in many countries of emigration, discrimination and multiculturalism in the countries of immigration. Migrants often interact and identify with multiple nation-states and/or communities, and that their practices contribute to the development of transnational communities (LEVITT, SØRENSEN 2004) or new types of social formations within a transnational social space (FAIST 2000).

Further, FEIST (2000) argues that cultural, political and economic processes in transnational social spaces involve the accumulation, use and effects of various sorts

of capital, their volume and convertibility such as economic capital, human capital, such as educational credentials, skills and know-how, and social capital. According to his outcomes, the reality of transnational social spaces indicates following three points (FEIST 2000):

- Migration and remigration may not be definite, irrevocable and irreversible decisions. Transnational lives in themselves may become a strategy of survival and betterment and, also, transnational webs include relatively immobile persons and collectives.
- Even those migrants and refugees who have settled for a considerable time outside their country of origin, they frequently entertain strong transnational links.
- These links can be of a more informal nature, such as intra-household or family ties, or they can be institutionalized, such as political parties entertaining branches in various countries of immigration and emigration.

This long-term relations support sustainable flow of remittances and investments to the country of origin. LEVITT, SØRENSEN (2004) point out that remittances are currently considered as the most visible indicator and measurement of the ties connecting migrants to their home countries. They also argue that transnational migration creates at least three distinct categories of inhabitants (LEVITT, SØRENSEN 2004):

- Those who actually migrate
- Those who stay behind but receive support from those who migrate
- Those who do not migrate and have no sources of outside support

Clearly, it is apparent that first two groups participate on stable networks within the frame of transnational concept (LEVITT, SØRENSEN 2004). The people from third group are those, who have no outside support are the most needy and they should be fundamental target groups for development interventions of governments from developed countries, international organizations and another development institutions.

The concept of transnational social spaces (transnationalism) is not accepted unambiguously within the migration studies community, indeed. VERTOVEC (2004) identifies set of critical challenges or questions used in literature and conferences that dealt with the transnationalism approach:

- The term ‘transnationalism’ is often used interchangeably with ‘international’, ‘multinational’, ‘global’ and ‘diasporic’. There is also the problem of suggesting

that all migrants engage in transnationalism, but in fact, there is great variation in migrants' border-crossing practices.

- The questions whether transnational activities among migrants are new, and to how, or to what extent, are they new?
- Research and theory have not adequately problematized the difference between trans-national, trans-state and trans-local processes and phenomena.
- There are false dichotomies between terms transnationalism vs. assimilation and transnationalism vs. multiculturalism.
- The question if the contemporary forms of migrant transnationalism are a function of today's modes of real-time communication and cheap transportation only?
- The question whether current patterns of transnational participation are among migrants going to dwindle or die with the second and subsequent generations of migrants?

Conclusion

Social scientists do not approach the study of migration from a shared paradigm, but from a variety of competing theoretical viewpoints fragmented across different social disciplines, regions, and ideologies. As a result, according to MASSEY et al. (1994), research on the subject tends to be narrow, often inefficient, and characterized by duplication, miscommunication, reinvention, and bickering about fundamentals. Given the fact that theories conceptualize causal processes at such different levels of analysis – the individual, the household (family, community), the national and the international – they cannot be assumed, a priori, to be inherently incompatible. It is quite possible, that individuals act to maximize income supports family (community) effort minimizes economic risk and increasing of capital in the form of remittances and/or social status (MASSEY et al. 1997). The very important role play conditions in which international migration proceeds, such as how do transfer networks work; institutional support from non-governmental organizations dealing with immigration issue (e.g. humanitarian aid, legal cooperation) in receiving countries; migrant networks connecting immigrants, former migrants and local population; the atmosphere in receiving society towards immigrants; historical development and international relations between the receiving and sending states.

The older and handed schemes presenting migration processes as the negative component of impoverishment or underdevelopment in economic poor countries (regions) were affected by De Haan's approach that brought 'a fresh air' to development studies in the context of perception causes of migration. A gap arose in the validity of the schemes and scholars in development studies, politics and, especially, workers in development assistance organizations received new

challenges for their work. His arguments that population movements are connected with the migration patterns incorporated in social environment and culture of local populations, and that migration processes take place within the frame of historical context and they are usually part of populations' survival strategies should play significant role in development assistance strategies of developed countries.

In the context of international migration and development linkages is important to find possible role of developed countries in the migration processes. The concepts of circular migration and transnationalism have a big potential for relevant changes in migration and development policies of developed countries. There is a great challenge for development experts and politics trying to find new ways and target groups for development programmes and migration policy so that they work in system coherency, more effectively and have a beneficial effect for both developed and developing regions, including the role of Central and East European countries.

CHAPTER FOUR

INTERNATIONAL MIGRATION AND DEVELOPMENT: ANALYSIS OF SELECTED LINKAGES AND CONSEQUENCES IN BANGLADESH, INDIA AND CHINA

Human migration processes are a catalyst for change and development in every society that is undergoing constant transformation. Migration processes are as old as mankind and people have moved from place to place throughout the ages, overcoming geographical distance on various levels. Migration flows represent one of the most important dynamic features of the contemporary world, and in relation to dynamic economic development of huge countries such as India and China create the great phenomena, in particular in South Asian subcontinent.

The prime aim of the present chapter is to highlight selected links and consequences between international migration and development on the general as well as regional level. The analysis of the issue is presented on Bangladesh-India and China brief case studies. The chapter consists of six thematic parts: First part deals with brief introduction to international migration and development issue, the second and third parts are in more detail oriented on remittances as one of the most cited phenomenon relates with the mentioned issue. The next one part of the chapter is also concerned with very frequently mentioned topic – skilled migration. The fifth part deals with brief case studies of Bangladesh-India and China international migration issue, and the last part of the chapter conclude the issue.

The present chapter uses primary and secondary sources of data and information, concretely selected statistics from relevant authors and organizations, author's own researched data, document-based research of key selected papers, studies, reports, selected books and other relevant publications, specialized websites, including selected electronic newspapers or databases in case of demand for 'fresh' information. Among the methods used are comparative and analytical methods, compilation, desktop analysis, field survey, and semi-structural in-depth interviews with experts and migrants during the field research in Asia.

Understanding the International Migration and Development Linkages

The United Nations (UNPD 2005) estimated that the global number of international migrants in 2005 was nearly 191 million, marking a rise from 176 million in 2000, and international migrants comprise 3.0 per cent of the global population. Development has always influenced migration and vice versa. The development paradigm incorporates a clear idea of progress, the notion that things are getting better. In the context SKELDON (1997) claims that living conditions have improved for vast and increasing numbers of the world's population over the last six decades in terms of their capacity to feed themselves, their life expectancy, their standard of health, their level of education, etc. However, for a large number of others, living conditions have hardly changed and, in some areas, have actually deteriorated.

Both migration and development were usually surveyed independently, and much research has focused separately on issues such as the integration of migrants into host societies and internal factors in local development, even though many studies and reports have shown a clear relationship between these phenomena. Similarly, ADAMS, PAGE (2005) note that despite the ever-increasing volume of official international remittances, very little attention has been devoted to analyzing the impact of these financial transfers on poverty in developing countries, except for a few local case studies. The linkages between international remittances sent home by migrant workers, and poverty alleviation in a broad range of developing regions, are under-researched. On the other hand, there are arguments that even though the broad discussion frequently suggests that the subject of migration and development is 'new' or has been neglected or marginalized up to now – and it is true that the salience of migration and development in multilateral organizations and international agendas has grown dramatically in recent years – this should not obscure the fact that there is a body of literature on various aspects of the subject that goes back at least a decade or two. As we move forward in policy discussion and new research directions, we should not lose sight of the findings of previous studies, lest we 'reinvent the wheel'.

Nevertheless if you compare the analytical reports of the UNITED NATIONS from the middle of 1990s (UNITED NATIONS 1996) with the second report from 2006 (UNITED NATIONS 2006), you can find the perceptible progress. Whereas the report (UNITED NATIONS 1996) trivially expressed, first on the level, that international migration and development are interrelated, and that linkages between the phenomena are numerous and complex. These linkages, the size, type and direction of migration movements, and national policies are all a function of the political, economic and social contexts of the time. However, about ten years

later new report (UNITED NATIONS 2006) progressed forward the issue and is already focused in more detail on the demographic, social and economic aspects of international migration in relation to development. It describes recent international migration trends; examines the interactions between international migration and population growth, fertility, mortality and health; discusses the economic aspects of international migration; and concludes with an overview of policy responses at the national, regional and international levels.

In September 2006, the United Nations held an unprecedented meeting of the General Assembly to discuss the relationship, which produced an informal agreement among states to hold an annual Global Forum on Migration and Development, the first to be hosted by the government of Belgium in July 2007. During the last decade the discussion about international migration and development linkages moved to focus on the three principal concerns (NEWLAND 2007):

- Optimism about positive impacts from remittances and other contributions by emigrants to their home countries,
- Concerns about negative impact from the loss of skilled people
- An underlying hope on the part of some major destination countries that accelerated development might slow migration flows from the developing countries toward the North

Remittances

Migration affects on sending countries in a variety of ways describes KATSELI et al. (2006) in their summarized report. One of the major impact of migration on development comes through remittances, which are sent by migrants to families, relatives or friends to country of migrants origin. **Remittances** are financial or goods transfers from migrants staying abroad. However, under International Monetary Fund's statistics, remittances are reported under three different headings, in particular transfers from workers staying abroad for one year or more (workers remittances), transfers from persons staying abroad for less than one year (compensation of employees) or flows of goods and financial assets linked to the migrants' cross-border movements (migrants' transfers), with general tendency in literature to focus especially on the first category (GAMMELTOFT 2002, GHOSH 2006).

Nevertheless, several definitions of remittances exist. In its broadest sense, remittances refer to cash or in kind transfers from one place to another. As Van Doorn (in DE BRUYN, WETS 2006) notes, another types of remittances can be distinguished: international or intra-national; individual or collective; formal or

informal; in kind, in cash or only financial. CARLING (2005) identifies several different types transfers of remittances to countries of origin on the basis of differentiate between the types of senders and recipients:

- Personal deposits or investments (migrant to migrant) - migrants' transfers of money for their own use, either depositing in bank accounts in the country of origin, or transferring savings accumulated abroad.
- ***Intra-family transfers*** (among migrant and non-migrant - family, friends) - in most countries, this is the most important remittance flow. Migrants' transfers to family members or friends in the country of origin, either.
- ***Charitable donations*** (between migrant and collective) - migrants' donations to charitable purposes, both crisis relief and long-term development in the region of origin, e.g. churches, mosques, etc.
- ***Collective investments in development*** (collective to collective) - transfers made by migrant organizations, especially hometown associations for investments in community development together with partners in the region of origin (e.g. remittance flows from USA to Latin America in many cases).
- Taxes or levies (between migrant and government) - mandatory remittances to the government or public institutions (as the school or hospitals to finance education and health care of family members/friends) of the country of origin or special form of a tax collected from emigrants (e.g. in Eritrea).
- Pensions (among government or private business and migrant) - regular transfers from former employers, pension funds or governments in countries of employment (and destination).
- Social security transfers (among government or private business and migrant) – social security benefits transferred from welfare state as the country of destination to their countries of origin after retiring there.

Monetary remittances are sent through a large number of different transfer mechanisms. Isern et al. (in DE BRUYN, WETS 2006) explain that any formal remittance system consists of three major building blocks:

- The institution which provides the transfer, including banks, money transfer agencies, postal banks, and credit unions
- The mechanisms that carry the transfer from one place to another, including cheques and bank drafts, money orders and giros, electronic transfer mechanisms such as SWIFT, and proprietary networks
- The customer interface through which cash is collected and/or disbursed to recipients, including automated teller machines (ATMs), retail or store fronts, fixed and mobile phones, and the Internet

Among the formal remittance methods are generally ranked (for details see CARLING 2005, DE BRUYN, WETS 2006):

- Cash-based electronic transfers
- Electronic account-to-account transfers
- Card-based transfers
- Paper-based transfers (e.g. checks)

Besides the mentioned formal remittance methods, informal remittances systems often make use of various informal transfer agencies. The fundamental informal methods include:

- Informal value transfer systems
- Personal couriers
- Remittances in kind

In the context PURI and RITZEMA (2001) cite two forms of unrecorded remittances which are likely to be quite significant, particularly for low-income migrants, who usually account for the bulk of remittances.

- Personal imports of migrant workers - i.e. goods imported by return migrants under the duty free allowance facility or brought along with them under personal baggage/gift facilities)
- The savings brought home on return – savings in the form of cash or traveller's cheques subsequently converted into local currency at domestic banks

DE BRUYN, WETS (2006), CARLING (2005) described informal value transfer systems (IVTS) as a heterogeneous collection of mechanisms for transferring outside the conventional, regulated financial institutional systems. The systems are similar to that of formal transfer agencies characterized by trust, a relative absence of written records, and a reliance on international ethnic networks. In most cases, there is no physical movement of money involved. With informal transfer agencies, the sender gives money to an intermediary (an informal transfer agent), who contacts an agent in the country of origin. The latter is responsible for giving the equivalent of the money that the sender has given to the intermediary then to the recipient. The recipient can take the money from the agent by using a code that she or he receives from the migrant, or by identifying him or herself to the agent (DE BRUYN, WETS 2006, CARLING 2005).

Informal value transfer systems are known by different names in different parts of the world. Among the most common are *hawala* (simply means “transfer”) and *hundi*

in South Asia and *xawilad* (or hawilad) on the Horn of Africa. The word hawala is often used to refer collectively to the IVTS that are used by migrants around the world to send remittances to various parts of Asia and East Africa (CARLING 2005). In the academic and policy literature, IVTS are also known as ‘alternative remittances systems’; ‘underground banking’; ‘ethnic banking’; or ‘informal funds transfer systems’ (EL QORCHI et al. 2003).

The share of remittances transferred through unregistered mechanisms varies widely. Available information comes mainly from sample surveys among remittance senders and receivers and the degree of under recording varies from country to country. For instance PURI, RITZEMA (2001) mention, citing the primary sources, the interval of 8 per cent (in case of Korea) and 85 per cent (in case of Sudan) for period 1980s - 1990s. El Qorchi et al. (in CARLING 2005) presents estimated percentage proportions of unrecorded remittances based on econometric modelling for selected remittance-receiving countries in 1985–2000. He mention similar interval between 10 per cent and 80 per cent.

There are various motives for sending remittances and the concept “Go away and stay away but don’t forget us” is an important strategy for many families in developing countries (see e.g. WUCKER 2004). However, a lot of authors claim that relations between remittances and development are rather under-researched, among others due to lack of reliable statistics (see e.g. LÓPEZ-CÓRDOVA 2005). In the context AMUEDO-DORANTES et al. (2005) recognize five groups of the motives:

- Remittances connected with altruistic behaviour towards families staying in the sending country
- Remittances for consumption smoothing based on efforts to diversify incomes and thus risk to the whole family
- Remittances for target saving to fulfil a specific goal such as housing construction or enterprise establishment
- Remittances as a migrants’ insurance tool to maintain ties with families, if something goes wrong in the new destination
- Remittances to repay initial loans for migration

Development Impact of Remittances

From geographical point of view, developing countries (both low income and middle income countries) are the dominant recipient of inward remittances (see Table 4-1). However, it is necessary to stress that the least developed countries lag in the

absolute volume of inward remittances, implying higher figures for Asian and Latin American regions than for Sub-Saharan Africa (see Table 4-2) with little assumptions for any change. At the national level, Mexico, India, China, Philippines and France were the top five recipient countries of remittances in 2006. On the contrary, USA, Saudi Arabia, Switzerland, Germany and Spain were the top five source countries of remittances in 2005, both rankings based on estimations of World Bank. Such a situation clearly demonstrates strong ties between neighbouring countries USA and Mexico, the importance of Saudi Arabia as the oil power for guest workers, position of Germany or Spain as countries with extremely strong migrants' communities or increasing importance of emerging superpowers China and India in the global economy. Relatively, measured by the share of remittances on national GDP, smaller economies like Tonga, Moldova, Lesotho, Haiti or Bosnia and Herzegovina belong to the top-five countries (WORLD BANK 2007).

Table 4-1: Distribution of workers' remittances, compensation of employees, and migrant transfers according to division of countries based on income (selected years)

Type of countries	2000	2001	2002	2003	2004	2005	2006
Low income	21.793	25.888	32.040	38.929	39.666	45.829	54.296
Middle income	62.714	69.636	83.763	104.478	121.082	142.940	153.232
High income	46.996	51.218	53.658	60.826	69.089	70.917	73.398
World	131.502	146.742	169.461	204.233	229.836	259.686	280.926

Source: WORLD BANK (2007) and author's own calculations

Geographical distribution of formal remittances during the last years shows trend in growth of remittances transport to sending countries in every regions. Registered global remittances rose from near 132 billion USD in 2000 to more than 280 billion USD in 2006 on the global level (for details see Table 4-2). However the differences between the regions in remittances earning is still deepened. The completely worst position has sub-Saharan Africa which "only" doubled remittances receiving during the period (from 4.62 billion USD in 2000 to 9.26 billion USD in 2006). In contrast to Latin America and Caribbean, as the absolute leader in remittances earning for a long time (excluding meantime 2002-2003), which registered almost triple increase for the period (from 20 billion USD in 2000 to 53.26 billion USD in 2006), together with East Asia and Pacific region (from 16.68 billion USD in 2000 to 47.54 billion USD in 2006). Nevertheless we cannot looked forward to marked change in near future.

Table 4-2: Distribution of workers' remittances, compensation of employees, and migrant transfers according to the geographical regions in 2000 – 2006 (in billions USD)

Region	2000	2002	2004	2006	Remittances as a share of GDP (2006)
East Asia and Pacific	16.682	29.481	38.812	47.542	1.4 %
Europe and Central Asia	13.083	14.032	21.307	32.419	1.4 %
Latin America and Caribbean	19.987	27.918	41.248	53.264	2.0 %
Middle-East and North Africa	12.920	15.242	23.051	25.162	3.5 %
South Asia	17.212	24.137	28.694	39.886	3.6 %
Sub-Saharan Africa	4.623	4.993	7.636	9.256	1.5 %
World	131.502	169.461	229.836	280.926	0.6 %

Source: WORLD BANK (2007)

Remittances play the most important role in South Asian and Middle-East and North Africa national economies because they generate 3.6 percentage share of GDP, respectively 3.5 percentage share of GDP in the regions. The smallest role remittances have in East Asia and Pacific and Europe and Central Asia regions where remittances generate 1.4 percentage share in the regions (see Table 4-2).

According to the study of STOJANOV, NOVOSÁK (2008) all developing countries received 912 billion USD in form of registered remittances in 2006, in contrast 105 billion USD received in the form of *official development assistance* (ODA) from OECD countries (for details see Table 4-3). And we have to account that only part of financial resources included with ODA come to people/communities in developing countries (estimated amount is lesser than 50 per cent), in contrast of remittances which majority of them is directly transmitted to people in economically poor regions (for more details see STOJANOV, JAMBOROVÁ, 2008). Nevertheless transaction costs (involving both explicit fees and exchange rate spreads) are estimated within the range of 7–15 per cent of the sum remitted (in the case of transfer costs to some leading recipient countries from USA in February 2005)⁷⁶ and have declined significantly over the past few years, probably as the reflection of greater intensity of competition among remittance-service providers, or the ability of such providers to spread fixed infrastructure costs over a larger volume of customers (IMF 2005).

⁷⁶ There are no systematic cross-country, time-series data on such costs (IMF, 2005: 83)

Table 4-3: Comparison of volume of the official development assistance (ODA) and remittances flowing to developing countries (in billions USD)

Year	ODA*	Remittances****
2001	53.6	95.5
2002	61.5	115.8
2003	72.5	143.4
2004	83.2	160.7
2005	10.0*	188.8
2006	105.2***	207.5
Total (2001-2006)	486.0**. ***	911.8

* Total net ODA members as well as non-members of DAC/OECD

** Without inclusion of ODA of Saudi Arabia at the year 2005

*** Preliminary estimate of net ODA, without inclusion of Arabic agencies at the year 2006

**** Official remittances, employee's compensations and migrations transfers

Source: STOJANOV, NOVOSAK (2008)

The impact of remittances on development is conditional on structural characteristics and behavioral responses due to restructured incentives. Thus, credit market conditions, determine not only the cost of transferring money and thus the channel chosen by migrants to send remittances back home, but also the way remittances are invested (KATSELI et al. 2006). The development impact of remittances also depend on their continued flow and on the ease with which the money can be transferred. Some family economies highly dependent on the financial flows can be hit hard when the flows suddenly decrease (MUTUME 2005). One of the author of the chapter can confirm rather ubiquitous presence of money-transfer companies in almost all cities and bigger towns in East African countries, especially in Kenya. The companies include world-wide extended the Western Union which is specialized on money transfer between families having nearly 250,000 commercial offices in the world, and local private transport provider Akamba Public Road Services which is successful example of competition to state public transport, post services.

The growth and development potential of remittances may be limited by local market imperfections, such as imperfect or absent rural credit markets in which case, recipients would be constrained to borrow against remittances or use them as collateral. Inefficient rural credit markets would also hamper the channelling of savings from households with remittances to those desiring to invest them in productive activities (KATSELI et al. 2006). At this approach Léon-Ledesma and Piracha (in KATSELI et al. 2006) argue that potential impact of remittances on the sending country may change with the type of migration (temporary versus

permanent/ skilled versus unskilled) and the likelihood of return migration as a consequence of behavioral responses to migration.

The results of analytical study (based on macro-data comparison) of World Bank's scientists (ADAMS, PAGE 2005) show that international migration and remittances significantly reduce the level, depth, and severity of poverty in low-income and middle-income developing countries. A similar increase in per capita official international remittances will lead, on average, to 3.5 percent decline in the share of people living in poverty. But the study also points out possibility that poor people, especially poor people from countries located near major labor-receiving regions, are more likely to remit through informal, informal channels. For this reason, a full and complete accounting of the impact of international remittances (official and unofficial) on poverty in the developing world needs more accurate data on the large level of unofficial remittances returning to developing countries (ADAMS, PAGE 2005).

The older paper by ADAMS, PAGE (2003) point out modestly different outputs. Based on calculations and data from 74 developing countries they argue that, on average, a 10 per cent increase in the share of international migrants in a country's population will lead to a 1.9 per cent decline in the share of people living on less than 1.00 USD per person per day. Similarly, on average, a 10 per cent increase in the share of remittances in country GDP will lead to a 1.6 per cent decline in the share of people living on less than 1.00 USD per person per day.

From the paragraphs above it is clear, that remittances may trigger development. But what are the relations between remittances and poverty? This issue is not as straightforward, as one could suppose. The problem is, who are the people sending remittances home. Such a question brings us to the domain of migration. There is a conventional idea that extremely poor people generally do not migrate (except the cases of displacement or involuntary migration) because migration always involves some costs of transportation and the abandonment of many of the few possessions the poor might have. The poorest of the poor cannot afford either risk or movement and the majority starves in situ. Even we can find some opposite examples from human history; during the "Great Famine in Ireland 1845-1850", it was rarely the poorest who emigrated to North America. It has been emphasized that migrants tend to be among the more innovative and better-educated members of any population (SKELDON 2002).

The impact of remittances is still a subject of debate among scholars. Knowledge about the role of remittances in families and communities is much more restricted than knowledge about their impact on national economies. The impact of remittances

varies according to both the overall level of development and the nature of local migration dynamics. If there are mechanisms that exclude the poorest strata of the population from taking part in migration, remittances are likely to exacerbate existing inequalities. However, if migrants are wealthier to start with, remittances are more likely to be used for productive investments rather than household consumption, and this could have positive community wide effects (CARLING 2005).

Most theories and conclusions are based on either empirical micro-scale studies or analysis of macro-economic data. Because the former are very context-specific and the latter only take into account formal transfer methods, it is very difficult to draw general conclusions that are valid for all remittance-receiving regions, and for all senders and recipients of remittances. In addition, most research focuses on the economic impact of remittances and hardly mentions social effects (DE BRUYN, WETS 2006). CARLING (2005) argues that it is possible to construct long lists of plausible negative and positive consequences of remittance inflows, but extremely problematic - and perhaps not very constructive - to attempt to estimate their overall effect on development processes.

At the macro-economic level, remittances provide foreign exchange that strengthens the balance of payments. They can also stimulate the import of capital goods and resources that are needed for industrial development. On the other hand, the demand for import can also have negative effects on the balance of trade (BRUYN, WETS 2006). CARLING (2005) argues that this can occur when the consumption patterns of migrants' families in the country of origin, as well as return migrants and non-migrant families, change because these groups get accustomed to foreign products. Furthermore, large influxes of foreign exchange can lead to an appreciation of the local currency and thus make exports less competitive. On the indirect, positive side, the demand for products from the country of origin by the migrant communities can lead to an increase in exports.

Financial transfers are also a more stable money influx than, for instance, foreign direct investments. Even in times of political and economic crisis migrants tend to send remittances to support their families. Remittances even tend to be counter-cyclical; in other words, the remittance influx is higher in times of crisis. On the other hand, remittances tend to decrease the longer the migrant community is in the destination country. When an economy is too dependent on remittances, a decrease of this money can have severe negative effects on the national income (BRUYN, WETS 2006).

One of the most commonly heard criticisms about remittances is that they are primarily used for consumption purposes instead of investment effects. So-called

“economic productive investments” are much less frequently mentioned as objectives of remittances. Even if this is true, for many families remittances are an important source of revenue. This extra income allows them to meet their basic needs or to overcome periods of economic crisis. It can also open up opportunities to invest in the family’s well-being, education of children, improvement of the family’s health status, and so on (BRUYN, WETS 2006). More recently, it is interesting to concentrate on the distinction between consumption and investment which has been criticized by researchers that expenditure on ‘consumption’ items such as health and education should be seen as investment in human capital (CARLING 2005). SKELDON (2002) argues the example of the expenditure on house construction, for example, can stimulate local building enterprise, thus generating employment and trade in materials.

Furthermore, increased consumption by poor families is often equivalent with poverty alleviation, which is a goal in its own right. The silencing of criticism for ‘squandering’ remittances is also based on the recognition that remittances are hard-earned money that migrants and their families should be entitled to spend as they wish (CARLING 2005). However, the contemporary literature on the impact of remittances indicates that the second- and third-round impacts of consumption expenditure are important in local job creation (SKELDON, HUGO 1999).

Some cost of remittances that should be considered is the social cost. A significant change in recent migration patterns is the “feminization” of migration: almost half of the migration population is female and they are not always wives following their spouses. This can result in a situation where a country benefits from migration through remittances and where a family is provided with the necessities of life. However, it is very often also a situation where the grandmother raises the children, in the absence of their mother, while the mother, earning money abroad, is exploited, and in the worst case, even abused. This is common in countries where migrants’ rights are not protected or guaranteed. If these women are raped, they lose their social position in their society when they return, which simply compounds the trauma of what they have already experienced. Thus, the economic benefits of this situation are often realized at a very high social cost (BRUYN, WETS 2006).

The use of remittances is hard to describe unequivocally. Often, the underlying system can be described as a system of communicating vessels. As described above, many migrants use their remittances to support their families’ basic economic needs. If this need is filled, money can be used for more productive purposes. If these necessities are met, there is room for community projects (BRUYN, WETS 2006).

Skilled Migration

Skilled migration represents a significant part of the wider topics migration and development and it is justifiable to expect that its importance in the global world will increase, among others due to ageing of population in developed countries. skilled migrants are defined in accord with DOCQUIER, MARFOUK (2006) as all working-age (25 and over) foreign-born individuals who have at least tertiary education attainment wherever they completed their schooling. However, definition of the term skilled migrant is rather ambiguous and different approaches based on both, supply (requirements on education) and demand (requirements on occupation type), approaches are employed (MARTIN et al. 2006).

Changes in migration policies of traditional immigration countries such as USA, Canada or Australia, where skills gained high weigh as the criterion to acquire permission to stay, confirm this expectation. Immigration policies of EU countries are still substantially oriented towards traditional issues such as asylum-seekers or family reunification, however, interest in brain migration has been rising as witnessed by 20,000 commercial offices issued in 2001 in Germany to hire 20,000 non-EU ICT specialists for a maximum five years (DOCQUIER, MARFOUK 2006). It is necessary to note that an alternative stance to the issue is based on 9/11 syndrome and measures connected with fight against terrorism, creating important barriers to international migration flows (e.g. KAUKAB 2005).

STARK et al. (1997) studied human capital depletion and formation in a economy open to out-migration, as opposed to an economy which is closed. For the last decades, the literature on labour migration between developing and developed countries has reflected the view, that international migration is associated with a brain drain: the countries of origin lose high-skill workers. The loss is considered to be real since absent migration the home country would have had a more skilful workforce, and per capita output (and national welfare) would have been higher. The greater openness in the issue seems to have unfavourable repercussion and for this reason the literature on the brain drain has consequently concentrated on the question of how to mitigate this adverse consequence (STARK et al 1997). They have demonstrated in their study that a brain gain may occur without using the argument that gain arises from new skills that are acquired abroad and are brought home upon return. Since expected migration favourably alters the incentives of a poor country's workforce to invest in human capital formation, policy makers may wish to reconsider before embarking on measures that hinder migration (STARK et al. 1997). Also BEINE et al. study (2001) shows that average level of human capital is higher in the economy opened to migrations than in the economy without migration possibilities.

The quantification of skilled migration suffers from the lack of reliable data on skilled migrants in different countries. What indicators are used to measure skilled migration? Besides absolute and relative numbers of skilled migrants related to the total migration stock, skilled migration rate is the indicator most frequently employed to evaluate extent of skilled migration. The skilled migration rate is the share of skilled migrants from a particular spatial unit (e.g. sending country, world and others) in the total population of skilled people coming from the same spatial unit. In this concept, skilled migration rate enables to compare intensity of skilled migration among countries of different population size.

DOCQUIER, MARFOUK (2006) presented data on migration stocks in OECD receiving countries. According to their estimations the total number of skilled migrants increased by 800,000 persons per year between 1990 and 2000, as well as the share of skilled migrants in the total migration stock from 29.8 per cent in 1990 to 34.6 per cent in 2000. It is much more than 11.3 per cent of world labor force with tertiary education. This finding is in accord with conclusions in CARRINGTON, DETRAGIACHE (1999) who also describe differences in the education structure of migration stocks to the United States according to source countries. In this regard, more than 75 per cent of Indian immigrants are skilled compared to 53 per cent for the Korean migration stock and only 13 per cent of Mexican immigrants are skilled compared to 42 per cent for Jamaica.

Further, DOCQUIER, MARFOUK (2006) estimated that around 90 per cent of highly skilled migrants lived in one of the OECD countries, with the United States (about 50 per cent of skilled migrants), Canada (13 per cent), Australia (8 per cent), the United Kingdom (6 per cent), Germany (5 per cent) and France (4 per cent) as the main destination in this respect. Outside OECD, Gulf States (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates), South Africa, Malaysia, Hong Kong, Singapore and Taiwan are other countries or dependant territories attractive for skilled migration.

DOCQUIER, MARFOUK (2006) estimate that the skilled migration rates of small countries with population less than 2.5 million inhabitants is almost seven times larger than the emigration rate of large countries with population more than 25 million inhabitants (see Table 4-4). This fact may be attributed to relatively higher emigration figures of small countries. Note that in absolute figures, the situation is understandably opaque with highest share of skilled migrants coming from countries with more than 25 million inhabitants.

Table 4-4: Total and skilled migration rates for groups of countries according to their population size

	Migration rate (percentage)	
	Total	Skilled
Large countries (over 25 mil. inhabitants)	1.3	4.1
Upper-middle countries (10-25 mil. inhabitants)	3.1	8.8
Lower-middle countries (2.5 - 10 mil. inhabitants)	5.8	13.5
Small countries (less than 2.5 mil. inhabitants)	10.3	27.5

Source: DOCQUIER, MARFOUK (2006)

Skilled migration is especially strong in the Caribbean region. Also African regions point out high numbers of skilled migration rates (see Table 4-5). The largest disparities between share of skilled workers among migrants and in the whole population are observed in the African regions, the result of generally low level of education. Note that the largest absolute stock of skilled migrants is from Europe especially from the United Kingdom, Germany and Italy and that other large countries (the Philippines, India, China and others) are the most important contributors to skilled migration in the absolute figures.

Table 4-5: Selected indicators of skilled migration according to regions

Region	Share in the OECD skilled stock	Skilled emigration rate	Share of skilled workers	
			among residents	among migrants
Caribbean	5.7	42.8	9.3	38.6
Central America	6.6	16.9	11.1	16.6
South America	5.6	5.1	12.3	41.2
Eastern Europe	7.8	4.3	17.4	34.2
Eastern Africa	1.7	18.6	1.8	40.8
Central Africa	0.5	16.1	1.6	30.9
Northern Africa	2.2	7.3	7.5	19.6
Southern Africa	0.8	6.8	8.7	62.1
Western Africa	1.6	14.8	2.4	42.0
Eastern Asia	11.3	3.9	6.3	55.5
South-Central Asia	9.2	5.3	5.0	52.5
South-Eastern Asia	10.5	9.8	7.9	51.4
Western Asia	3.5	6.9	11.4	22.9

Source: DOCQUIER, MARFOUK (2006)

In future it is justifiable to expect that importance of skilled migration will increase. Position of skills in migration policies of both, traditional immigration countries such as the United States and more restrictive Europe, confirms this expectation.

To acquire work-permit in the United States is much easier for skilled migrants than their non-skilled colleagues. In the latter case, employer is required to prove in advance that the job cannot be filled by an employee from the United States or that the prevailing wage was assigned to the migrant. On the contrary, only complaints may be a cause to government checks in the former case (MARTIN et al. 2006).

Although almost five decades passed, many questions in the debate have remained unanswered due to lack of reliable data, available to test hypotheses and models related to impacts of skilled migration on sending and receiving countries. Conclusions about the role of migration in development differ hugely and recent papers and studies show the polarization in the debate.

Selected Factors of Migration Processes in India and Bangladesh

Permanent human migration flows are important socio-economic indicator of societal processes, including demographic and environmental changes. Because so many factors invariably are at work, LIVERNASH (1995) refers, that is difficult to precisely determine how much population size, growth, or density may contribute to either environmental degradation or international migration. Nevertheless the presence of such factors certainly indicates which countries are at high risk of uncontrolled, large-scale and poverty-induced migrations flows. In the context LIVERNASH (1995) just mentions the example of migrations of *Bangladesh* people to Indian states such as *Assam*, *Tripura*, and West Bengal.

The research analytical report of SIWEK et al. (2006), based on geographical desktop analysis, deals with potential causes of international migration from selected Asian regions, including India and Bangladesh. First of all the study identified some migration flows, factors and consequences in the sub-continent since the half of the 20th Century. India get independent in 1947, partly as the Hindu state. This religious feature causes sectarian problems, violence and pressure for assimilation of religious and ethnic minorities. There is a short list of essential migration flows in the region (SIWEK et al. 2006):

- Migration of Muslims from current India to current Pakistan and Bangladesh – the greatest flow ran in 1947. The violent incidents still continue
- Emigration of Sikhs from India – the flow started mainly from 1980 after the unsuccessful attempt connected with establishing of the theocratic state Khalistan
- Immigration of Indian Tamils from Sri Lanka – repatriates of descendants of planters due to economic reasons and separatist or their familiars

- Emigration from East India – scattered migration of religious and ethnic minorities (especially Catholics, Burma’s tribes) outside India caused by sectarian and political repression
- Immigration of Tibetans – main flow started since 1959 after the Chinese occupation of Tibet
- Labour migration - scattered migration from Bangladesh as well as India to UK, USA and Persian Gulf states due to economic reasons

First outcomes of the field research provided in Bangladesh and India during the March 2008 by one of the author of the chapter indicate that there is long-term single-direction migration flows of people from current Bangladesh (East Pakistan or East Bengal in past) to India, in particular to West Bengal and Assam provinces (states) dating since 19th Century at latest. These processes acquired international dimension since 1947 when India and Bangladesh (or more precisely East Pakistan as the part of Pakistan) get independence. However there are not any exact statistics about the issue because the India does not have any obligatory identity cards or equivalent of these. Further, the international border between the states are practically open due to many river canals and some mountains, and people from both countries can freely move. In the context one of the interviewed expert from India grandly proclaimed that each people who across the Indian border are Indian citizens. Nevertheless, the illegal migrations from Bangladesh to India are sources of deepening tensions between the two nations (compare with BHAUMIK 2008).

Causes of Migration between Bangladesh and India

LIVERNASH (1995) sees the main reasons for the migration flows in large absolute population, rapid population growth, and very little cropland in capita. According to him, 12 to 17 million people have migrated from Bangladesh to India between 1950s and 1990s; 7 million migrants of them to state Assam currently represent one third of the state’s population. At this approach, RAHMAN (2000) pays attention to a complex combination of circumstances, geopolitical locations and environmental conditions which has turned Bangladesh into a major “reserve of cheap labour”. Emigration partly solve domestic unemployment and it is source of foreign exchange earnings. Bangladesh had approx. 3 mil. overseas workers who remitted more than 1.5 billion USD in 1998 (RAHMAN 2000).

The preliminary outcomes of the field research in Bangladesh by one of the author identified the following essential causes for migration of Bangladesh people to India:

- *Economic reasons with combination of poverty*

The economic factors play the most significant role in decision-making process of Bangladesh migrants, say each of the interviewed experts. Labour migration, temporarily or permanently as well as circular migration is one of the family strategy for survival or improving the quality of live. The main identified destinations are Indian states West Bengal, especially the surroundings of Kolkata and border regions; Assam, in particular the border regions again, rural areas near the Brahmaputra valley and bigger cities such as Guwahati (Gauhati); and Tripura with border regions particularly. According to the experts the migration flows have mass dimension. Another frequent migrants destination outside the subcontinent are Middle East, especially Persian Gulf Arabian states, and South-East Asian countries such as Malaysia and Singapore.

- *Environmental factors*

The environmental factors play generally the second most important role as the reason for migration, however in selected regions can be the most significant element determining the temporarily as well as permanent migration. In the cases natural disasters and ecological processes (erosion) form the most important factors for decision-making. The research identified the main environmental reasons for human migrations such as river bank or river islands erosion; floods; tropical cyclones; river dam construction in one case; land salinization in selected regions; and natural sources scarcity such as safe drinking water and especially cropland. Moreover, relatively unknown factor remain the impact of regional or global climate change however some migrants underline the strongest and most destructive effect of last tropical cyclone Sidr from middle of November 2007 for last three decades.

- *Demographic factors*

The demographic factors such as high population density (more than 1,000 people per square kilometers), continuing population growth and crowded capital Dhaka (Dacca) with estimated 12-14 million, many of the living in the slums, inhabitants create general framework for both above mentioned prime causes for migration. Firstly the lack of employment opportunities and land scarcity generate, together with cultural and historical consequences, the “permanent migration atmosphere” in the society, on the internal as well as international level.

- *Civil conflicts and human vulnerability*

The selected regions in Bangladesh, especially in the East, are affected by civil conflicts or human vulnerability from time to time. The most famous affected area

is Chittagong Hill region with some tribal minorities living there. Some tribal members, any tens of thousands, emigrated to Indian states Tripura and Mizoram, however they have been returned during the late 1990s since a peace treaty was signed between the Bangladeshi government and tribal rebels (for some information see BBC 1998).

The report of the International Organization for Migration (IOM 2005) mentions that for many Bangladeshis living near the Assamese border, Guwahati (Gauhati), the capital of the state, is the largest day labour market, and they congregate daily at railway and bus stations to find work on Indian construction sites or farms. Indian officials view this kind of migration with alarm as they are wary that the migrants will establish themselves, send for their family, acquire a work permit and then eventually a ration card which entitles the family to all kinds of pro-poor schemes (IOM 2005).

In the context some interviewed experts expressed the fear about the ethnic and environmental future of the Assam. They stressed the Bangladesh migrants relatively high birth rate in comparison Assam population birth rate and woods, grazing and forest land are also being taken over for farming by the migrants. The Bangladeshis immigrants amount, at minimum, one third of the Assam population, and continuing deforestation presents one of the biggest environmental problem. One interviewed expert recommended for using the ID card and internal migration's control, including repatriation of illegal migrants to their country of origin.

Further, HUNTER (2005) also argues that migration as a demographic process can be associated with environmental hazards (for details see following chapter), and in fact migrants "transfer" the problems from Bangladesh to India.

However, a study of Afsar (2003 in IOM 2005) of internal migration in Bangladesh showed that all types of migration had increased significantly. Rural-urban migration was found to account for nearly two-thirds of outmigration from rural areas. The share of rural-to-rural migration was 10 per cent compared with 24 per cent for overseas migration. The latest estimates indicate a 6.3 per cent annual increase in migration, when Dhaka is the most common destination because it offers greater work opportunities. Most people look for work in the garments industry, rickshaw transport and the domestic sector. Rapid urbanization is creating these kinds of jobs that exert a stronger attraction than traditional push factors such as frequent natural disasters and poverty and destitution. The garment industry currently employs around 1.8 million people (80-90 per cent of whom are women) in more than 3,500 small and medium-sized factories spread around "Export Processing Zones" and urban areas of Dhaka, Narayanganj, Chittagong

and Khulna, says the report IOM (2005). Detail information about the urbanization in Bangladesh and rural-urban migration during the 1960s – 1970s offers the study of KHAN (1982).

An Overview of Migration in India

Since achieving the independence in 1947, two distinct streams of migration have left India: people with professional expertise or technical qualifications emigrating to industrialised countries, and semi-skilled and skilled workers emigrating to the Middle East, says report of SRIVASTAVA, SASIKUMAR (2003). Data on these labour flows are limited, but estimates and trends exists. Emigration to industrialised countries grew steadily between 1950 and 2000, nearly 1.25 million Indians emigrated to the US, Canada, UK and Australia during this period. Average annual flows to these destinations increased nearly five-fold between the 1950s and the 1990s. Migration to the Middle East increased rapidly between the late 1970s and early 1980s, substantially again during the 1990s. Today, some 3 million Indian migrants live in Persian Gulf countries (SRIVASTAVA, SASIKUMAR 2003).

SRIVASTAVA, SASIKUMAR (2003) claim that most migrants come from Kerala, Tamil Nadu, Andhra Pradesh and Punjab. According to them the current number of Indian migrants overseas accounts for less than 1% of the total workforce in India. However, the effects of migration are significant in major sending regions. In Kerala, for example, emigration has recently led to a considerable reduction in unemployment.

Recent official statistics show that rural-rural migration continued to dominate, accounting for roughly 62 per cent of all movements in 1999-00 (Srivastava and Bhattacharyya 2003 in IOM 2005). Workers from backward states like Bihar, Uttar Pradesh, Orissa and Rajasthan routinely travel to the developed “green revolution” states of Maharashtra, Punjab and Gujarat for the transplant and harvesting season.

However, new insights into migration in terms of patterns, causes and effects are continuously emerging and three important trends may be discerned (IOM 2005):

- Very high levels of temporary migration
- An increase in rural-urban migration due to a variety of new pushes and pulls
- A greater propensity to migrate among certain castes

The preliminary author's field research outcomes identified following reasons for Indian migration flows in Assam (North-East India):

- Poverty or complex of economic reasons, including the unemployment in selected Indian regions
- Environmental factors such as river or island erosion, floods and river dam construction
- Hindu-Muslim conflicts in Bangladesh

The study of SIWEK et al. (2006) identified another causes of migration for whole Indian context:

- Local discrimination of ethnic and religious minorities
- Caste system
- Regional (civil) conflicts (e.g. separatists or leftish armed movements)
- Conflict in Kashmir

An estimated 20 million people migrate temporarily each year in India. High levels of temporary migration are reported in a number of village studies (IOM 2005). A study by Mosse et al. (1997 in IOM 2005) of the first phase of the Western India Rainfed Farming Project (Madhya Pradesh, Gujarat and Rajasthan) revealed that 65 per cent of households included migrants. A few years later another study in the same area found that in many villages up to three-quarters of the population to be absent between November and June (Virgo et al. 2003 in IOM 2005). In Andhra Pradesh, a study by Society for the Promotion of Wasteland Development (SPWD) in the highly drought prone and poor district of Ananthapur similarly showed an increase in migration between 1980 and 2001 (Rao 2001 in IOM 2005). Migration among small and medium farmers has increased mainly because of the lucrative Bangalore market which pays Rs.100 to 150 per day, nearly three times more than the local wage.

Karan's study (2003 in IOM 2005) of labour migration in northern Bihar based on primary survey data collected in 1981-83 and 1999-2000, from six randomly selected villages (two each in Gopalganj, Madhubani and Purnea districts) showed that increasing rural-urban migration to work in the non-farm sector was the new trend. The traditional destinations of rural Punjab and Haryana are not as popular as they were 20 years ago because fewer jobs were available as agriculture became more mechanized. He found that migration rates had almost doubled from 7.5 per cent to 13.4 per cent of the total population during the intervening period. There had been an increase in long-term migration, but this concerned mainly the upper and wealthier classes. Though migration duration for the poor also increased, there were

still more short-term migrants among them. Roughly 24 per cent migrated to work as non-farm labour in 2000 against 3 per cent in 1983. The figures for agricultural labour were 15 and 1 per cent, respectively. Dayal and Karan (2003 in IOM, 2005) studied 12 villages in Jharkhand and found that one-third of the households had at least one member migrating. Short-term migration was higher among poorer groups, involving over 80 per cent of the landless and 88 per cent of illiterates.

Studies conducted by SPWD in Rajasthan show very high migration rates. In Jhadol *tehsil* of Udaipur, a typically drought-prone area, 50 to 75 per cent of the population migrates seasonally to work in agriculture in Gujarat. In Girva, another drought-prone tehsil, 25 per cent of the households have commuters who work in sand mining, stone quarrying and construction work and another 25 per cent migrate over long distances to work as, e.g. truck drivers, while a further 10 to 15 per cent work in service sector jobs in the urban informal economy (Rao 2001 in IOM 2005).

The main point of the mentioned studies is that, in the absence of other opportunities to diversify locally, many households are exploring opportunities outside the village. An important but under-researched dimension of migration in India is the relationship between migration and the caste system. Some studies have noted that certain castes and tribes have a higher propensity to migrate. Deshingkar and Start (2003 in IOM 2005) for example, found that the scheduled tribes had higher migration rates in Andhra Pradesh and Madhya Pradesh. Similar observations have been made by Dayal and Karan (2003 in IOM 2005) regarding Jharkhand: whereas 15 per cent of scheduled castes and tribes migrated, only 8 per cent of upper castes and 3 per cent of “other backward castes” migrated. Migrant job markets are often segmented along caste lines at the destination, and discrimination may prevent lower castes from earning as much as others for the same work.

Remittances are the main benefit of external migration, providing scarce foreign exchange and scope for higher levels of savings and investments. SRIVASTAVA, SASIKUMAR (2003) claim that remittances over the past 30 years have financed much of India’s balance of trade deficit and have thus reduced the current account deficit. Remittances have also had a considerable impact on regional economies. The most striking case is that of Kerala, where remittances made up 21 per cent of state income in the 1990s (SRIVASTAVA, SASIKUMAR 2003).

Table 4-6: Top remittance-receiving countries in absolute figures in 2006 (in billions USD)

Country	Remittances
India	25.7
Mexico	24.7
China	22.5
The Philippines	14.9
France	12.6

Source: WORLD BANK (2007)

According to WORLD BANK (2007) updated statistic the countries with a largest absolute remittances inflow in 2006 was just India with 25.7 billion USD. The another positions occupied Mexico (with 24.7 billion USD), China (22.5 billion USD), Philippines (14.9 billion UAD) and France (12.6 billion USD) (see Table 4-6). In the context is interesting that India alone received more remittances than whole Middle-East and North Africa region (25.2 billion USD); and Least Developed Countries.⁷⁷

Migration and China

Emigration is not a new phenomenon for the Chinese Republic. Chinese immigrants are among the most ancient diasporas in the world. During the modern history period 1950s and 1979, the People's Republic of China was "closed" to the outside world and movement of population was strictly controlled. Since 1979 the open doors policy, with the focus on economic reform has been introduced and the central government loosened its control over movement of population, which was strictly controlled by the household registration system known as hukou during the pre-reform era (1949-1979). According to XIANG (2003) is international migration viewed as one of the tool for improving the economic development through the border trade or knowledge transfer. Currently Chinese people from cities or larger towns are able to apply for a passport by presenting their ID card and residence document. China Daily newspaper from July 6, 2004 (in OMELANIUK 2005) brings information that there were 20.2 million outbound Chinese tourists in 2003 (compare with OMELANIUK 2005). According to the article the passports are available on demand and citizens can join freely outbound tourism groups.

⁷⁷ Remittance statistics for some regions (in particular in Africa and Asia), or group of states (especially in several countries recovering from conflict, even if they are known as heavily depended on remittances from abroad, e.g. Somalia and Afghanistan), are affected by the fact that many countries have incomplete statistics (for details see WORLD BANK 2007, compare with CARLING (2005)).

Another migration flows originate from coastal region where is a tradition of emigration, mainly in Fujian Province (for more details see LIANG, ZHANG 2004) and Zhejiang Province, many Chinese immigrate to Europe through family reunification (see for example PIEKE 2002). OMELANIUK (2005) indicates well-established familial and other networks in the countries of destination; education opportunities for children abroad; relative ease of exit from China nowadays; global business opportunities; and for many the quick, easy services provided by smuggling agencies as the main push/pull factors of present international migration outside the China.

The study of SIWEK et al. (2006) identified prime causes of international migration from China:

- Complex of economic reasons (increasing of unemployment,) with combination to poverty
- Better education opportunities (study abroad)
- Environmental degradation and displacement (land degradation, natural sources scarcity, river dams construction, urbanization)
- Social and political conditions for living (e.g. absence of political freedom and religious liberty; absence of democratic institutions; ethnic minorities policy)

ZHANG (2003) pays attention to skilled migration of technical persons, academics and professionals with higher education using the famous term 'brain drain'. According to him some 300,000 skilled migrants leave China after they have completed their higher education which is serious risk for China's economy, social, technological, and cultural development (ZHANG 2003). On the contrary OMELANIUK (2005) claims that current economic growth and greater education opportunities in China may slow this down. In the context the report of UNITED NATIONS (2006) designate China as well as India, the Philippines and the Republic of Korea among developing countries, that are main sources of the largest numbers of highly educated migrants to OECD countries. However, the data available cannot distinguish between migrants who had been educated in the countries of origin and those educated at destination.

The study of LIANG and MOROOKA (2004) several new emigration trends in China. First of them is finding that Fujian and Yunnan provinces were most important Chinese emigrants regions in the 1990s and 2000. Guangdong (Canton) province no longer plays a major role in the migration processes. The second finding deals with the change in migrant selectivity for emigrants from Fujian province. Today's emigrants from the province are much more likely to come from rural areas and with only a junior high or elementary school education.

Further, China is one of the greatest global recipient of remittances as well as India (see Table 4-6), however XIANG (2003) claim that with Chinese integration into world's economy, remittances and investments from older migrants generation became less important and, by contrast, international exchanges in the high-technology sectors and the expansion of Chinese firms' international markets became a new priority.

DE HAAN (1999) points out that most migrants - and much migration is by single persons - maintain close links with their areas of origin and the literature on circular migration shows that a range of factors are responsible for this pattern, including perception of migration as the part of a 'diversification' strategy, patterns of landholding, land rights, and patterns of demand for labour in the rural society are equally important. In the context ROBERTS (1997) describes general and specific arguments for circular migration and diversification strategy of rural Chinese households. Among some general reasons, common for many countries, rank spatial and occupational diversification, security for times of unemployment, sickness and old age, and the institution of community-owned land which one will lose if not farmed. However, in China there are five additional specific factors that intensify the relation between Chinese living in rural areas and their land:

- The right of resettlement in the village is lost by permanent outmigration (Siu 1993 in ROBERTS 1997).
- Land allocations have been readjusted with some frequency in the past, and peasants are afraid they will forfeit their land in the next reallocation of land rights (in Judd 1992 in ROBERTS 1997).
- Peasants fear there could be a major change of internal government/regional political praxis which is relatively tolerance to land tenure, off-farm employment opportunities, or migration. The land is understand as their "route of retreat" (Li 1991; in ROBERTS 1997).
- Peasants are more risk-averse with regard to basic food security and experience with famine is relatively recent. Consequently most Chinese peasants never abandon basic food production on at least a small plot of land (Odgaard 1992 in ROBERTS 1997).
- Labor requirements in Chinese agriculture are highly seasonal and, there is still little mechanization. A survey of 4,000 households in 8 provinces found that even inter-provincial migrants returned to work an average of 37 days on their own farms each year (Song 1996 in ROBERTS 1997).

Oi (1989 in ROBERTS 1997) literally quotes, that "those who can work in factories do; the others, often women and the older members of the family, work the entire family's fields". This reality also determines the preferences in sex of children in the country.

Conclusion

New globalized technologies enable the rapid transfer of humans, capital, goods, services, information and ideas from one region to another. Growing interdependence between countries, coupled with widening inequalities, will probably lead to the further intensification of international migration. For all that migrants share on world population going not to change too much and some increase it is possible in a absolute figures only.

The contemporary world is characteristic by large social and economic disparities between particular regions and countries, linked to the high level of poverty in the least developed of them. The development efforts to reduce the inequalities and combat the poverty stand high on the international political agenda for a last two decades, at least. Because of controversial efficiency of any development tools, as the official development assistance, the study of positive impacts of remittances and international migration generally are observed with increasing consideration (and some expectation relates with political consequences on the international level).

Relatively new surveyed international migration phenomena and trends press on scientists, another interested scholars, and decision-making people take into consideration that migration is integral part of many nations, their history and culture (e.g. various forms of circular migration, sending remittances, etc.) together with new processes (e.g. increasing women migration and its impact on social stability within family and society in developing countries). Managing international migration more effectively has become a top policy priority for most developed and developing countries even if some authors are sceptical about opportunities to manage human migration flows. Also migration and development policies need to become more coherent and do not contradict each other.

Migration and development issue is closely connected but the conclusions about the role of migration in development differ hugely and recent papers and studies show the polarization in the debate. On the one hand there are expectations that international labour migration can reduce economic and social inequality in some regions and reconcile development tendencies, on the other hand there are fears of brain drain processes and emigration of skilled workers which can cause reverse trends. In the context is very interesting briefly mentioned phenomenon of circular migration connecting positive benefits of international migration without brain drain consequences for sending societies.

However for full and complete accounting of the impact of international remittances on development/poverty in the developing regions needs more accurate data on the

large level of unofficial remittances returning to developing countries (ADAMS, PAGE 2005). Also monitoring and evaluation of another migration aspects, as the for instance circular migration is impossible without the availability of reliable data and information (AGUNIAS, NEWLAND 2007).

It is widely recognized that migration, may generate important gains not only for migrants but also for host and sending countries. Developing countries in particular may have a lot to gain in terms of growth, investment, human capital accumulation and poverty reduction if they manage to restructure effectively their economies following emigration and diffuse these benefits throughout the economy (KATSELI et al. 2006). In respect the facts, some authors appeal for policies that accept the wider mobility of the population (SKELDON 1997), which could be migration “plan B” for the Millennium Development Goals’ fulfilment (PRITCHETT 2003) in the case very presumable not achieving the principal goals and tasks in 2015. In the context of researched both countries, the great signification of the remittances for the economies underlines the fact, that during 2003, Western Union company opened 9000 new agent locations in China and India alone (CARLING 2005).

At this approach circular migration phenomenon can represent possible positive way how can we use international migration flows for development improvement of economic poor countries, even if the impact of such circular migration on the development of countries of origin is complex. Scholar studies are just beginning to accumulate the information and data and mixed results from these studies, although still few and mostly preliminary in nature, suggest the promise as well as the perils of circular migration (AGUNIAS, NEWLAND 2007). The present knowledge of particular research works dealing with the issue in China and India shows positive as well as negative results. For instance, China recently has experienced a significant rise of returnees with advanced technical knowledge since 1999. A survey in 2002 of 154 returnees and locals in high-tech zones in six Chinese cities found that 48 per cent returnees in the private sector brought back foreign technology as compared to only 21 per cent of locals (AGUNIAS 2006). Further, about 30-40 per cent of higher level employees in Indian software firms had relevant work experience in a developed country (COMMANDER et al. 2004). However, there is an example of study of Kerala, South-West India (NAIR 1999), found that returned migrants are, in general, middle-aged persons with low-levels of education, skills, and experience. And not surprisingly, half of them were found to be unemployed upon return (NAIR 1999). Even if, this conclusion does not have to be just unambiguous¹, it is true that circular migration is not any ‘heal-all’ on long-term and complex development challenges.

CHAPTER FIVE

DEVELOPMENT MODELS OF CHINA AND INDIA

The long-term unprecedented economic growth of China and India has become one of the most fascinating topics in the contemporary world. This is naturally caused by the fact that almost 40 % of the world population live just in these two countries. Thus, a high economic growth of either China or India must necessarily change global economic, political, and environmental balance. So where is the secret of the recent China's economic growth? What are the consequences? In which aspects does the economic growth of India differ from that of China? These are some questions with which this chapter deals.

Economic Reforms in China - the Historical Perspective

The China's economic policy during the *Mao Zedong* era was directed towards the fulfilment of three major goals - to become economically independent, to catch-up the Western world with respect to per capita income and living standards, and to achieve a high level of egalitarianism (CHAI, ROY 2006). Note that the first goal was conditioned by a practically absolute isolation of China from the rest of the world, with a weak relationship even with the socialist bloc led by the USSR (ZHANG 2003). The so called *Feldman Development Paradigm* was chosen as the strategy how to meet the goals. The idea of the paradigm is rather simple, with a decisive role ascribed to heavy industries. Easy said, the machines produced in privileged heavy industries produce other machines for light industries and through higher wages an increasing consumption is stimulated. The additional link between heavy and light industries creates the main advantage of the strategy. Note that over 50 % of investments in China were directed to heavy industries in 1952-1978 (CHAI, ROY 2006).

The application of the Feldman Development Paradigm in China had some specifics when compared with other socialist countries. Traditionally, the agricultural sector is squeezed to draw funds for industrialization. However, there were important limitations to employ such a strategy in China because of its large rural population and the overall inefficiency of its agricultural production. During the so called *Great Leap Forward* (1958-61), *Mao Zedong* tried to stimulate the inefficient agricultural production through two measures. First, the so called peoples' communes were

established to mobilize the surplus labour-force for both, agricultural production and large investment projects (e.g. irrigation). Second, rural-based industrialization was expected to provide the tools, which were necessary for an increasing efficiency of the agricultural sector. However, the reality turned out to be one big disaster. An extremely low quality of products and a decreasing efficiency of labour-force in the commune system led to a drop in grain production. When combined with the bad climatic conditions and the halt of the Soviet assistance, China was hit by a famine in 1961 resulting in the loss of millions lives. Consequently, the weak position of the agricultural sector in the Chinese economy was partially strengthened (e.g. through increased procurement prices of grain) but its position remained inferior. Another specific feature of the Chinese industrialization was also connected with the large surplus of rural labour-force. Because heavy industries created only a limited number of new jobs it was necessary to prevent a large scale rural-urban migration through specific measures. Finally, the egalitarian goal was supported e.g. by an enterprise-based social system or by a forced displacement of educated people to rural areas (CHAI, ROY 2006).

Overall, the full employment and existence of social benefits belonged to the assets of the Maoist system, which, however, appeared to be inefficient from the economic point of view. An overproduction of some types of goods and an insufficient production of others (especially agricultural and consumer goods), a generally low labour productivity and a poor quality of production, and the Mao's controversial socioeconomic experiments led to a severe economic stagnation of China at the end of the 1970s. Simultaneously, a public dissatisfaction with the Mao's ideology was widespread. Thus, the Mao's death in 1976 created opportunities to change further development paths of communist China. *Deng Xiaoping*, the new political leader of the Chinese Communist Party (the CCP hereafter), tackled the opportunity, criticizing the Mao's too ideological policy and calling for the need to implement market forces into the Chinese economy as the triggers of its economic performance. The *Deng's* efforts succeeded and in 1979 the first phase of economic transformation process was launched. The following almost thirty years of reforms showed a gradual implementation of the strategy in practice (*crossing the river while groping for stones*).

“*Deng Xiaoping* is rightfully called the main inspirer and initiator of market reforms in China. (...) His main merits lay in his unusually clear strategic thinking. He, like no other government figure of our time, was capable of decisively breaking with outdated dogma and advancing and asserting promising new ideas. These ideas, along with *Deng's* spirit of perpetual innovation, make up a great legacy of which the Chinese people can rightly be proud.” (BERGER 2005)

The first phase of China's economic reforms (1978-1983) was focused on rural areas with the goal to foster agricultural production. To achieve the goal, the state

purchasing prices were substantially increased and simultaneously a price premium for production over the contracted quotas was offered. Thus, a potential for trade emerged. Moreover, a new social organisation in rural areas was established. The traditional *commune system* (see Box 5-1) was dissolved and replaced by a new system based on the household responsibility for production. In this regard, land remained a collective property especially of villages but the use-right was contracted to peasants initially for 15 years, after 1993 for 30 years. Thus, farmers regained a certain degree of independence in their decision making process, including the choice of crops or a management system (ZHANG et al. 2006). These steps contributed to a substantial increase in both, the efficiency and the total volume of agricultural production, with grain production rising over 20 percent between 1979 and 1984 (SECKINGTON 2002, ZHANG et al. 2006). However, several new problems related to the dissolution of the peoples' communes (maintenance of rural infrastructure, a demise of the rural social system), emerged that, together with the shift of emphasize towards urban areas and industrialization, led to the halt of the agrarian boom in the mid-1980s and to increasing disparities between urban and rural areas.

Due to the increasing efficiency, a lot of peasants became abundant in the agricultural sector. At the same time, peasants were allowed to engage in other economic activities and a lot of small service and manufacture facilities emerged, absorbing millions of peasants (MACKENZIE 2002). In this regard, the so called *township and village enterprises* (further TVEs), characteristic by the cooperative or communal ownership and by a private-style organisation, represented one of the most dynamic sectors in the Chinese economy, especially in the 1980s and early 1990s (WANG 2005). Their growth was conditioned by the need to increase self-sufficiency of local economies after fiscal decentralization and by the aspiration of local cadres to reinforce their political position. Thus, TVEs created not only new employment opportunities with increasing rural incomes, but in some cases, they became the most important tax source for local budgets. In this respect, the success of TVEs enabled to reduce the fiscal burden imposed on peasants and so increase social stability in the country. However, since the late 1990s, the position of TVEs has been eroding, especially because of an increasing competition from more effective private enterprises and a decreasing willingness of banks to finance ineffective TVEs (WANG 2005).

Box 5-1: The peoples' communes

In the 1950s, the Chinese agricultural production experienced an important organisational shift away from the traditional landlord system, which allowed peasants to use land for their production but rents were transferred to landlords. However since the 1950s, this system was

gradually replaced, first by the so called mutual aid groups and later by the elementary agricultural producers' cooperatives. These both consisted of only few households, which cooperated with the aim to increase their efficiency. Note that the decision-making process of particular households was independent and everybody could leave the cooperatives. However, in the late 1950s, the so called advanced agricultural producers' cooperatives - peoples' communes were introduced as the highest collective form of organising peasants in rural China. The peoples' communes were substantially larger than the preceding organisational forms, the largest ones with almost 100.000 members. They represented an important political and administrative force in rural China, providing the basic services such as health care, education and welfare. However, the independent decision-making process of peasants was suppressed. An output of production was distributed administratively with no respect to the performance of individuals. Similarly, peasants were practically not allowed to leave the peoples' communes under the *hukou* registration system. These led to a slump in agricultural production and famines in many parts of China. Corruption became widespread. In the late 1970s, the system of the peoples' communes was definitively abandoned and the household responsibility system emerged. The political and administrative tasks, formerly realized by the peoples' communes, were transferred to the newly established township and village governments.

Source: SECKINGTON (2002), HART-LANDSBERG, BURKETT (2004), ZHANG et al. (2006)

In the first phase, economic reforms in urban areas were initiated as well. In selected state owned enterprises (SOE), a certain degree of freedom to fire and hire employees and the possibility to keep a part of profit for investments were granted to the management. Simultaneously, restrictions on private enterprises were gradually relaxed. Since the onset of reforms, the Chinese government has given a high priority to foreign direct investments (FDI hereafter) - a source of know-how, new technologies and capital. Thus, the *Open Door Policy* (see Box 5-2) was launched in 1979, designating four *Special Economic Zones* (SEZ hereafter) with advantageous conditions offered to the potential foreign investors (HART-LANDSBERG, BURKETT 2004). However, the initial phase of urban reforms met several problems as well. Prices substantially rose because of the efforts to transfer sales into the unregulated market and because of an increasing demand. Simultaneously, wages of state employees were increased with negative impacts on the indebtedness of the country. Finally, unemployment emerged as a new social problem. Therefore, the Chinese leaders decided to temporary halt the reform process in urban areas in 1981 (SECKINGTON 2002).

Box 5-2: Open Door Policy, foreign direct investments and special economic zones

China naturally represents an attractive destination for foreign investments. Its large domestic market, cheap labour-force, and political stability belong to the most important magnets in this regard (NOVOSELOVA 2005). However, during the Mao's era China was closed to the FDI inflow and the first step changing this situation came only in 1978 when the new Law on Chinese-Foreign Joint

Ventures was passed. This Law enabled to establish a joint firm by a foreign and a Chinese partner wherever in China. However, the establishment had to be enacted by the Chinese government, a step which should have contributed to the attraction of foreign investors into these sectors where Chinese firms were not able to cover the domestic demand, to the diffusion of new technologies into the Chinese economy, and to an increasing export. Nevertheless, foreign investors did not reveal an interest to invest in China. Thus in 1979, the Law on SEZs was passed, creating preferential conditions for foreign investors (e.g. tax breaks, generally low taxes, a better access to capital and others) in several designated areas. This strategy succeeded and the FDI stock in China began to rise, even though not spectacularly. To foster the FDI inflow, the requirement on the joint venture was eased in 1986 and further SEZs were opened, contributing to a substantial FDI growth. Moreover, the opportunity to found a wholly foreign-owned firm was conditioned by its export-orientation or technological-advancement, a clear sign of China's effort to improve the quality of its inward FDI. Finally in 1991, the third milestone of the China's FDI policy extended the advantages for foreign investors practically across the whole country. Consequently, the China's FDI stock skyrocketed and China became the largest FDI recipient among developing countries. Its accession to the WTO played a positive role in this way as well.

China gained a lot of positives from the FDI inflow, especially new jobs and foreign capital and after the initial disillusion the quality of the FDI inflow has been increasing (GRAHAM 2004). More recently, 450 of the world's 500 biggest transnational companies invested in China and over 30 of them have chosen China as a venue for their regional headquarters (NOVOSELOVA 2005). It is noteworthy, that the combined share of the Asian newly industrialized countries (Hong Kong, South Korea, Singapore, and Taiwan) as source countries of FDI in China was almost 50 % in 2005. Furthermore, the tax havens (the Virgin Islands, the Cayman Islands, Samoa, and Mauritius) provided more than 20 % of FDI in China in 2005. This is a bit undesirable finding for the Chinese government because a lot of these investments were provided by Hong Kong's firms, reducing China's tax revenues.

Table 5-1: FDI inflows to China (selected years)

Year	1985	1990	1995	2000	2002	2004	2005
FDI inflow (billion USD)	1.7	3.5	35.8	40.8	52.4	60.6	60.3

Source: GRAHAM (2004), China Statistical Yearbook 2006 for the years 2004 and 2005

Coastal China with its relatively more developed infrastructure and qualified labour-force was the first region where SEZs were located. Thus, the first three SEZs were opened in the province of *Guangdong* (the cities of *Shantou*, *Shenzhen* and *Zhuhai*) and the fourth one in the province of *Fujian* (the city of *Xiamen*). Moreover, 14 coastal cities were designated as the so called *Economic and Technical Development Zones*, providing practically the same incentives to foreign investors as SEZs. However, it is necessary to stress that over 100 other SEZ-like zones existed China, which provided incentives with permission of a regional but not of the central government. In this regard, the aforementioned third milestone of the China's FDI policy legitimized the status of these "SEZs" (GRAHAM 2004). Note that the *Shenzhen SEZ* (high-tech industries now), the *Guangzhou Development District* (the key location for transnational corporations in the province of Guangdong), the *Pudong New Area in Shanghai* built on marshlands in 1990, the *Tianjin Economic and Technological Development Area*, *Dalian Development Area* (the key location for transnational corporations in the North-East China), and the *Beijing Economic-Technological Development Area* are regarded as the best SEZs in China. Coastal China is also the main location of FDI in China.

Besides SEZs, other factors such as transportation costs or educated workforce play an important role. Thus, more than 75 % of FDI flowed into Coastal China in 2004, with the provinces of *Jiangsu* (20 %), *Guangdong* (15 %), *Shandong* (11 %), and *Shanghai* (10 %) ahead. On the contrary, the share of the Western provinces in the total FDI inflows was only 3.2 % in 2004. It was even more alarming that despite the efforts of the China's government to attract FDI into the Western provinces the share dropped from 5.5 % in 2004 (NOVOSELOVA 2005).

Source: GRAHAM (2004), NOVOSELOVA (2005)

During the next three years, a comprehensive debate on the economic problems followed. The debate concluded that the high inflation and unemployment were the consequences of a restricted nature of reforms and it was recommended to extend independence of SOEs and to stimulate private, especially foreign investments. Thus, the second phase of reforms (1984-1991) was focused on the acceleration of reforms in urban areas. The most important tools included (HART-LANDSBERG, BURKETT 2004):

- Prices of agricultural and consumer goods were newly determined by market forces. Only prices of the main industrial commodities were set directly by the central government.
- The relationship between the central government and SOEs was redefined. Instead of subsidies, SOEs were newly financed by their profit after taxation and bank loans.
- Management of SOEs gained an extended power to fire and hire workers on the contractual basis. However, the long-term employees kept their social benefits.
- The financial independence of local and provincial governments was strengthened. A province was allowed to keep the surplus value from the economic activities realized in its territory and the same principle was applied with respect to the relationship between regional and local governments.
- Another SEZs or SEZ-like zones were designated and the China's FDI policy was gradually liberalized.

The second phase of economic reforms contributed to the spectacular economic growth of China with an increasing quality of life for many people. However, the problems of a high inflation and budget deficit reappeared in 1988 (BERGER 2004a) and the Chinese government decided to decrease the amount of money in its economy through restrictions on bank loans. The following economic recession seriously hit especially rural areas where the TVEs' activities were highly dependant just on bank loans. Consequently, the political debate on the nature of economic reforms was sparked once again, with the conservative wing of the CCP calling

for a return to the pure centrally planned system in accord with the best socialist principles.⁷⁸ In fact, the conservative voice remained unheard and the third phase of economic reforms was triggered in 1992 (SECKINGTON 2002). BERGER (2005) stresses the importance of the *Deng's* legendary southern trip (tour) in 1992 where he introduced his reform ideas to the representatives of provinces and cities. Consecutively, the main *Deng's* ideas became the core of the CCP policy in the 8th five-year period (BERGER 2005):

- To grasp all developmental opportunities
- To reform all institutions, not able to adjust to the speed of development
- To support all tools, which may strengthen Chinese productive forces (e.g. modernization)
- To reinforce the role of SEZs in the Chinese economy, regardless the rhetoric of their opponents
- To support a faster development of selected regions with a spatial diffusion of positives later
- To fight against corruption and crime

Privatization of SOEs and TVEs, instead of their revitalization, became the most important innovative feature of the third phase of economic reforms.⁷⁹ Thus, creation of the *socialist market economy* instead of the market socialism became the fundamental goal of the third reform period. Note that the neoclassical rhetoric, stressing a higher efficiency of private firms than SOEs, was widely applied to explain this step. Moreover, privatization enabled to solve the debt problems of the central government through abandonment of its social commitments to SOEs and through privatization revenues. Only key industries⁸⁰ and the largest SOEs were excluded from the privatization process (HART-LANDSBERG, BURKETT 2004) but an extensive privatization and the only 11 % share of the total number of enterprises, the state sector continues to play a key role in the Chinese economy with the 45 % share of profits and 57 % share of taxes collected in the country in 2005 (BERGER

⁷⁸ Differences between the conservatives and the reformists may be illustrated also in the interpretation of two important political events of this time – the collapse of the Soviet bloc and the demonstration on the *Tiananmen Square*. The conservatives stressed the need to halt reforms as a prevention of the Soviet-like events in China and explained the *Tiananmen* demonstrations as a disillusion from reforms. On the contrary, the reformists regarded reforms as a prevention of the Soviet-like events in accord with the wishes of Chinese people as expressed by their demonstration on the *Tiananmen* square.

⁷⁹ FANG, MEIYAN (2004) give a drop from 78.3 % to 28.9 % share of the state sector in the total urban employment during the period 1978-2002.

⁸⁰ Military and airspace, oil production and refining, coal and metallurgy, communications, power generation, transport, finance and some other industries

2006a). During the third phase of reforms, China further reinforced its emphasis on international trade and foreign investors as witnessed by its entry into the *World Trade Organization* (the WTO) in 2001 (see Box 5-3). Consequently, China moved between the top-three countries in the total volume of foreign trade, became the world-leading country according to the hard currency reserves and overtook the United States with respect to the FDI inflow (GARNAUT 2005, BERGER 2006b). Moreover, GARNAUT (2005) points to the potential of China to become the world-leading exporter in five years.

Economic reforms brought a lot of positives for China, which BERGER (2006a) summarizes in the tenth five-year period (2001-2005) as follows:

- High economic growth figures around 9,5 % per year
- Increasing total foreign trade and total FDI figures
- Construction of new infrastructure (dams, transport and power generating facilities)
- Millions of new jobs created in urban areas resulting in a decreasing poverty

However, the spectacular economic growth of China was connected not only with successes. On the contrary, some issues began to be perceived as serious problems, potentially endangering the fragile internal social integrity, already by the third generation of political leaders. Thus, calls for a change of the Chinese development model in the direction of a higher complexity emerged (BERGER 2004b). In the tenth five-year plan, China failed to fulfil especially the following objectives (BERGER 2006a):

- To increase the share of consumption and services in the China's GDP structure
- To decrease energy consumption per unit of GDP
- To increase the total area of croplands
- To improve environmental situation (especially to reduce air and water pollution)

Box 5-3: China and the WTO

After 15 years of negotiations, China formally joined the WTO in 2001. According to DECKERS (2004), this step represents a strategic decision to definitively cope with the pre-reform heritage. However, the entry into the WTO means also the China's commitment to gradually dismantle both tariff⁸¹ and non-tariff barriers of free trade. Furthermore, China commits itself to give foreign firms

⁸¹ The China's WTO commitments included e.g. the decrease of agricultural tariffs from 31 % to 14 % in average by 2004 and of manufacturing products from 24.6 % to 9.4 % by 2005 (WANG 2000).

a wider access to its domestic market and to follow the transparent, non-discriminatory rule of law in accord with the WTO rules on all levels of government⁸² (FARAH 2006). The consequences from the WTO entry for China may be summarized as follows:

Potential benefits:

- Creation of clear rules of international trade and FDI resulting in a higher international credibility of China
- An increasing domestic demand on imported goods
- Bankruptcy of ineffective enterprises in the increasing domestic and global competition (a desirable economic restructuring)

Potential losses:

- An increasing competition for local firms and ineffective state-owned-enterprises resulting in the threads of unemployment and social instability
- The necessity to accept the WTO rules with no respect to the China's internal attitudes, resulting in a decreasing possibility of the central government to influence its economy
- An increasing dependence on technology transfers and foreign TNCs

Barriers of the WTO rules implementation:

- An inferior role of law (arbitrary interpretation and application of law) – violation of intellectual rights, low quality of production, corruption
 - Interests of provincial and local governments not in accord with the WTO norms and requirements⁸³
 - Different interests of particular departments and central agencies⁸⁴
 - A lack of support from the most affected social groups (farmers, laid-off SOE workers)
-

Source: KIM (2002), DECKERS (2004), WANG (2000), FARAH (2006)

Based on this assessment, the current premier *Wen Jiabao* named an irrational economic structure, a shortage of domestic innovations, a slow replacement of the economic growth model, a wasteful management of resources and growing environmental pollution as the greatest challenges of contemporary China. Unemployment, increasing spatial disparities, an increasing social differentiation and an underperformance of social services were denoted as other serious problems (BERGER 2006a) and GARNAUT (2005) adds inefficient state-owned businesses and an unwillingness of international partners to adjust to the rapidly increasing

⁸² The WTO requirements include e.g. the publishing of a journal with a newly enacted legislation in China or the creation of a contact point providing all information on the legislation of China related to trade.

⁸³ The implementation of the WTO norms may substantially undermine the power of provincial and municipal leaders.

⁸⁴ For example the unwillingness of the Ministry of Agriculture to open its sector

export from China. Overall, the problems threaten sustainability of the Chinese economic growth, creating the need to search an alternative economic growth model, focused more on qualitative than quantitative aspects of development (BERGER 2004b). According to BERGER (2006b), the implementation of these aspects will be difficult because of the social costs of painful reforms and different interests of central and regional/local governments. On the contrary, KIM (2002) claims that the WTO entry may serve as an important external trigger (*rapid waters should wash away dirty sands*) in this regard (see Table 5-2). Similarly, GARNAUT (2005) is rather optimistic claiming that political leaders of China are aware of the problems and that they have practically unlimited opportunities to choose a suitable solution. GARNAUT (2005) concludes that China will catch up the total economic size of the United States within one generation.

Table 5-2: Characteristics of the Chinese economic system before and after the WTO entry (expectation)

	Before 1979	1979-2000	After the WTO entry
Features of economic systems	Political logic prevailed Command economy	Introduction of market principles Bureaucratic market economy (corruption)	Economic logic prevails Preliminary market economy
Relationship between market and planning	Planning as the principal driving force Fraction of market at the fringe of planning	After 1992 market as the principal driving force Planning as a supportive tool	Concept of a fair competition introduced
Central-local relationship	A vertical relationship (budget allocation)	Coexistence of a vertical and horizontal relationship	Horizontal economic management, decentralization
Relationship between the party and the law	An absolute superiority of the party	Superiority of the party, introduction of economic laws	Party's leadership, rule of law under enforcement

Source: Adapted according to KIM (2002)

Economic Reforms in China - Selected Consequences

The long-term economic growth of China was caused by several driving forces. YING (2003) highlights especially the transfer of resources from agriculture to the sectors with a higher added value (see Table 5-3) in this regard. WU (1998) adds other factors such as the increasing economic efficiency, inflow of foreign direct

investment, and trade surplus. All these driving forces have been closely related to the reform period, which naturally had also other consequences. Some of them are sketched out in this subchapter.

Table 5-3: Economic indicators of China (selected years)

Year	1978	1989	1997	2003	2005
GDP (billion Yuan)*	365	1,699	7,897	13,582	18,308
GDP per capita (Yuan/person)*	381	1,519	6,420	10,542	14,040
Primary sector (share in GDP)	27.9 %	24.9 %	18.1 %	12.6 %	12.6 %
<i>Primary sector (share in employment)</i>	<i>70.5 %</i>	<i>60.1 %</i>	<i>49.9 %</i>	<i>49.1 %</i>	<i>44.8 %</i>
Secondary sector (share in GDP)	47.9 %	42.8 %	47.5 %	46.0 %	47.5 %
<i>Secondary sector (share in employment)</i>	<i>17.3 %</i>	<i>21.6 %</i>	<i>23.7 %</i>	<i>21.6 %</i>	<i>23.8 %</i>
Tertiary sector (share in GDP)	24.2 %	32.3 %	34.4 %	41.5 %	39.9 %
<i>Tertiary sector (share in employment)</i>	<i>12.2 %</i>	<i>18.3 %</i>	<i>26.4 %</i>	<i>29.3 %</i>	<i>31.4 %</i>
Total exports (billion USD)	9.8	52.5	182.8	438.2	762.0
Total imports (billion USD)	10.9	59.1	142.4	412.8	660.0

* At current prices

Source: China Statistical Yearbook (2006)

Increasing Socioeconomic and Spatial Disparities

In 1978, China was a country with a very low level of socio-economic disparities (WANG 2000). However, the situation changed rapidly during the reform period and nowadays, the level of socio-economic polarization in China is comparable with the situation in the United States. Thus, it is rather undisputable that economic reforms contributed to this change because the transition to global market economy enabled the creation of a new middle class represented especially by private entrepreneurs, white-collar employees in foreign companies, media stars, and scientists. Moreover, labour markets became highly uncertain when new relations between employers and employees based on flexibility emerged (FANG, MEIYAN 2004). Economic reforms also weakened the traditional social security system (see Box 5-4) with negative impacts on poor people. Thus, WANG (2000) claims that private business owners, artists, corrupted officials and FDI employees are perceived as the main winners and SOE workers, farmers and unemployed people⁸⁵ as the main losers

⁸⁵ In China, unemployment is estimated at around 4 % according to the official statistics. However, this number is much higher around 10 % unofficially (e.g. HART-LANDSBERG, BURKETT 2004, FANG, NEIYAN 2004, or XUE, WEI 2003). The difference is given by a specific definition of the term unemployment with respect to e.g. laid off employees of SOEs, retiring age, or rural underemployment (XUE, WEI 2003, HUANG 2003).

of the reform period. The Gini coefficient figures document an increasing income polarisation of China, with 28.8 in 1981, 38.8 in 1995 (YAO 1999) and even 46.9 according to the most recent UNDP data.

Box 5-4: The social security system in China

The Maoist social security system was primarily based on the ideas of full employment and social services provided by work units (so called *danwei*) in urban areas and by the communes in rural areas. *Danwei* organized residents according to their workplace, offered a life-long employment and basic social security (*iron rice bowl*) and the larger ones also housing, health care, education, and other welfare services. Note that the neighbourhood committees provided social services for unemployed. The social security system of rural areas was far modest.

Economic reforms have substantially weakened the traditional social security system because of the eroding effectiveness of *danwei* provided by SOEs and because of the dissolution of the communes. The public sector has become the most important provider of social services because but a large burden of social security was transferred directly to citizens, especially in rural areas (DUCKETT 2003). Contemporary, China tries to improve its social security system, as may be illustrated by recent changes in the health care system. By 2010, China plans to extend its urban health care system to include children, students, and unemployed people as the last remaining groups uncovered by a medical insurance. There are also efforts to reinforce the health care system of rural areas where only 330 million inhabitants were covered by a medical insurance at the beginning of the 21st century (DUCKETT 2003). The pension system represents another problematic area of contemporary China. In rural areas, such a system is virtually missing and the urban pension system is strongly underfinanced (WALDMAN 2005).⁸⁶

Source: DUCKETT (2003), WALDMAN (2005)

The increasing socio-economic inequalities of China have two important spatial dimensions. Despite a high expectation and some improvements in the initial phase of reforms, the development of rural areas lagged far behind cities. Whereas cities in China gained a lot of Western features, the life in rural areas has remained trapped in clans, barter economy, and poverty (BERGER 2004b). This fact naturally results in a lower average income in rural than urban areas and in relatively high rural-urban disparities compared with other countries (ZHANG 2003). Similarly, YAO (1999)

⁸⁶ These problems are expected to become even more serious because of the ageing population of China. Note that China belongs to the countries which were able to substantially reduce their population growth. This was caused by two traditional factors. Economic development of the country was complemented by the China's *One Child Policy* which posed harsh sanctions on women and children, born illegally over the allowed number. XIAOKANG (1996) describes several cases when pregnant women were forced to leave their homes and hide in wild or in illegal villages near large cities to escape the abortion. Moreover, illegally born children lost their human rights with similar impacts on their place of living.

denotes poverty in China as a typical rural feature though the level of poverty fell impressively after 1978⁸⁷. Nevertheless, lay offs from SOEs, the unwillingness of private firms to finance social security of their employees, and a gradual removal of the traditional *hukou* system (see Box 5-5) strengthened the problem of poverty also in urban China (XUE, WEI 2003).

Box 5-5: *Hukou, floating population and shanty-town communities*

Hukou represents a powerful system of a household registration, which bound Chinese people to their places of birth and restricted their opportunities to move. MACKENZIE (2002) denotes *hukou* as the broadest experiment of a population control in the human history. Initially, *hukou* was formulated in the mid-1950s with the aim to create a rural “industrial reserve army”. However, *hukou* went into the full effect only between 1961 and 1963, after the failure of the *Great Leap Forward* experiment, when a starvation in urban areas evoked the fears of mass rural emigration with a further deterioration of the adverse situation in cities (slumization). *Hukou*, issued in two versions as the agricultural for rural and non-agricultural for urban citizens, became a powerful tool, how to prevent rural-urban migration. Without the non-agricultural *hukou*, it was not possible to buy basic staples, to find a job or to have access to the amenities such as housing, education or medical services in urban China. But, except the recruitment for the state-initiated projects, it was not possible to acquire the non-agricultural *hukou*. Thus, the spontaneous migration was practically undermined by the *hukou* system.

Economic reforms changed the situation dramatically and new migrants without the local *hukou*, also known as the so called ***floating population***, emerged as a new typical feature of China. Note that the rural migrants living in cities are the most numerous group of the floating population (LIANG, MA 2004). What are the reasons of this change? A high number of new jobs in cities and the new opportunities to find a job or to buy a food in the free market belong to the most important pull factors of the increasing urban-rural migration. LIANG, MA (2004) estimate the total number of the floating population around 150 million people, with the Coastal provinces as the most important target destination. CHUNGUANG (2006) gives even a higher number of 200 million people and GUO, ZHANG (2004) mention the city of *Dongguan* where 5 million migrants outnumbered 1.5 million urban residents at the turn of the century.

The aforementioned changes substantially weakened the whole *hukou* system and induced an ease of several restrictions in this regard. Now, rural migrants may obtain the urban *hukou* in the city, where they have a stable source of income and a stable place of residence. However, this formulation is often interpreted in the way which excludes low-income migrants (LIANG, MA 2004). Therefore, the poor migrants without the local *hukou* have, unlike other citizens of the city, no access to free health care, education, and other social benefits. Nowadays, the Chinese central and provincial governments try to reform the *hukou* system and improve the position of rural migrants in cities. Nevertheless, their efforts founder at the interests of local governments and urban residents, unwilling to shoulder additional social costs of rural migrants and to abandon the lucrative business with *hukou*.

⁸⁶ QIAN, WONG (2000) point out that the number of people living in poverty dropped from 250 million people in 1978 to 58 million people in 1995 in rural areas of China.

Several studies (e.g. CHUNGUANG 2006, or GUO, ZHANG 2004) point to an inferior position of rural migrants in urban China (peasant workers). The demanding, dirty, and dangerous jobs are the most frequent type of employment, occupied by peasant workers. Moreover, this type of jobs tends to be temporary with no or only a short-term contract. Only a minimal wage without other social benefits is usually paid to peasant workers. Most rural migrants work for 9-15 hours per day, with only four days in month for a rest. Note that urban residents are not willing to make these jobs. The quality of housing is another area which makes the life of peasant workers harsh because the urban planning committees are not able to ensure a descent housing for all. Thus, many peasant workers live in relatively new shanty-town communities together with poor urban residents. Overcrowding, garbage on streets, missing access to sewage system and water supplies belong to the typical features of these communities. Furthermore, a lot of people live either in the buildings which were built illegally, thus facing a thread of demolition, or in the areas in inner cities which were chosen for demolitions in a short period. The peasant workers in SEZs usually live in better dormitories provided by their employers. However, their freedom tends to be restrained by many regulations, including the ban to abandon their place of employment during working days. Despite all the hardship the number of peasant workers tends to be increasing (LIANG, MA 2004). It is true that the position of peasant workers in cities is inferior but still better than in their villages.

Source: LIANG, MA (2004), MACKENZIE (2002), CHUNGUANG (2006), GUO, ZHANG (2004), HAGEL (2006)

Regional disparities represent the second dimension of the spatial inequality problem. In this respect, the main goal of the Maoist regional policy, to reduce disparities through a support given to the Central and Western provinces, was fulfilled with limited achievements and simultaneously this strategy did not contribute to the economic development of China (TAN 2002). Therefore, a new policy, based on the growth pole strategy, was chosen by the reform architects. Note that the China's growth poles are predominantly located in its coastal provinces, which have the best assumptions to absorb foreign investments and technologies and to participate in foreign trade. A time-space diffusion of positives into the interior provinces was expected only later (LIN, CHEN 2004). Thus, two fundamental changes related to the regional inequality problem may be observed during the reform period:

- A changing political importance of particular provinces with respect to the emphasis on the economic instead of military-strategic interests

Table 5-4: Selected economic indicators in particular regions of China (2000)

	Eastern region	Central region	Western region
Average income of urban population per capita	7,929 RMB	5,191 RMB	5,642 RMB
Average income of rural population per capita	3,200 RMB	2,071 RMB	1,691 RMB
Primary sector (share in total employment)	42.9 %	56.8 %	61.7 %
Secondary sector (share in total employment)	27.2 %	17.5 %	12.9 %
Tertiary sector (share in total employment)	30.0 %	25.8 %	25.4 %

Source: SHEN (2004)

- Increasing regional socio-economic disparities when the Central and especially Western region of China lag in both, static and dynamic figures of economic indicators nowadays (see Table 5-4)⁸⁸

LIN, CHEN (2004), YING (2003), YAO, ZHANG (2001), SHEN (2004) explain the economic underperformance of the Western region especially by the following three groups of factors:

- The development of the Western region is seriously affected by its rather inconvenient natural conditions with a high share of deserts in the total area, and with other environmental problems. Furthermore, the potential of resource endowment is unused because of extremely high transportation costs. However note that it would be not well-founded to expect a spatially even development of China (see Box 5-6).
- The Western region is characterized by a worse investment climate than the Eastern region because of its lower share of qualified people in the total population⁸⁹, its lower quality of infrastructure including SEZs, and its extremely high transportation costs. This fact naturally results in a lower inflow of investments.
- Actors in the Eastern region are better skilled in the negotiations with the central government, domestic and foreign investors. Thus, they are able to gain a larger autonomy from the central government and to attract investors. Moreover, the predatory behaviour of local governments is more widespread in the Western region. Note that a relatively higher dependence of the Western region on the ineffective SOEs plays its part as well.

Box 5-6: Growth poles in China

KENG (2006) claims that because of its various topographic assumptions an equal development of all parts of China is unlikely. On the contrary and in accord with the modern theoretical approaches, he supposes the emergence of ten metropolitan economies as the economic growth engines of China. Six of these regions are located in the Coastal and four remaining in the Inland region (see Table 5-5) and in aggregate they contain 65 % of China's population and 80 % of GDP.

⁸⁸ TIAN (2004) provides data on other indicators. Thus, economic activities in coastal region contributed to 57 % of China's GDP and 66 % of industrial output while only to 41 % of population and 14 % of land area at the turn of the century. The same figures for Western region were 18 %, 14 %, 28 % and 71 % respectively.

⁸⁹ There is also a large migration of educated people from the Western to the Coastal regions (TIAN 2004).

Table 5-5: Metropolitan economies – the growth engines of the Greater China

Coastal Region	Liaoning (Dalian, Shenyang)
	Capital (Beijing, Tianjin, Tangshan, Shijiazhuang)
	Shandong Peninsula (Jinan, Qindao)
	Greater Shanghai (Shanghai, Hangzhou, Suzhou, Ningbo)
	Taiwan-Fujian (Taipei, Kaoshiung, Xiamen, Fuzhou)
	Pearl River Delta (Hong Kong, Macao, Guangzhou, Shenzhen, Zuhai)
Inland Region	Jilin-Heilongjiang (Changchun, Harbin)
	Yangtze River Downstream (Nanjing, Yangzhou, Hefei)
	South Central (Wuhan, Changsha, Nanchang)
	Sichuan (Chongqing, Chengdu)

Note: The Greater China includes Hong Kong, Macao, Taiwan

Source: KENG (2006)

The increasing socio-economic polarization of China may represent a serious threat to the reform process through a social conflict between the “reform winners and losers”. ZHANG, ZHANG (2003) even speak about a threat to the territorial integrity of the country. The spatial concentration of ethnic minorities in the interior provinces reinforces the rationale of this thread. Furthermore, the whole problem is worsened by the more and more frequent complaints of the Western leaders on the uneven development of China, including an undervalued import of raw material from the Western to the Coastal provinces. Not surprisingly, the goal to reduce socio-economic disparities has been positioned high on the contemporary political agenda of China.

As a reaction, the ambitious *Western Development Strategy*, known also as the *Go West Program*, was formulated in 1999, though the origins of the strategy were dated back to the 8th Five-Year Plan when a number of large investment projects were launched, including the construction of the *Three Gorges Dam*, or coal mines in Inner Mongolia. However, a real comprehensive strategy was designed only in the *Western Development Strategy* for the 10th Five-Year Plan (2001-2005) with the major goal to stimulate the development of the Western region especially in five priority areas (TIAN 2004):

- Large infrastructure projects focused on the construction and development of airports, electric networks, pipelines, highways, railroads and other facilities
- Environment projects focused on the improvements in water supply and on the fight against desertification
- Economic restructuring focused on the development of tourism, environment-friendly agriculture, upgraded traditional activities (e.g. traditional Chinese medicine), and high-tech industries

- Science and education
- Attraction of foreign investors

However, the aforementioned disadvantages of the Western region seriously undermined the potential of the strategy. In addition, the decentralization process and a huge fiscal deficit have seriously weakened the central government ability to promote the Western development (WANG 2000, TIAN 2004).

International Relations of China

As already given above, China was an inward looking country during the Mao era. Economic reforms, which stressed the importance of international trade and foreign investments, naturally changed this situation dramatically. The *Peaceful Development* became the leitmotif of China's foreign policy already during the *Deng Xiao Ping's* leadership. The idea of this policy is simple. Development is expected to prevent internal conflicts and peace is a necessary assumption of development (BHATTACHARYA 2005). In this way, survival of the CCP at power should be ensured. Moreover, *Deng Xiao Ping* upheld the idea to *keep head down and never take the lead* (HARRIS 2005). Thus, China should have been aware of their strength to influence international relations. However, the recent economic rise of China may change this policy. So let us look at the relations between China and other world's regions a bit closer.

The United States is the long-term superpower number one in the international politics. Therefore, it is natural that the China's economic rise evokes the consideration whether China is able to threaten the U.S. hegemony. Nevertheless, because China is still not strong enough to challenge the U.S. position, the China-U.S. relations turn around a bit more modest topics. The "Taiwan question" belongs to the most sensitive issues in this regard. The so called *One China Policy* is the only possibility acceptable for China which is not willing to recognize Taiwanese independence. Therefore, a lot of tensions were caused by the rhetoric of the Taiwanese and U.S. representatives who questioned the unity of China and Taiwan. The same may be said about the U.S. military deliveries for Taiwan (ERICKSON, GOLDSTEIN 2006). Several economic topics represent other sensitive issues in the China-U.S. relations. China tries to ensure new markets, technologies, and resources and the United States may be a seductive target in this way. The question is what is acceptable for the United States. The Chinese state firm *The China National Overseas Oil Corporation* did not succeed to acquire the California based oil firm *UNOCAL* in 2005 because of a delicacy of this bid. Protection of intellectual rights and the U.S. trade deficit are other contentious economic issues between China

and the United States (HARDING et al. 2006). Contemporary, the trade with China makes one fourth of the U.S. trade deficit with a dynamically increasing trend (BOWN et al. 2005). This fact evokes complaints from the U.S. side, especially about the undervalued Yuan and loss of manufacturing jobs. Consequently, the potential of trade battles between China and the United States is rather high. Finally, China is often criticized for human rights abuses by the United States.

However, there are also issues where China may cooperate with the United States. ERICKSON, GOLDSTEIN (2006) stress the active involvement of China in the war against terrorism as one of the most significant examples of this kind. China played an important role in the persuasion of its long-term ally Pakistan to provide a support for the *Enduring Freedom* operation. There may be also common interests of both countries as oil importers (HARDING et al. 2006). Altogether, ERICKSON, GOLDSTEIN (2006) characterize the relations between China and the United States as a combination of diplomatic carrots and military sticks. HARDING et al. (2006) claim that China needs the United States as the main market for its export and the United States needs China to finance its consumption. The military stick is reflected in the increasing military budget of China and in the U.S. military support to Taiwan. Similarly, China tends to reinforce its influence in the organisations where the United States is not the member state (the ASEAN-China Free Trade Agreement, the Shanghai Cooperation Organisation) and the United States tries to keep or improve its relations with the traditional or potential rivals of China, such as Japan or India.⁹⁰

The relations between China and the European Union (EU hereafter) represent a bit different story. EU played an active role in the development of China as its major trade partner, important source of foreign investments and technologies, and supporter in diplomatic issues. Note that such a strategy was motivated by the EU efforts to the development of China in a desirable way with the goals (HOLSLAG 2006):

- To continue in market liberalization in accord with the WTO commitments of China
- To strengthen democracy (e.g. rule of law) and human rights (e.g. the Tibet issue, *Falun Gong*, religious freedom) in China

⁹⁰ The relations between China and Japan are historically very complicated. Thus, the Japanese textbooks, which incorrectly interpreted the Japan invasion during the Second World War, were able to spark sharp anti-Japanese protests in China. The same was caused by the Premier Koizumi's visits in the *Yasukuni Shrine* to celebrate Japan's war victims, including war criminals. Note that the non-diplomatic Koizumi's approach worsened not only the Japan's but also the U.S. position in Asia (BOJIANG 2006, HARRIS 2005).

- To abandon the China's policy of sovereignty and non-intervention with respect to non-democratic countries
- To reinforce the position of sustainable development principles in China

EU chose the so called soft-power approach based on the communication, search for common topics, cultural exchange programmes, and similar measures to fulfil its goals. Repressive economic tools were applied only rarely with the embargo on arm export as one exemption. HOLSLAG (2006) explains the choice of this approach by a rather weak EU position in international policy. Thus, China is not perceived as a political thread by EU. On the contrary, EU has much at stake with respect to the economic relations with China because it is much more dependant on export than the United States. However, the achievements of the EU policy towards China were rather limited. There was only little progress in democracy and human rights in China. China liberalized its economy but not according to the EU notions. China is now able to compete not only in low-skilled industries but research improves its position also in high-tech industries. This is a real thread for Europe. Finally, China still follows the business is business strategy with respect to developing countries.

The China's policy towards developing countries is motivated by its economic and political interests. In this way, China tries to ensure a stability of raw material imports, a better access to new markets on one hand and a political support in the sensitive issues such as human rights or independence of Taiwan (YOUDE 2007, TAYLOR 2006). The Peaceful Development is once again the principal motto how to reach these goals, with especially two tools applied. First, China emphasises the principles of sovereignty and non-interventions. Therefore, China claims that the problems of human rights or democracy are not their subject of interests and it is solely a matter of internal decisions.⁹¹ Naturally, such a stance is warmly welcomed by the corruptive political leaders in the countries like Sudan, Zimbabwe, Iran, or Venezuela. China coins such an approach also in the international organizations.⁹² Second, China provides an economic aid to reinforce its negotiating position. However, unlike the Western countries, China does not condition its aid by the good governance or structural adjustment requirements. This is also greatly welcomed by African and other dictators.⁹³ Finally, the soft power tools such as scholarship

⁹¹ China refuses the Western concept of human rights claiming that perception of human rights is strongly dependant on the level of socio-economic development (WEATHERLEY 2001).

⁹² During the recent Sudanese crisis, China opposed the U.N. interventions to secure stability in the country. In this regard, China followed not only its non-interventionist strategy but also its economic interests because Sudan belonged to the most important oil suppliers of China (JAKOBSON, DAOJIONG 2006).

⁹³ Angola could refuse an IMF conditional loan at the turn of century because China offered a generous unconditional financial package.

for foreign students, doctors and teachers, or cultural exchanges, are often used by China (FURNISS 2006).

In its international strategy, China tries not to compete with U.S. and European transnational corporations (e.g. TAYLOR 2006). Therefore, Africa attracted a rather broad attention of China nowadays.⁹⁴ There is an exponential growth of China's economic activities in Africa. TAYLOR (2006) points at the increase of total trade between China and African countries from 2 billion USD in 1999 to 39.7 billion in 2005, with 100 billion by 2010 expected. Traditionally, the access to resources (oil, copper, bauxite, uranium, and others) and markets is the main motivation of China for its economic activities in Africa. Not surprisingly, the oil producing countries such as Angola and Sudan belong to the most important trade partners in this regard (TAYLOR 2006).⁹⁵ China also represents an important source of investments in Africa. However, China emphasises infrastructural investments with a limited modernization effects. Furthermore, complaints about the destructive impacts of the low quality import from China on domestic production are heard from local enterprises and ordinary people in Africa more and more frequently. Thus as FURNISS (2006) claims China is welcomed by corruptive governments but less by African people. A hostile behaviour towards China has become rather frequent in some African countries (TAYLOR 2006). Furthermore, the China's policy undermines the African efforts to shape its further development through the initiatives such as NEPAD. Based on this assessment TAYLOR (2006) asks whether China is a leader of developing countries or a new exploiter.

Finally, China applies the ***Good Neighbour Policy*** with respect to its neighbouring countries. This approach is reflected also in the leading role of China in the ***Shanghai Cooperation Organisation***⁹⁶ (the SCO hereafter). The original goal of the SCO was to solve border disputes between its member states. Later, the agenda of the SCO was extended by the fight against terrorism (e.g. operations against cross-border

⁹⁴ Note that the year 2006 was labelled as the *China's Year of Africa* (FURNISS 2006).

⁹⁵ Because of its increasing oil appetite since the mid 1990s, China is eager to gain access to oil reserves in other countries. There are two state owned giants in the sector in China, the *China National Petroleum Corporation* and *China Petrochemical Corporation* (Sinopec), which operate globally. Their strategy is oriented towards the purchase of overseas oil assets or towards the long-term contracts with the aim to secure stable oil supplies. Such a strategy should not only cover the increasing oil demand in China but also diversify its oil reserves when it is relatively cheap from both, economic and political perspectives (JAKOBSON, DAOJIONG 2006). It is noteworthy that the China's SOEs are much more competitive than the traditional Western TNCs such Shell. Supported by the state they are practically always able to outbid competitors (FURNISS 2006, TAYLOR 2006).

⁹⁶ The Shanghai Cooperation Organisation includes China, Russia, Kazakhstan, Uzbekistan, Tajikistan and Kyrgyzstan.

smuggling, establishment of common anti-terrorist troops) and religious separatism (e.g. Muslim *Uighurs* in China) on one hand, and by the economic cooperation to reduce poverty on the other hand. Just these two measures were expected to strengthen the stability of the China's backyard. However, China follows also other goals through the SCO, especially securing of a preferential access to oil and gas in Kazakhstan and prospectively in Turkmenistan. Once again, the principles of non-intervention and peaceful development are employed in this regard. Thus, China provided the SCO members not only loans for infrastructure construction (e.g. oil pipelines in Kazakhstan) but also a diplomatic support in the international organizations (e.g. Uzbekistan for the events in Andijan).⁹⁷ Finally, China supports the SCO as a potential counterweight to the U.S. hegemony. Note that the potential of the SCO to play an important role in international politics further increased with the invitation of India, Iran and Afghanistan as the SCO observers (CHUNG 2006). Through this step, China tries to prevent the establishment of close ties between the United States and India. However, the China-India relations are much more complex and intricate (HARRIS 2005).

Box 5-7: China and Zimbabwe

The history of relations between China and Zimbabwe has its roots already in the Mao era when China tried to strengthen its position in the Third World. In Zimbabwe, China decided to support the party led by *Robert Mugabe*, the opposition not only to the white government supported by the United States but also to a party supported by the Soviet Union. *Mugabe* won the elections in 1980, in the same time when *Deng Xiao Ping* became the leader of China. And just in this time, the interests of both countries diverged. *Mugabe* was interested more in friendship to legitimize his government while *Deng* in economic relations. Moreover, Sweden and other Western countries provided Zimbabwe a strong support because the *Mugabe's* government was perceived as democratic. Nevertheless, the relations changed once again after the *Tiananmen* events when China searched for partners to prevent an UN resolution against its human rights abuse. In this regard, China chose a clever rhetoric that it was necessary to fight against the U.S. hegemony and other enemies through a close cooperation on the international scene. The principles of friendship, sovereignty, non-intervention, and beneficial development became the leitmotifs of its policy not only in Zimbabwe. Besides the political support, China gained also a better access to the Zimbabwean resource endowment, represented by copper, platinum, and tobacco. Thus, the China's gains from the relations with Zimbabwe are rather obvious. But what did Zimbabwe gain from relations with China?

Naturally, there were some economic benefits for Zimbabwe. China provided financial means for investments in infrastructure, health care facilities, mining activities, cell phones and power generation. Furthermore, trade cooperation between China and Zimbabwe, as well as tourism between the both countries, tended to develop. Nevertheless, these economic benefits were too limited to spark

⁹⁷ Note that the oil firm PetroKazakhstan was acquired by a Chinese firm and that Uzbekistan is a key country for the construction of oil pipelines between Turkmenistan and China (ERICKSON, GOLDSTEIN 2006).

a higher economic growth in the country. Thus, what was the main rationale of the Mugabe's policy? The answer is rather interesting. *Mugabe* and his Zimbabwe looked for a new identity, regardless of economic costs. Note that the *Mugabe's* earlier strategy of this kind had been based on the refusal of the South African apartheid, despite strong trade relations between these African countries. Such a strategy had enabled to gain a support from the Western world which had perceived Zimbabwe as a democratic island in Africa. However, Zimbabwe had lost this identity after the end of the South African apartheid. Moreover, *Mugabe* had begun to be criticized for his human rights abuses and election frauds. And just the ***Look East Strategy*** became the solution of this problem.

In his rhetoric, *Mugabe* highlighted that China and other Asian countries (Indonesia, Malaysia, and Iran) had a similar colonial experience as Zimbabwe. *Mugabe* also sent a message to the Western countries that he did not need them more and that there were other sources of investments. It was important for *Mugabe* that China did not condition its aid by human rights or political reforms as the Western countries did. Finally, *Mugabe* gained an international support of China in the international organisations such as the United Nation. Altogether, *Mugabe* created a new international identity of Zimbabwe with the support from China.

Source: YOUDE (2007)

Reforms in India: an Alternative Strategy?

In the 1950s, the economic position of India was better than of China in several aspects. First, India achieved a higher GDP per capita level. Second, modern industrial sectors, as well as railway network, were more developed. Third, the average crop area per farmer was three times higher in India than in China. Fourth, India had a better access to foreign capital because of its active role in international trade and investments. Finally, India was characteristic by a well-developed democracy, rule of law and civil sector as a legacy of its colonial past (CHAI, ROI 2006).⁹⁸ However, the choice of the further development strategy did not fully use the India's economic potential of this time. The Prime Minister of India, *Jawaharlal Nehru*, decided to follow the socialist development path based on a dominant role of state in economy. Despite the economic growth of India reached relatively high figures in the socialist period, it accelerated only in the second halve of the 1980s when a first wave of reforms was initiated (DELONG 2001).

What is the rationale of the socialist choice? DELONG (2001) explains this decision by the efforts of the *Nehru's* political faction to ensure a relatively even distribution

⁹⁸ On the contrary, China had a better potential in its human capital. In this regard, India lagged not only in the education indicators but also in its rigid caste system and religious values which were less conducive to diligence, commitment to group, and education than the Chinese Confucianism. Note that the ethnic diversity of India represented another challenge for its economic development (CHAI, ROI 2006).

of benefits in an ethnically and socially diversified country. Naturally, this step should have strengthened the political position of the faction as well. To fulfil this goal, the market based development was not perceived as the best solution because of the concentration of wealth in hands of rich people (CHAI, ROI 2006). Furthermore, the memories on the Great Depression period were still young while successes of the USSR in mobilization of its economic resources rather impressive (DELONG 2001). Thus, a mixed-economy strategy was chosen which combined the development of inefficient state-owned heavy industries on the basis of import-substituting industrialization and of regulated private small-scale enterprises in agriculture and some other sectors (CHAI, ROI 2006). DAS (2006) characterizes such a strategy as a mix of inefficient and monopolistic public sector and over-regulated private sector. The regulations used by the Indian government in the pre-reform period were extraordinary broad and included (AHLUWALIA 2002, DAS 2006):

- Sectors reserved solely for public firms (iron and steel, telecommunications, air transport and others)
- A system of licenses for a number of industries⁹⁹
- The anti-trust policy which limited investments above a determined value for around 800 items (e.g. garment, shoes, and others) with the aim to support domestic small-scale enterprises
- The ban on import of consumer goods
- A system of quos and tariffs on import of capital and intermediary goods
- A system of restrictions imposed on foreign investments including limited ownership share, complicated and time consuming approval procedures and others
- Rigid labour laws which discriminated employers in favour of employees¹⁰⁰
- A widespread bureaucratic harassment through inspections and other procedures

Thus, only the election of *Rajiv Gandhi* for the India's Prime Minister in 1984 was the first step towards a gradual dismantling of the regulation burden, also denoted as the so called ***Licence Raj***. DELONG (2001) highlights the Gandhi's positive stance to reforms and a large majority of his Indian National Congress party in the Indian

⁹⁹ The idea of licenses rested on the control of investment in selected industries to regulate production capacities. However, such a system was violated by the proponents of the Delhi regime who bought the licenses unless creating the expected production capacities. Naturally, such a step prevented competition (DELONG 2001).

¹⁰⁰ DAS (2006) describes a case when an employer tried to fire an employee who had repeatedly slept in work. However, the employee challenged this decision at court and only after 17 years in 2001 the employer was able to lay the employee off.

Parliament as two important triggers of the whole process. Thus, in the late 1980s, the manufacturing licenses and import quotas imposed on a number of products were removed, the import tariffs and taxes were reduced, and the anti-trust policy eased. Nevertheless, as DELONG (2001) claims the extent of reforms was rather disappointing and also AHLUWALIA (2002) regards the Gandhi's measures as only some steps in the reform direction. However, these steps stimulated international trade which contributed to economic growth acceleration but also to a relatively high trade deficit. Consequently, the balance of payments crisis led to the rupee devaluation in 1991. Only after this crisis, systematic reforms in India designed by the Prime Minister *Narasimha Rao* and his Finance Minister *Manmohan Singh* were launched.

Thus, the reformist governments continued in the deregulation of the trade, FDI and other barriers, and privatized a number of state owned enterprises. These measures resulted in the long-term economic growth around 6 % per annum in the period 1992-2002 and 7.5 % in 2002-2006 (DAS 2006) and also poverty was reduced substantially. In addition, several Indian transnational corporations emerged such as *Infosys*, *Wipro* or *Tata Motors* (DAS 2006, AHLUWALIA 2002). Nevertheless, a number of problems have remained. India is severely indebted now and its investment climate is far less attractive than in other developing countries. Regulations are still excessive, including high tariffs and taxes, rigid labour law, and a relatively poor infrastructure. There are huge differences between Indian provinces as well. While the provincial governments in Gujarat or Karnataka are friendly towards investors (see Box 5-8) this is not the case of e.g. Bihar or Utter Pradesh (AHLUWALIA 2002). The Indian public sector is still very inefficient. DAS (2006) even points to an inadequate provision of the basic public goods such as education and health-care. He mentions the existence of studies which revealed an extraordinary high absence of teachers and health-care workers in their workplace because the Indian labour-law practically does not allow to fire them. DAS (2006) claims further, that a low quality of public schools and health-care facilities led to the establishment of many semi-legal private schools and health-care facilities even in the poorest parts of Indian cities.

Box 5-8: Bangalore - IT capital of India

The origins of the software industry are connected with the separation of hardware and software production in 1969 and the advent of Intel microprocessors three years later. Consecutively, demand on software increased markedly especially in the 1990s. However, software production, with its typical procedures consisting of requirement analyses, specification of requirements, design, coding, testing and implementation, is still a labour-intensive, craft-like industry. This fact and the development of satellite communication enabled to relocate software production to developing

countries which offered a large pool of skilled and cheap workforce and an adequate infrastructure. India belongs to the most successful countries in this respect because of several assets attracting the interest of software firms (PARTHASARATHY 2004):

- A large pool of skilled workforce with limited employment opportunities in the domestic market
- Mastery in English because of the colonial legacy
- The ability to work with various operational systems and hardware platforms
- The twelve hours time difference between the United States and India

These factors were supplemented by an active state policy towards attraction of foreign software firms in the 1990s. Special *Software Technology Parks* with an excellent communication infrastructure became the most typical feature of this policy. Altogether, India experienced boom of the software industry in the 1990s, including investments of domestic firms.¹⁰¹ With around 1,000 software firms, including Texas Instruments, IBM, Hewlett Packard, Motorola or Microsoft, and 80,000 IT professionals, Bangalore is understood as the IT capital of India. Especially services in data management (e.g. call-centres, payrolls, insurance claims, medical prescriptions processing) and software development (e.g. maintenance, training) are provided here (VAN DIJK 2003), more and more often as a package and with a greater emphasis on the quality of products.

Why was just Bangalore so successful? Several factors must be considered in this regard. First, Bangalore has a rather long history of R&D activities. Already in 1909, the Indian Institute of Science was established here. Later, Bangalore became the centre of the air force research and a number of universities and polytechnic schools as a source of skilled and cheap workforce were established. Furthermore, several large public firms, such as *Indian Telephone Industries*, *Hindustan Machine Tools* or *Bharat Electronics*, were founded in Bangalore before and immediately after the Second World War. Second, massive investments into infrastructure were realized, including a new international airport and several scientific parks. Note, that the Indian state Karnataka was one of the first which pursued an active IT policy through tax incentives, marketing and infrastructural investments. Third, Bangalore is well-known for a mild climate because of its high altitude and for a relatively higher quality of life compared with other parts of India. Fourth, labour turnover is relatively high, working as an important source of skill and technology transfers. Interaction between commercial and scientific institutions acts in the same direction. Fifth and finally, returning migrants from the United States played a substantial role through the creation of close ties between the U.S. firms and their Indian suppliers (CANIELS, ROMIN 2003, VAN DIJK 2003, PARTHASARATHY 2004).

Source: CANIELS, ROMIN (2003), VAN DIJK (2003), PARTHASARATHY (2004)

It is obvious that the India's development path is completely different from this of China. DAS (2006) emphasises three specific features of the so called "*India model*" distinct from the "*China model*":

¹⁰¹ However, a further qualitative development of Indian software firms founders at weak domestic market which makes contacts with customers, which are necessary for product innovations, more difficult (PARTHASARATHY 2004).

- A consumption-based growth instead of investments, with a stronger orientation to the domestic instead of export market
- A private sector-based growth with a rather counterproductive role of state
- A service-based growth instead of manufacturing,¹⁰² with a stronger position of high-tech¹⁰³ in manufacturing

Note that the India's regulated economy represents a barrier for the development of low-skilled manufacturing because India is not able to compete with other developing countries. However, the *Indian model* has also some assets compared with China. DAS (2006) highlights especially lower socioeconomic inequalities of India. Overall, DAS (2006) labels China as the world's workshop while India as the world's back office. The question remains whether this position of both countries in the international division of labour will change in the future.

¹⁰² Note that the manufacturing share in the total GDP was 27 % in India while 46 % in China in the mid-2000s (DAS 2005).

¹⁰³ DAS (2005) contends that 125 firms from the world's top 500 established their R&D facilities in India.

CHAPTER SIX

ENVIRONMENTAL LIMITS OF ECONOMIC GROWTH IN INDIA AND CHINA

The economic development of India and China for last decades is integral part of many text-books. However we know, at least from the philosophical point of view, that each of the growth has its own limits. The economic growth closely depends, among others, on natural sources, environment and ecological consequences which are commonly named as *environmental limits*.

Population growth, which adds to the necessity for rapid economic growth, is important factor for China's and Indian economic future. Indian and China's economies will have to solve the problem of increasing trend of their energy consumption. LIVERNASH (1995) pays attention to the fact, that China and India with sources of less than 10 per cent of demand in middle of 1990s, planned to build about one-fourth of the world's new capacity. Both China and India will depend on their coal supplies over the next few decades. He estimated that China's coal production rose from 1.0 billion tons in 1992 to 1.4 billion tons in 2000, and coal accounts for roughly three-fourths of China's total energy consumption. In India, coal production totalled at about 240 million tons in the early 1990s, and production is projected to increase to nearly 600 million tons in 2010 (LIVERNASH 1995).

At the approach we have to call attention to emissions of carbon dioxide, one of the main greenhouse gases, which play significant role in global warming and climate change. Even if the India is currently the fifth largest energy consumer in the world with *carbon dioxide emissions* in 2003 amounting to 1.05 billion tons, and China with emissions of 3.76 billion tons (SRIVASTAVA 2006), both states are part of the Non-Annex I group of countries of the Kyoto Protocol with no obligation to reduce their emissions of greenhouse gases in the first commitment period, 2008–2012.

The industrial and population growth in the countries as well as poor environmental management and agricultural techniques cause many environmental problems in both India and China. India and China are rapidly becoming planetary powers that significantly affect the world by their consumption and production. The prime aim of the chapter is to make a survey of environmental issues that can determined future development of both mentioned countries. The work is based on the classical desktop analysis and personal experiences author of the chapter with survey in selected regions of both countries. The sources are selected in the same way

as in the previous chapter. The chapter is structured into four parts dealing with selected environmental limits of economic growth of particular countries and the environmental migration issues. In case of India is collectively used example of Bangladesh due to close migration linkages between the countries.

Environmental Limits of India

The rapid economic and population growth as well as rising expectation for a better life, the *natural resources exploitation* in Indian subcontinent face increasing pressure. In the context GUPTA and DESHPANDE (2004) claim that the quantity and quality of basic resources, such as clear air, crop-land and safe drinking water are critical to ensure adequate food supplies, public health and transportation.

The human population as estimated in 2001 is 1,027 million with an average growth rate of 1.95 per cent (between 1991 to 2001). Much of this population resides in rural areas with the average population density of the country at 284 persons per sq. km. Gangetic Plains of India has an overage of 456 persons per sq. km. The rate of growth of population during 1981-1991 in dryland region has been 29 per cent as against 23 per cent for the country. Seven districts in Rajasthan showed very high growth rate of 30-35 per cent (UNCCD 2006).

The food growth (average annual rate of change) by 3.2 per cent from periods 1979-1981 and 1990-1992 did not continue and decreased to half level 1.7 per cent between the periods 1995-1997 and 2001-2003. The population growth from the same periods decreased from 2.1 per cent to 1.7 per cent (FAO 2006b). It probably caused by exhaustion of “green revolution” in India.

The most significant environmental issues in India we can classify to following groups:

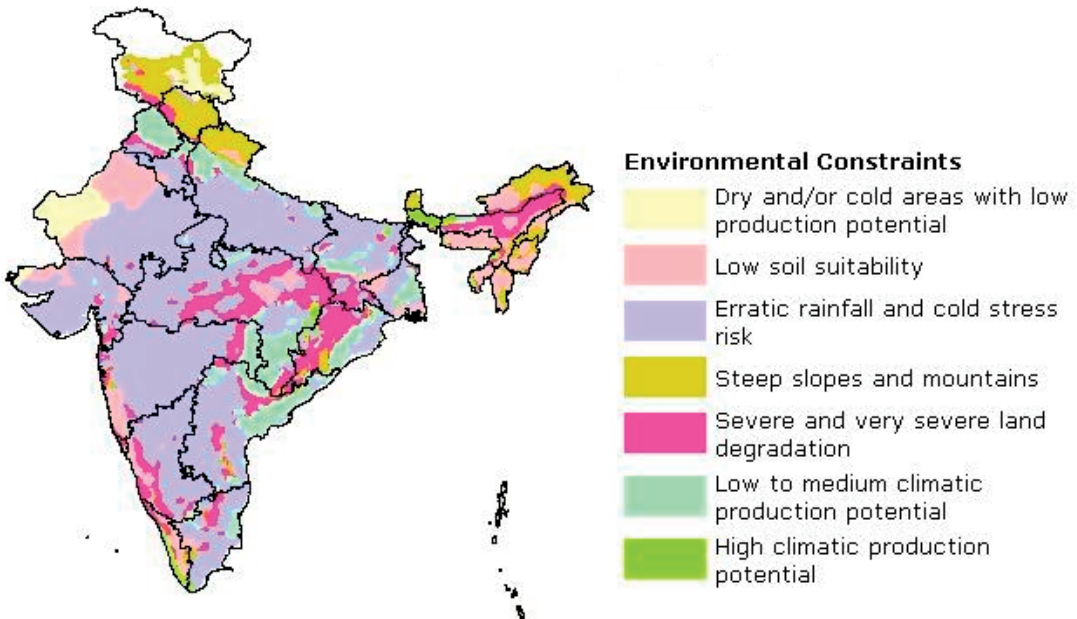
- *Natural disasters* such as floods, tropical cyclones, droughts, earthquakes
- *Deforestation*, soil erosion, and *desertification* (land degradation)
- *Air pollution* from industrial effluents and vehicle emissions especially in the growing cities in India
- *Safe water deficiency*, water pollution from raw sewage and run-off of agricultural pesticides
- *Climate change*, including glacier outburst in the Himalayas

Some natural disasters like widespread and destructive flooding from monsoonal rains as well as droughts and severe thunderstorms are on the rise with climate change. Moreover, the prime environmental Indian limits are identified in Figure 6-1.

Among the most frequent natural disasters events in India belong tropical cyclones, floods, earthquakes, droughts and land degradation. In the context we can mention selected examples from the last period. These few cases allow to basic understanding of the quantitative extent of the disasters and their geographical distribution.

About 12 million people had been affected by the floods in July 2004, which had disrupted essential supplies (AHMED 2004). According to the ANDERSON (2004) floods in the year affected three states: in Bihar 10 million people from 16 districts were displaced or trapped by flooding as of July 16, 2004; Assam experienced the worst flooding in 25 years and 7.5 million had to be displaced; and another 90,000 people were displaced in Tripura. Some people in Assam claimed that “this is the worst flooding in recent memory”. We can only speculate if the event is the impact of climate change in the region.

Figure 6-1: Environmental limits of India



Further thousands of people in the India's North-Eastern state of Assam have moved to high ground after rivers burst their banks and swamped temporary homes they have been living in since massive floods in 2004. Low-lying areas in the state were under water due to torrential rains, with the Dhemaji district, 300 km (185 miles) east of the state's main city, Guwahati, worst hit. "Some 15,000 people have moved to raised ground after floodwaters entered their temporary shelters," said Ananda Baruah, a senior flood control official (PLANET ARK 2006).

At least one million people have lost their homes to floods in 2006 in eastern India. The flooding, triggered by annual monsoon rains, has hit an area where 2.3 million people live and damaged thousands of acres of paddy in the coastal state of Orissa (JENA 2006). According the officials sources in the southern state of Andhra Pradesh, swollen rivers have swamped hundreds of towns and villages, forcing people to take refuge on rooftops and in trees. Authorities say at least one million people have been displaced and rescuers were using boats to reach those stranded in the three districts of the state (HAIDER 2006).

Table 6-1: Type of drylands in India

Type of drylands	Area (in million of hectares)
Arid	50.8
Semi-arid	123.4
Dry sub-humid	54.1
Total	228.3

Source: UNCCD (2006)

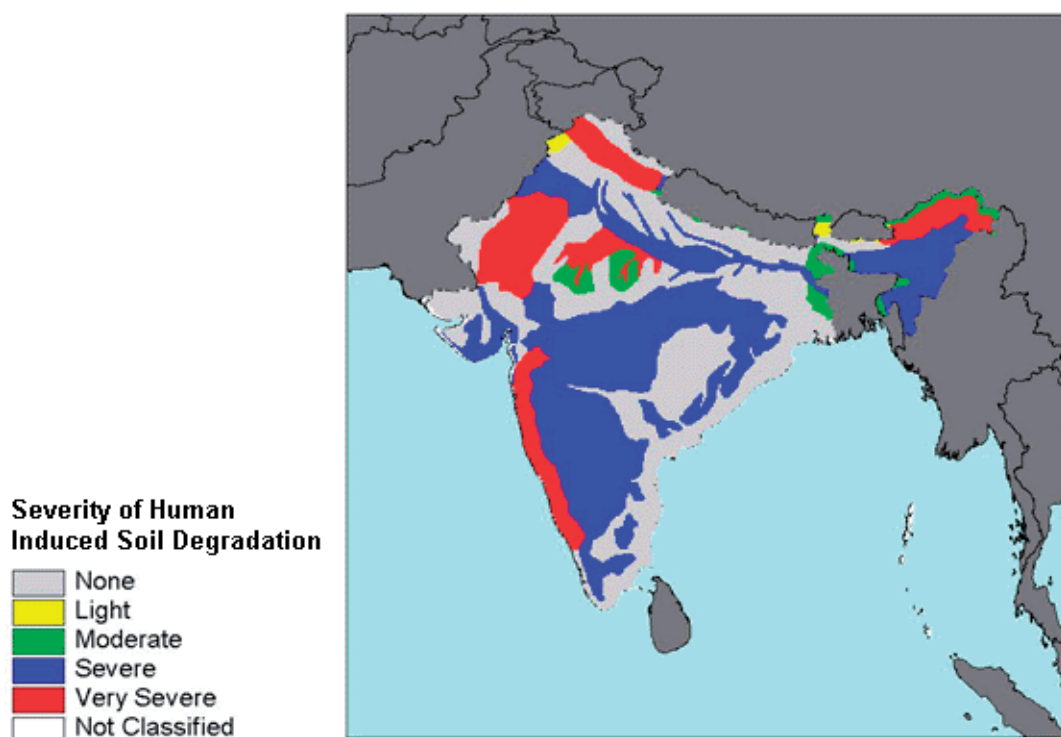
Desertification (land degradation) is relatively widespread phenomenon in India because of unsustainable agriculture. In particular, soil acidification and salinization are increasing (UNEP 1993). These problems are widespread in the countries of South Asia as shown in Figure 6-2. In India land degradation causes productivity losses of around 2.4 billion USD (UNEP 2002). Drylands areas occupied approx. 60 per cent (180,000 hectares) of total land area in India in 1950-1981 (WRI 2006). In current time the drylands cover of about 228.3 million hectares (69.6 per cent) of the total land area (328 million hectares) of the country (for details see Table 6-1).

Per capita land availability in India has declined from 0.89 hectare in 1951 to 0.3 hectare in 2001. Per capita availability of agriculture land has declined from 0.48 hectare in 1951 to 0.14 hectare in 2001. Per capita land resources is further exacerbated by degradation and desertification of land. About 107.43 million hectares or 32.75 per cent of the total geographical area of the country is affected by various forms and degree of land degradation (for more detail see Table 6-2; UNCCD 2006).

Table 6-2: Type of land degradation in India between 1990-2003

Type of degradation	1990-1999		2000-2003	
	Millions of hectares	Percentage share of total area	Millions of hectares	Percentage share of total area
Water erosion	107.12	61.70	57.15	17.42
Wind erosion	17.79	10.24	10.46	3.18
Ravines	3.97	2.28	2.67	0.81
Salt affected	7.61	4.38	6.32	1.92
Water logging	8.52	4.90	3.19	0.97
Mines and industrial waste	-	-	0.25	0.08
Shifting cultivation	4.91	2.82	2.37	0.72
Degradated forests	19.49	11.22	24.89	7.58
Coastal sandy areas	2.73	1.57	0.11	0.30

Source: UNCCD (2006)

Figure 6-2: Severity of Human Induced Soil Degradation in India

Source: FAO (2005)

The river water resources are estimated at around 1,953 cubic kilometers. About 93 per cent of the available water resources are used for agriculture, and only 4 per cent for industrial purposes. The total water requirement by 2050 is expected to grow to 1,180 billion cubic meters. The national average of annual per capita availability of water is about 1,829 cubic meters which may decline to 1,557 cubic meters by 2015 due to increase in population (UNCCD 2006).

The Ganges river basin is one of the most fertile and densely populated in the world and covers an area of 1 million square kilometers. In India, the river provides water for drinking and farming for more than 500 million people. The water supply to the river depends on the rains brought by the monsoon winds from July to October and the melting snow from the Himalayas during the period from April to June. The delta also experiences strong cyclonic storms before and after the monsoon season which can be devastating. In November 1970, for example, 200,000 – 500,000 people were killed in such storms. Hindus regard the Ganges as the holiest of rivers, they bathe in it and drink the water despite pollution from chemical wastes, sewage and even the remains of human and animal corpses (traditional funerals). But beside the contamination, the river inherently is endangered because of climate change. The Himalayan glaciers that are the sources of the Ganges could disappear by 2030 as temperatures rise (IPCC 2007).

The ground water potential varies in different regions of the country. However, due to heavy extraction of ground water and its limited recharge, the ground water is getting depleted at a fast rate. This depletion is mainly caused in most of the dryland comprising States of Punjab, Haryana, Uttar Pradesh, Rajasthan, Andhra Pradesh, Karnataka, Madhya Pradesh, Orissa and Maharashtra (UNCCD 2006).

The general climate of the country is tropical monsoon, with an annual precipitation estimated at 1,200 mm. The distribution of the rainfall across the country varies from less than 100 mm in extreme arid areas of western Rajasthan to greater than 3,600 mm in north-eastern States and 1,000 mm from east coast to 3,000 mm in the west coast (UNCCD 2006).

Environmentally-Induced Migration in India and Bangladesh

The report by Siwek et al. (2006) identified some potential causes of migration due to environmental factors:

- Natural disasters (e.g. floods, earthquakes, tsunami)
- Food deficiency and undernourishment caused by environmental degradation, long-term and recurred seasonal drought, overfishing, sea and coast pollution

- Food deficiency caused by soil/land degradation (desertification), save water deficiency, soil pollution, etc.
- Lack of save water, water contamination by chemicals
- Low fertility caused by desertification (land degradation), salinisation, overgrazing, soil erosion, deforestation, decrease of rainfalls and moving the rainfall season
- Development projects construction such as river dams

However HUNTER (2005) also argues that migration as a demographic process can be associated with *environmental hazards* in several ways:

- Proximate environmental hazards might influence residential decision-making by shaping the desirability of particular locales. In the case environmental hazards is factors shaping migration.
- Migration can represent an exacerbating force with regard to environmental hazards as a result of increasing population density in vulnerable locales, for instance the movement of poverty-stricken households to floodplains in Bangladesh (Lein 2000, Zaman 1991 in HUNTER 2005).

India's coastline is about 7500 km long and is densely populated as well as low-lying. MYERS's (1993) argues, that sea-level rise coupled with increase of inland floods (from melting Himalayan glaciers) would affect estimating 142 million inhabitants of India's coast living of flood zones and people from Bangladesh. His "conservative" estimation for 2050 is 30 million environmental displacees for India and 15 million for Bangladesh.

However, MYERS (2001b) modified in May 2001 his own forecasts about total numbers of people at risk of sea-level rise (there are not environmental refugees, you can see the change of style), including the numbers for Bangladesh and India. In Bangladesh could be 26million and in India 20 million people at risk (MYERS 2001a).

Floods and cyclones in Bangladesh regularly cause, often with dramatic outcomes, temporary local displacement. Agriculture in Bangladesh is very much dependent on annual flooding and the floods, therefore, take on unique cultural meaning. Although necessary, the persistent floods also change river courses, with many Bangladeshis losing homes and lands to erosion annually (Zaman 1991 in HUNTER 2005). In some regions land remain under water for around seven months every year and agriculture production is strictly limited by environmental constraints. The floods have significant impact on migration decision-making process in these regions. Villagers cannot rely on agriculture to fulfil their needs and are forced to look for work elsewhere (RAHMAN 2000).

In a survey undertaken in a Bangladesh floodplain in the mid 1980s, 64 per cent of sample households reported having been displaced by erosion at least once, with the mean number of displacements being seven. Typically, migrant households relocate only a short distance away; nearly 88 per cent of households had remained within 2 miles of their previous residence. Such short distance mobility (perhaps temporary) is a product of lack of resources, presence of kin, and belief that land will re-emerge to be reclaimed (Zaman 1991 in HUNTER 2005). Migration in these localities is a household coping mechanism, with household members typically having little faith in finding permanent residence and for this reason displacees often continue to live in fear of eviction, either by governmental authorities or natural forces (HUTTON, HAQUE 2004, Haque, Zaman 1989, Zaman 1991 in HUNTER 2005).

In 1995, the Flood Plan Coordination Organization estimated that river-bank erosion displaced over 728,000 people between 1981 and 1993 along Jamuna, Ganges-Padma and Meghna rivers. Over 40 per cent of the displacee-squatters had been uprooted three or four times and 36 per cent had been displaced between five and ten times. Another 14 per cent had been displaced more than ten times. Only 5 per cent of the displaced surveyed had been displaced just once and 8 per cent twice. Whereas river-bank erosion mostly affects small landowners, although large landowners can also be negatively affected (Greenberg 1986, Rogge and Elahi 1989 in HUTTON, HAQUE 2004).

In the middle of 1970s, India has been affected most of the dry-season flow of the river to one of her internal rivers, before it reaches Bangladesh. At Bangladeshi regions Khulna and Rajshahi were affected agricultural and industrial production, disrupted domestic water supply, fishing and navigation, and changed the hydraulic character of the rivers and the ecology of the Delta in the down-stream areas. These trans-border human-inflicted environmental changes have resulted in the loss of the sources of living of a large population in the south-western part of Bangladesh and have necessitated their migration in the pursuit of survival. The absence of alternatives in the other parts of the country has left no other option for these Bangladeshis but to migrate into India. The large-scale migration, from the late 1970s, of these Muslim migrants into Hindu-dominated India has culminated in a number of native-migrant conflicts in the receiving society (SWAIN 1996). At least four million Muslim Bangladeshis from the mentioned regions have just disappeared from their own government's census calculation and changed population growth and density in the areas. The Indian state of Assam, which received a large proportion of these migrants, was the first to experience conflict (SWAIN 1996). Tension between native Hindus and migrant Muslims in the Assam has been increasing since 1979 and gradually spreading to other parts of India. Conflicts between natives and migrants have now spread to other parts of India and have become a major issue for politically rising Hindu organizations (SWAIN 1996).

Nevertheless disasters do not always create outmigration and show that migration is some kind of strategy for survival. The study by PAUL (2005) provides empirical evidence of the non-occurrence of out-migration in the aftermath of the 14 April 2004 tornado in Bangladesh. Data collected from 291 respondents from eight tornado-affected villages suggest that no one from these locations migrated to other areas. The constant flow of disaster aid and its proper distribution by the government and non-governmental organizations (NGOs) were the main reasons why victims did not leave (PAUL 2005).

For example, WANDSCHNEIDER, MISHRA's (2003) study of Bolangir district in Orissa, with persistently high levels of poverty, estimates that nearly 60,000 people having left the district in search of employment during the 2001 drought.

Studies in the drought-prone areas of West Bengal by Rogaly et al. (2002 in IOM 2005) observe that over 500,000 tribals, Muslims and lower caste people migrate seasonally to the rice-growing areas of the state. Madhya Pradesh shows similarly high levels of outmigration from both drought-prone and forested tribal areas. For example, DESHINGKAR, START (2003) found that more than half the households in four out of six study villages in Madhya Pradesh included migrant family members. The proportion was as high as 75 per cent in the most remote and hilly village with infertile soils.

At the approach of environmental migration LONERGAN (1998) estimated that development projects in India forced over 20 million persons to leave their habitats in the past three decades. According the World Commission on Dam (WCD) report (WCD 2000) large dams in India forced to leave 16-38 million people. But these numbers do not include the millions displaced due to other aspects of the projects such as canals, powerhouses, project infrastructure, etc. Unfortunately, resettlement programmes have predominantly focused on the process of physical relocation rather than the economic and social development of the displaced and other negatively affected people. The result has been the impoverishment of a majority of resettlers (WCD 2000).

Environmental Limits of China

Every year *natural disasters*, such as floods, drought, storms, hail, earthquakes, landslides and mud-rock flows destroy millions of the houses and hectares of crops in China and millions of the people have to be relocated. For example heavy flooding along the Yangtze in 1998 left the streets of Wuhan waist-deep in water while about 3,000 died and 14 million were made homeless along the river (REUTERS

2007c). In the period between January 1 and July 20 in 2004 natural hazards have damaged about 18 million hectares of crops. About 1.6 million hectares of arable land yielded no harvest. An estimated 388,000 houses collapsed and 2.4 million were destroyed, forcing the relocation of nearly 1.3 million people and have killed 659 people and caused losses of about 4.75 billion USD. Floods accounted for more than half the deaths and affected 45.7 million people in the same period. The hardest hit provinces and regions were Yunnan, Guizhou, Sichuan and Chongqing in the southwest, Hubei, Hunan and Henan in central China and Guangxi in the south (LIM 2004). During 2005 eight hurricanes have hit China's southeast and southern coastal areas. As of mid-October, disasters had taken 1,796 lives and left 461 people missing. More than 15 million people have been displaced and 1.6 million houses destroyed this year, resulting in direct economic losses of approx. 22 billion USD (LIU 2005).

In 2006 more than 1.3 million Chinese have fled their homes in the path of a super typhoon Saomai, the strongest to threaten the country in 50 last years. The center of the tropical storm was near Wenzhou city in Zhejiang province (MACFIE, SHIPENG 2006). Floods and landslides have killed at least 360 people across China during the summer in 2007 and destroyed more than 4 million hectares of crops. According to the figures from the State Flood Control and Drought Relief Headquarters (in REUTERS, 2007a) the direct economic losses were 3.21 billion USD, apart from 217,000 houses wholly or partially were destroyed. Most of the deaths occurred after downpours across the Jialing River Valley in the southwest province of Sichuan which has resulted in floods in almost all the tributaries of Jujiang River and triggered severe mountain torrents, mud-rock flows and landslides (REUTERS 2007a). More than 1 million people have been evacuated in Henan, Anhui and Jiangsu provinces together from the projected path of floodwaters from the Huai river (REUTERS 2007b, REUTERS 2007c).

BROWN (2004) argues that Gobi Desert in China is growing by 10,400 square kilometres a year and the migration stream is swelling. Asian Development Bank's (in BROWN 2004) preliminary assessment of *desertification* in Gansu province has identified 4,000 villages that face abandonment. Desert expansion has accelerated with each successive decade since 1950. China's Environmental Protection Agency (in BROWN 2003) reports that the Gobi Desert expanded by 52,400 square kilometres from 1994 to 1999 and Gobi far from within 250 kilometres of Beijing. BROWN (2003) reminds that Chinese population of 1.3 billion and a livestock population of just over 400 million are weighing heavily on the land and huge flocks of sheep and goats in the northwest are stripping the land of its protective vegetation, creating a dust bowl on a scale not seen before. North-Western China is on the verge of a massive ecological meltdown.

WANG et al. (2000) argue the average drought affected an area in the period 1949 - 1990 was 195.92 million hectares (approximately 2 million square kilometres) and the drought disaster area was 7,689 million hectares by year (approximately 77,000 square kilometres). The authors indicate that average loss of cereal production was 11.0 million tons, but in 1988 the cereal loss was 31.2 million tons and 28.4 million tons in 1989. Major natural factors that cause droughts in China are a huge population and very low water resource occupation rate, very uneven and imbalanced distribution of water and land resources, and a great variation of precipitation and runoff within and from year to year, claim WANG et al. (2000).

Another region's serious environmental problem is *land degradation*. SMIL (1995) argues that about 70 million hectares of China's pastures have depleted since the early 1950s. At least one-third of Inner Mongolia's grassland suitable for cattle grazing is affected by soil degradation and all of the region's three largest grasslands – Hulun Buir, Songnen and Horqin – are deteriorating. Qinghai's high-altitude grasslands decreased by about one-fifth during the past generation because of overgrazing, desertification and conversion to crop fields, and according to official figures, China's net loss of arable land amounted to about 17 million hectares between 1957–1990 (SMIL 1995). He also argues, if the arid North's arable land loss was merely proportional to its share of the nationwide cultivated area – a conservative assumption given the region's high erosion and desertification rates – it would amount to about three million hectares. Given the North's average ration of about 5.5 peasant per hectare of cultivated land this would translate to the displacement of some 17 million people during the past (SMIL 1995).

In this context, author of the chapter is not sure whether comparison of agricultural degradation at North part of China with other cultivated areas is correct because of quite different environmental conditions and population density at mentioned areas. Nevertheless, it cannot change anything about the environmental degradation and possible migration flows from the Inner Mongolia.

With Chinese coal consumption far exceeding that of the United States and with its oil and natural gas consumption climbing fast, it is only a matter of time when China will also be the world's top emitter of carbon, claims BROWN (2005). *Climate change* will alter (or is altering right now) regional agricultural and industrial potential and could trigger large-scale migrations. HARDY (2003) argues that lifestyle of most human populations is adapted to a very narrow range of climatic conditions and human settlements are generally concentrate in areas of high industrial or agricultural potential, that is, areas with hospitable climates, near coastlines, in river and lake basins, or close to major transportations routes. According to most scenarios, climate change will place added demands on urban

infrastructures. Climate change could accelerate urbanization, as people migrate away from low-lying coastal to interior areas or from drought-stricken farms to cities (HARDY 2003).

China's urban population is expected to almost double to a total of more than 600 million and this will engender greatly increased demands for water for household use, to the detriment of the country's agriculture which currently takes 87 per cent of all water consumed in order to maintain food production, expects MYERS (1997). The worsening of sustainable access to safe drinking water in Chinese cities can contribute human migration in future. While coverage increased in rural areas, access to improved sources decreased in urban areas. This contrasting trend in the region reflects what happened in China over the decade (1990 – 2002), according to UNSD (2004), with coverage in urban areas decreasing from 100 to 92 per cent. In rural areas coverage improved in the same period from 60 to 68 per cent, but in the country there are still almost 300 million people without any access to safe drinking water. The important impact plays out on human migration from rural areas, but the most crucial is leading to increasing water's consumption of industrial production concentrated in Beijing or around urban areas on the coast above all.

While China consumed amount 562.3 billion cubic meters of water in year 1997, in year 2010 total water supply is expected to be 646 billion cubic meters, and for the year 2025 amount 720 billion cubic meters in the situation, when China predominantly depends on surface sources of water, point out WANG et al. (2000). Considering present lack of water in cities and some parts of China, we can expect some tensions among states sharing the same water resources together with China. As long as China wants to increase the consumption of water from rivers as Brahmaputra or Mekong for irrigation of agricultural fields or industrial production, in negative way this could affect the needs of India, Bangladesh, Laos, Cambodia and Vietnam which are likely to protest. India and Vietnam waged wars against China in the past.

Environmentally-Induced Migration in China

MYERS (1997) estimates that largely *sea-level rise*, flooding of coastal-zone and result of increased droughts and disruptions of rainfall regimes could put large numbers of people at risk of displacement by the middle of next century if not before. Preliminary estimates indicate that the total number of people at risk of sea-level rise in China is 73 million (MYERS 1997, MYERS 2001b, compare with MYERS 2001a).

Upper reaches of the Yangtze River and Yellow River (especially in areas affected by the construction of dams and soil degradation), Southeast coastal regions (annually hit by tropical hurricanes and floods) and North and Northwest regions in China (threatened by desertification and drought) belong to source areas of contemporary environmental migration. The contemporary targeted areas for people from the environmental devastated regions are coastal areas (especially cities), Beijing and other big cities, and Tibet (e.g. for displace people from the Three Gorges Dam area). Some of the migrants cross the border to neighbouring countries, primarily to Russia, Kazakhstan and other Central Asian states or further to the USA, Australia and Europe (see Table 6-3).

Table 6-3: Contemporary environmentally-induced „hot spots”

Contemporary threatened area	Contemporary targeted areas
Upper reaches of the Yangtze River and Yellow River	Sea coast areas (cities), Beijing, Tibet
South-East China (sea coast area, river banks)	Cities near the coast sea; Europe, Australia, USA
North and North-West China (especially Gansu, Inner Mongolia provinces, Xinjiang AR)	Cities, Beijing, Tibet, Central Asia, Russia, Europe

Source: STOJANOV, NOVOSÁK (2006), updated

New potentially threatened regions in China with a prospective growth of number of environmental migrants are lowly situated coastal areas in the Southeast and East China (primarily because of prospective sea level rise and raised intensity and number of hurricanes due to predicted global or regional climate change), the reaches of the Yangtze River and Yellow River (especially in areas affected by floods, construction of dams and soil degradation), North and North-Western China (affected by desertification, drought and lack of sustainable sources of safe water). New potential targeted areas for displaced people in China will be cities in central and western parts of China, the capital Beijing or occupied Tibet. Some of the migrants will cross the border to Central Asia countries, Russia (especially to Siberia), South-East Asia states with a greater Chinese minority (e.g. Indonesia and Malaysia), USA, Australia, Europe (see Table 6-4).

Table 6-4: Prospective environmentally-induced „hot spots”

Prospective threatened area	Prospective targeted area
Reaches of the Yangtze River and Yellow River	Cities in central and western parts of China, Beijing, Tibet
South-East, East China (low situated sea coast)	Central parts of China, USA, Australia, South-East Asia, Central and Western Europe
North and North-West China Gansu, Inner Mongolia provinces, Xinjiang AR, Hebei, Henan provinces)	Russia (e.g. Siberia), Central Asia, Beijing, Tibet, Europe

Source: STOJANOV, NOVOSÁK (2006), updated

Absolute majority of contemporary and prospective environmental migrants are/will be internally displaced peoples, who do/will not leave China. Considering the present lack of cultivated soil or grassland, sustainable sources of safe water and other natural resources, together with difficult living conditions of the migrants, can undermine social stability in targeted areas and elicit crises or conflicts.

Concluding Remarks

The evidence of Indian and China's growth is everywhere and the pace of the economic change in the countries is breathtaking, say FLAVIN, GARDNER (2006). However, the emergence of Indian and China's significance on the economic and politic field on the global level is completed by environmental consequences of the growth. Some authors (e.g. LIVERNASH 1995, FLAVIN, GARDNER 2006) pay attention to situation that global ecosystems and planet natural resources are simply not sufficient to sustain the current economies of the industrial countries. The environmental limits such as ability to increase oil production, safe water deficiency, lack of cropland with combination of desertification, and the economic impacts of environmental degradation together with climate change in some regions are the factors that make it impossible to continue current patterns on such a vastly larger scale.

Currently India and China become a one of the most polluters in the world, including the emissions of greenhouse gases. Nevertheless on a per capita basis, these emissions create 0.99 tons for India, and 2.9 tons for China, in comparison with 19.68 tons for the United States of America and 3.99 tons for the world (SRIVASTAVA 2006). Just energy consumption is the greatest emitter of the environmental pollution.

Both countries are annually affected by natural catastrophes as well as the human-induced disasters. Natural disasters generally affect the populations living on the coastal areas and big river valleys, however the desertification and water deficiencies take generally place at inlands. Population pressure in combination with environmental pollution and lack of food is typical for cities or areas with high population density. Development projects generally affect people living near the rivers or another water sources, and on the croplands. Climate change has regional character and various level of consequence, nevertheless it most affected the economically poorest areas (for some geographical examples see Table 6-5).

Table 6-5: Environmental „hot spots“ in India and China

Environmental Factors	Affected Regions - India	Affected Regions - China
Natural disasters	Coastal areas, Ganga and Brahmaputra river basins, states of Orissa, Assam, Andhra Pradesh	Coastal areas, South and South-East China
Desertification (land degradation)	West India, South-West India, North-East India	North and North-West China (Inner Mongolia, Uyghur region), Tibet
Water deficiency	States of Punjab, Haryana, Uttar Pradesh, Rajasthan, Andhra Pradesh, Karnataka, Madhya Pradesh, Orissa and Maharashtra	North China, cities
Population pressure	Gangetic Plains, Rajasthan, river valleys, cities	River valleys, coastal areas, cities
Climate (e.g. sea-level rise)	South India, small islands	South and East China
Food deficiency (security)	Rural regions	Rural regions
Development projects	River basins	River valleys

Migration due to the depletion of natural resources (water, land, etc.), or due to drought, lack of water and desertification caused by climate change, is a historical human phenomenon. Some observers emphasize that civilizations, including Indian and China's have declined and fallen due to climate-related reasons throughout the history, nevertheless the scale of the recent threat is set to outstrip all historical projections and contexts, in particular in the two mentioned countries. Debate about the possibilities of predicting the effects of this threat is becoming more frequent in both science and humanitarian activities, however the issue is still under-researched. However modern civilization brings new phenomenon relates with environmental degradation - ,development-induced displacement', as the economic development consequence – the extent of the phenomenon is still unclear.

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