

# ASIA

## ANALYTICAL REPORT FOR THE WHITE PAPER ON AUSTRALIA'S AID PROGRAM

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## Executive summary

### *The strategic context*

1. The Asian story is important. Asia is home to more than half the world's population, and two thirds of the world's poor. It is also home to the fastest growing economies in the world, and by 2050 three of the four largest economies in the world—Japan, China, and India—could plausibly be in Asia. Asia has produced some of the most dramatic reductions in poverty in history, with India, China and Vietnam each halving their rates of poverty in a decade and lifting tens of millions out of poverty.

2. But growth is not uniform and poverty is still a major issue. Asia is home to seven of the world's Least Developed Countries or 12 Low Income Countries, a number of fragile states, and countries with longstanding and poor records of growth and stability such as the Philippines. North Korea and Burma have poor growth histories and prospects in the near term. Inequalities are also emerging within national borders. And, despite great progress, there are still more than 700 million people living on less than US\$1 a day in Asia. Importantly there are a further 1.9 billion living on less than US\$2 a day, who can be tipped back into extreme poverty by external shocks or changes in circumstances.

3. Regional power dynamics are changing, and regional stability in the next ten years will depend upon how the great power relationships evolve and how the region accommodates the economic and political rise of China and India. Growth is amplifying the twin challenges of state strength and state weakness in Asia. Increasingly, national economic security for countries in the region will be determined by a country's access to export markets, its capacity to retain international competitiveness, and its secure access to resources, especially water and energy. Stability is also affected by the fact that the Asia and Pacific regions are home to at least five countries with nuclear weapons and at least three potential flashpoints (Korean peninsular, Taiwan Straits, Kashmir). Peaceful, democratic elections in Indonesia last year were important for stability in Indonesia and the region more generally. But there remain several longstanding internal insurgencies in Asia (including in the Southern Philippines, Nepal and Sri Lanka), and terrorism has emerged as a key issue in the region.

### *Strategic development challenges in Asia*

4. Asia faces enormous—and varied—development challenges, including poverty, economic, demographic, social, environmental, and health.

5. Some challenges require large funding. East Asia alone requires approximately US\$200 billion annually over each of the next five years if it is to alleviate the critical infrastructure bottlenecks already constraining growth. An estimated US\$30 to US\$40 per capita is needed annually to finance the minimum health service package in Asia, but Bangladesh, Cambodia, Laos, Pakistan, Mongolia, and Vietnam all spend less than US\$10 per capita. Similar large-scale financing needs exist in the education sector.

6. Few growth and development challenges can be solved by money alone. Much important work can be achieved through ideas, good policy and good leadership. Asia

has 88 million unemployed youth and the trend is worsening, with all that means for social and political stability in the region. Money alone will not solve this. Policies and institutions matter. Well designed aid can help shape the enabling environment for a vibrant private sector.

7. Some development challenges in Asia are longstanding and some are new. In the health sector alone, tuberculosis—an old enemy of the poor—kills 700,000 people a year in South-East Asia and infects a further three million. Polio has just re-emerged in Indonesia and there are relatively new and emerging challenges, including HIV/AIDS, SARS, and other pandemics.

8. How well Asia responds to such large and varied challenges will affect developments in the region and beyond. The breadth and depth of Australia's relations with Asia—economic, political, security, and environmental—means there are direct national interests at stake. Australia cannot disentangle itself from these challenges, or from Asia's responses to them. Nor should it.

### *Aid: making good choices*

9. Australian aid has assisted development in Asia to date. It can do so in the coming decade too. But aid cannot—and should not—try to respond to every development challenge, especially in a region as large and varied as Asia. Making good choices about where, why, how, and for how long aid should be provided in Asia is critical to the effectiveness of Australia's engagement with the region.

10. Four principles should therefore be used to screen and prioritise broad strategic options for Australian aid in the region. The first principle is that aid should make a clear contribution to economic growth in Asia, as a necessary (although not sufficient) condition for stability, security, and poverty reduction in the region. The second principle is that, given Australia's proximity to the region, priority should be given to aid activities that most align with Australia's national interests (broadly defined). The third principle is that, given the small size of aid relative to the challenges of the region, aid modalities need to be chosen which have the biggest long-term impact. The fourth principle is that, while strategic focus is important in Asia, so too is flexibility and the capacity to respond to the rapidly changing environment of the region (page 15).

11. This chapter offers a menu of prioritised choices for the Australian Government, together with recommendations for the coming decade. Some challenges and choices are thematic, focusing on what Australia should do. Other choices are more operational: 'how' we should do it. Still other choices are centred around programs and countries, focusing on where Australia should devote its attention and put its resources.

12. Common themes underpin these choices. Aid to Asia, for example, needs to be larger, bolder, more focused, and more modern. Ideas will count as much as money, although both will be needed.

### *Recommendations on what Australia should do*

13. First, Australia should **consolidate its efforts** in sectors central to driving good quality growth and reform in Asia, such as economic governance and trade/economic integration. This is increasingly important as China and India expand their economic

engagement within the region and beyond. All countries in Asia will have to manage the rapid structural change of their economies if they are to retain their international competitiveness and therefore their primary sources of growth. The Philippines and Indonesia face particular challenges here, given their declining competitiveness. But aid can play a catalytic and helpful role in supporting necessary economic reforms. Fine tuning of Australia's work on economic governance is also recommended to give more explicit attention to private sector growth and investment: these main drivers of sustainable growth in Asia may have been underplayed in Australia's strategies to date (pages 15 to 17).

14. Second, Australia should **significantly scale up** its engagement in certain sectors or the forms of aid which will increasingly drive growth and reform in Asia. For example, the Australian Development Scholarships program should be significantly expanded and further modernised, because scholarships can build supply *and* demand for reform within developing countries; drive reform from within; build the next generation of leaders and reformers; and build good people-to-people links. Tertiary education and scholarships can be potent forms of assistance in fragile states. Significant opportunities also exist for scaled up and high-impact engagement in the health sector where development issues and Australia's national interests closely coincide. Opportunities include an initiative for preparedness and response to pandemics; leveraging up the impact of some of the large funders of health in the region; addressing some larger system-wide failings of health service delivery; and helping to plug priority but overlooked public health needs. Similar strategic opportunities are available in education including upper secondary, tertiary, vocational, and girls' education (page 17).

15. Third, if Australia is to help shape the main drivers of change in Asia, then it needs to **work in new areas** not traditionally large in the aid program. Physical infrastructure (especially transport) and resources (especially energy) are key drivers of the level—and quality—of economic growth in Asia, and for this reason alone should attract more Australian attention. The nature of those massive investments will have profound environmental impacts on the region and, arguably, even on climate change globally. There is a great deal Australia could do to help shape the directions these large investments will take, including by through regulatory environment and governance arrangements of public infrastructure; promotion of clean and efficient energy; and conservation of water and other resources (page 22).

16. There is also a case for considering initiatives in the relatively new field of political governance, especially building up the *demand* side of reform and the *how* of reform (page 25).

### ***Recommendations on how Australia delivers aid to Asia in the coming decade***

17. Australia already has a number of comparative advantages in the way it approaches and delivers aid in the region. But if Australia is to increase its impact over the coming decade it needs to consider three changes in the way it delivers aid.

18. First, Australia needs to be much more strategic and proactive in the way it engages with the large **multilateral** development institutions operating in the region. The World Bank and Asian Development Bank (ADB) lending to Asia was more than US\$10 billion in 2004—some 30 times larger than Australia's bilateral program to the region.

The Global Fund to fight AIDS, Tuberculosis, Malaria—and similar new foundations—bring billions of dollars more to the region. Australia, an essentially grant donor with strong country presence and knowledge of the region, should be in a good position to leverage the policy and lending operations of such institutions. Even more importantly, however, Australia should contribute to the analytical, research, and advocacy agendas of these large, influential institutions in the coming decade (page 26).

19. Second, it needs to be recognised that **ideas** will be a more potent source of quality growth and development in much of modern Asia than will traditional technical assistance and projects. Australia should therefore pay more attention to supporting and disseminating analytical work and applied research on the *how* of reform; vigorously pursuing institutional links; promoting centers of excellence on priority issues directly relevant to Asia, including clean energy; and building people-to-people links to promote and sustain reform (page 26).

20. Third, **aid architecture** in Asia is rapidly changing and Australia needs to respond to, and help shape, these changes. At the **multilateral** level, the coming decade will see major changes to the way the World Bank and ADB engage in the region. The role of newer but potentially significant institutions like the Global Fund to fight AIDS, Tuberculosis and Malaria will also need attention. And many would argue that decisions made—or not made—under the World Trade Organization (WTO) will drive economic growth and development in a globalising region like Asia. There are also important developments arising at a **regional** level in the coming decade, including the East Asian Summit, cooperation in the Mekong subregion, and similar initiatives. At the **bilateral** level, the coming decade will see the continued rise of new and important aid providers in the region (including China) at a time of when traditional Western donors change the levels and nature of their engagement and increasingly harmonise activities. **Non traditional development**—for example remittances and migration—will also be increasingly important in Asia in the next ten years although rapidly increasing cross border flows of money and people have ambiguous development impacts and carry security implications. There are policy, operational, and resource implications in all this for Australia, and AusAID (page 28).

### *Recommendations on where Australia provides aid*

21. Situations can change quickly at the country level in Asia and aid programs need to respond accordingly: the rapid and large scaling up of aid to post Tsunami Indonesia and elsewhere is the latest illustration of this. Looking ahead, a significant shift in North Korea or Burma could require large and rapid responses from Australia. Flexibility and nimbleness of aid at a country level are therefore important.

22. On the other hand, a ten-year time horizon—as offered by the White Paper — provides an opportunity to have an aid program that is strategic, focused and of sufficient duration that it can make real differences.

23. More specifically, **Indonesia** should, quite properly, be the largest and broadest development program Australia has in Asia in the coming decade: Indonesia's size, proximity and development challenges overlap with the national interests Australia has at stake with that country. For similar reasons, Australia should also continue with its broad spectrum relationship with **East Timor**, focused on maintaining stability, developing human capacity, and improving viable youth employment. In fragile states such as East

Timor, Cambodia and the Philippines, young people are potential agents for change in demanding reform. But they are also potential agents for instability, especially if unemployed. A development focus on education and employment opportunities for young people can therefore help promote governance and stability (page 29).

24. The **Philippines**—especially Southern Philippines—poses special developmental challenges and issues of national interest: innovative activities in education, building demand for reform and promoting stability in Mindanao may be the most fruitful strategic intervention. The **Mekong** region has special characteristics and opportunities for strategic aid engagement (pages 30).

25. Whether Australia should provide aid to fast-growing **China and India** in the coming decade is an important policy decision for Government. The arguments for and against this are discussed in this paper. A bold, forward-looking, flagship initiative for **East and South Asia** is canvassed that would demonstrate development impact and align closely with Australian national interests (pages 32 to 35).

### *Conclusion*

26. Asia is large, highly varied and facing complex challenges that affect the lives of billions of people. How it responds to these challenges will directly affect Australia's national interests. Aid, though small, can help shape the response to these challenges, but it needs to be selective and sustained if it is to have impact.

27. The package of recommendations in this chapter are tailored to the special needs of a rapidly changing and varied Asia. Taken together, they seek to get to the heart of promoting durable reform in Asia. The recommendations are coherent and self reinforcing: shifting upstream to engage more on analytical and applied research that will complement an expanded and new generation of scholarships, institutional links, and enhanced engagement with the policy and analytical agendas of the multilateral development banks. Each element of the package can be applied in varying degrees to the differing country needs of Asia: from large and fast growing East and South Asia, to small and vulnerable fragile states.



## Asia: the strategic and development context

### A story of growth—at least for some

1.1 The Asian region has experienced remarkable economic growth over the last 15 years, halving the rate of poverty in countries like India, China and Vietnam in a decade. The region has rebounded from the 1997 financial crisis, and East Asia in particular has seen dramatic growth, with China averaging 9.7 per cent growth over the last ten years. Growth in South Asia has also been strong, largely due to the trajectory of India. Growth in the region looks set to proceed over the next decade, as China and India continue to benefit from—and themselves drive—trade. The world's economic centre of gravity will likely continue to shift to Asia: by 2050, based on current trends, China and India could well join the United States and Japan to form the four largest economies in the world.<sup>1</sup>

1.2 Economic growth has brought opportunities to the region, including an increase in linkages between East, South-East and South Asia. The search for further growth and the desire to prevent another shock such as the 1997 financial crisis will likely keep driving regional trade, economic and financial cooperation efforts. The economic interdependence of the region has increased—at least among the economic reforming countries—and a number of bilateral and regional trade agreements have been forged or are under negotiation. The imperatives of these trade arrangements and of WTO accession and membership are shaping policy and institutional reform throughout Asia and the pattern of growth in the region and beyond. Some sub-regional connections are also growing: strong trade flows with China, for example, are creating an economic growth corridor in the Mekong.

1.3 Linkages are also increasing politically, as the regional architecture evolves into a broader pan-Asian construct. China is continuing to look outward, India is looking to its east, and the East Asia Summit process is bringing together the ASEAN plus three (China, Japan and South Korea) states with India, New Zealand and Australia.

1.4 But the remarkable story of economic growth in Asia has to be seen in the context of the enormous challenges still remaining. Table One tells the story: growth is not uniform, with some 700 million people living on less than US\$1 a day and 1.9 billion living on less than US\$2 a day. Asia is also home to seven Least Developed Countries<sup>2</sup>, and using a slightly different classification system, is home to 12 Low Income Countries.<sup>3</sup> Tuberculosis—an ancient enemy of the poor—kills 700,000 people a year in South-East Asia alone, and infects a further three million.<sup>4</sup> Median fecal coliform levels in Asian

<sup>1</sup> Goldman Sachs. Global Economic Paper Number 99. 'Dreaming with BRICS: The Path to 2050'. October 2003.

<sup>2</sup> Least Developed Countries are defined by the United Nations using three criteria: income per capita of less than \$US750 per annum; weaknesses in human resource profile; and economic vulnerability. With these criteria, Asia is home to the following Least Developed Countries: Bangladesh, Bhutan, Cambodia, East Timor, Laos, Myanmar, and Nepal. The number rises to eight if Afghanistan is included in the definition of Asia.

<sup>3</sup> Bangladesh, Bhutan, Burma, Cambodia, India, Indonesia, DPRK, Laos, Nepal, Pakistan, East Timor, and Vietnam. The number rises to 14 if Afghanistan is included in the definition of Asia.

<sup>4</sup> *HIV/AIDS, Tuberculosis, Malaria. The Status and Impact of the Diseases*. The Global Fund to Fight AIDS, Tuberculosis and Malaria. 2005. Page 32.

rivers (a key indicator of health risk) are three times the world average and 50 times higher than the level recommended by the WHO.<sup>5</sup>

Table One

Selected indicators for countries in the Asia region

Country	Total population 2003 (millions)	Total expected population 2015 (millions)	Gross national income 2003 (billions US\$)	Gross national income per capita 2003 (US\$)	Share of population living on less than US\$2 day (%)	Share of children under five who are underweight (%)
Australia	19.90	21.9	436.50	21,950	n/a	0
Afghanistan	n/a	n/a	n/a	n/a	n/a	n/a
Bangladesh	138.10	166.0	55.00	400	82.8	52
Bhutan	0.87		0.55	630	n/a	n/a
Burma	49.40	55.7	n/a	n/a	n/a	n/a
Cambodia	13.40	16.4	4.10	300	77.7	45
China	1,288.40	1389.5	1,416.80	1,100	46.7	10
DPRK	22.60	24	n/a	n/a	n/a	28
India	1,064.40	1231.6	570.80	540	79.9	46.7
Indonesia	214.70	246.8	173.50	810	52.4	27
Laos	5.70	7.3	1.90	340	73.2	40
Malaysia	24.80	29.6	96.10	3,880	9.3	n/a
Maldives	0.29	n/a	0.69	2,350	n/a	n/a
Mongolia	2.50	2.9	1.20	480	74.9	13
Nepal	24.70	31.1	5.90	240	82.5	48
Pakistan	148.40	192.8	77.60	520	65.6	35
Philippines	81.50	98.2	87.80	1,080	46.4	n/a
Sri Lanka	19.20	21.5	17.80	930	50.7	n/a
Thailand	62.00	66.3	135.90	2,190	32.5	n/a
East Timor	0.87	n/a	0.37	460	n/a	43
Vietnam	81.30	92.4	38.80	480	n/a	34

Notes: n/a = data not available

Source: World Bank, *World Development Indicators 2005*

## State strength, state weakness, and uneven internal growth and other challenges

1.5 The region also faces the twin challenges of state strength and state weakness. Economic growth is fuelling a potentially destabilising change in regional great power dynamics, while amplifying the stresses on the states left behind.

### *State strength*

1.6 Regional stability in the next ten years will depend upon how the great power relationships—between the United States, Japan, China, India, and Russia—evolve, and how the region accommodates the economic and political rise of China and India.

<sup>5</sup> *Environmental Challenges of Development in the East Asia and Pacific Region*. World Bank.

1.7 China's rise and its relations with the United States, Japan and India will be of particular importance to the regional balance of power. United States-China relations will depend on the degree to which the United States seeks to remain engaged in the region and how it responds to the increasing economic, political and diplomatic influence of an ascendant China. China-Japan rivalry remains deep seated, and may increase further as China continues to rise and Japan moves to adopt a more active strategic posture.

1.8 The Asia and Pacific regions are home to the world's largest militaries and at least five nuclear powers. While interstate conflict in the next ten years is unlikely, there is a risk that the regional balance of power will fail, and interstate conflict ensues. Traditional flashpoints in the region include the Korean peninsula, the Taiwan Straits and Kashmir.

1.9 But new dimensions are being added to interstate relations by growing nationalism within some states, increasing pollution, and by growing rivalry for markets and access to natural resources, especially energy. In some instances these issues will breed cooperation, such as energy pipelines linking states, and the growth of regional and subregional bodies to oversee resource allocation and to mediate in disputes. But they could also breed competition and stoke tensions. The intensifying search for export markets and for secure sources of energy, for example, is already a key driver of China's and India's foreign policy. While the India-China relationship has been maturing economically and politically, scope still exists for competition in the over markets in South-East Asia and energy in Central Asia. Energy is also an increasing source of friction in the China-Japan relationship.

1.10 Fast economic growth has brought significant development and social challenges to the states that have most benefited from it. The environment is one such issue: China has 16 of the world's 20 most polluted cities, and underground water reserves are only a quarter of their level of 40 years ago as a result of urbanisation and inefficient and excessive industrial use of water.<sup>6</sup> China now has 52 river sections so contaminated they are not suitable even for irrigation.<sup>7</sup>

### *State weakness*

1.11 Some states are gaining little benefit from the region's economic growth and the disparity in the performances of states looks set to grow starker over the coming years. Important parts of North-East Asian economies have by and large integrated into a globalised production chain. But all states, especially those in South-East Asia, also face the significant challenge over the coming decade of improving export competitiveness and moving up the value chain in light of the dramatic change in the economic landscape brought about by China and India's growth and export prowess. States such as Taiwan, South Korea, Thailand, and Vietnam are well placed to continue to benefit from the region's growth trajectory because they have demonstrated a capacity for rapid structural change in their economies.

1.12 Some states may not be able to adjust their economies quickly and deeply enough in response to the rise of China and India. Indonesia and the Philippines—home to more than 90 per cent of the population of South-East Asia—face challenges. As shown in Table Two, these countries already face deteriorating competitiveness across the board.

<sup>6</sup> *China 2001–2010: Political, Economic and Social Issues of Reform and Transformation*. FitzGerald, Davies and Tang, 2005.

<sup>7</sup> *Connecting East Asia*. Page 22.

1.13 The slipping of Indonesia and the Philippines to last and second last rankings respectively on physical infrastructure is worrying, given the critical role of infrastructure in determining international competitiveness.

**Table Two**

**Competitiveness rankings out of 60 countries**

	2001	2002	2003	2004	2005
<b>Philippines</b>					
Economic performance	33	40	34	43	37
Government efficiency	34	35	32	38	42
Business efficiency	31	36	40	48	49
Infrastructure	42	43	47	56	59
<b>Indonesia</b>					
Economic Performance	40	37	42	51	55
Government efficiency	37	47	46	56	54
Business efficiency	43	44	49	57	58
Infrastructure	46	48	48	59	60

*Source: World Competitiveness Yearbook, 2004, and ADB<sup>8</sup>*

1.14 Indonesia's democratic elections last year went smoothly, and continued the trend of democratisation in the region. But Indonesia faces significant challenges, including weak institutions, separatist concerns, terrorism, and the pressing need for economic reform. The Philippines' trajectory has been resolutely negative for a number of years: it is beset with a fiscal crisis, weak governance, poor service delivery, and political instability.

1.15 Several fragile states in Asia lack the human capacity, and physical, social and institutional infrastructure to capitalise on regional growth and risk lagging ever further behind. A vicious cycle exists in fragile states, in which weak governance and institutions, poor service delivery, a stalled economy, and instability combine to further corrode governance and institutions, reduce service delivery, erode state legitimacy, breed greater instability, increase the numbers of poor, drive investors further away, and drive the economy further down. This cycle is even more pernicious in conflict or post-conflict environments.

1.16 Cambodia, East Timor, Laos, and Nepal are among the poorest countries in the world, with weak governance, poor human development indicators and a chronic lack of human capacity due in part to their history of conflict. Cambodia, Laos and Nepal might benefit from their geography: Cambodia and Laos are in the Mekong growth corridor and Nepal is next to India. But they might also remain fragile and unstable and therefore havens for transnational crime. Cambodia also faces immediate challenges in adjusting to China's rapid expansion of clothing and garment exports in Cambodia's traditional export markets.

<sup>8</sup> *Draft Regional Cooperation Strategy Program: Southeast Asia Region*. ADB. March 2005.

1.17 East Timor has one of the highest fertility rates in the world, with an average of nearly eight children per woman. Large numbers of young men have few job prospects: this fuels urban drift, social instability and crime, and can also lead to political instability as disaffected youth rally around any cause and any demagogue. Other states, including Cambodia and the Philippines, have similarly pronounced youth bulges, with population growth rates outstripping economic growth rates over the medium to long term.

1.18 North Korea and Burma have a different pathology: they have strong regimes and strong elements of the state apparatus combined with a closed and profoundly weak economy, weak governance, and weak society. The collapse of the apparatus of state power in either of these states could mean they lurch into acute crisis, with significant economic, humanitarian and security consequences including potentially sizeable refugee flows.<sup>9</sup>

1.19 Managing state weakness is a key issue facing the region in the next decade. Instability within fragile states can radiate out into the region in the form of refugees, violence, pandemics, and transnational crime. The security, economic and humanitarian impact would increase dramatically if they collapse.

### *Uneven internal growth and other challenges*

1.20 Growth has not only been uneven among the states throughout the region. States such as China, India and Vietnam are experiencing starkly uneven growth internally. Uneven internal economic growth and the phenomenon of jobless growth are contributing to urban drift throughout the region as large numbers move to the cities in search of work. By 2020, two billion people—half of Asia's population—will live in urban areas with about half of those in slums. Eighteen of the world's 27 mega-cities will be in Asia.<sup>10</sup>

1.21 The World Bank notes that economic growth in China no longer has a dramatic impact on reducing poverty: 'Most of the remaining poor are cut off from the dynamic market economy for one reason or another: they are in remote locations far from markets and/or ethnic minorities not well integrated into society and/or disabled'.<sup>11</sup> This has led to a sharp rise in rural and urban inequality in recent years.

1.22 These trends have important implications for internal social and political stability, and could even derail growth in these states. There are significant interactions between large numbers of unemployed males and the potential for social and political violence, and security more generally. One study<sup>12</sup> notes that 'neither poverty alone nor worsening economic trends predictably produce acute conflict. Nor are economic conditions and

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<sup>9</sup>That risk, however, is not an argument for turning a blind eye to such authoritarian and closed regimes or preferring the status quo. As noted in one recent study looking at the link between poorly governed states and United States national security: 'Local elites cannot be evaded or wished away...we know from decades of painful experience that benign neglect, indulgence, or isolation seldom loosen these groups' hold on power'. (Reference: *On the Brink: Weak States and US National Security: A Report of the Commission for Weak States and US National Security*. Centre for Global Development. May 2004). Having said that, it is also clear that finding entry points to promote reform in such countries is difficult.

<sup>10</sup> *Megacities*, Asian Development Bank Seminar Series. Megacities are defined as having a population of ten million or more people.

<sup>11</sup> *Improving the Efficiency of China's Growth is Important for the Whole World*. David Dollar. World Bank.

<sup>12</sup> *Youth and Conflict: A Toolkit for Intervention*. US Agency for International Development, Office of Conflict Management and Mitigation.

trends by themselves useful in explaining failed states. However a disproportionately large youth cohort correlates with the potential for violence, especially if the youth have frustrated aspirations through *some* level of education but *limited* employment opportunities. Development agencies therefore need to note that education *per se* is not always a force for stability.<sup>13</sup> This is important, since Asia has an estimated 38 million people aged 15 to 24 who are unemployed and this trend is worsening.<sup>14</sup>

1.23 Asia also faces the demographic challenge of ageing and the prospect of old age poverty. The United Nations notes that more than half of the world's population already live in Asia and this will increase to 63 per cent by 2050; that the number of people aged 60 and over in China, India and Indonesia alone will increase from 222 million in 2000 to 831 million in 2050; and that population dynamics have created several gender related issues which could worsen the welfare situation, particularly of women for countries in Asia.<sup>15</sup> The challenge of an ageing population is acute in Japan, but also will occur in the next half century in China, Sri Lanka, Thailand, and several North and Central Asian states still developing.<sup>16</sup> Within the next decade or two, the demographic imperatives of an ageing population in some states and youth bulges in others might lead to political movement in the region on the issue of labour mobility.

1.24 Uneven access to state resources, service delivery, economic opportunity, and poor governance—combined with sectarian tensions—have given rise to internal conflicts (for example, in the Philippines). The state has little reach into parts of the Philippines, particularly in the south, and this political vacuum has been filled by both Muslim and Communist insurgents. Localised violence in parts of the region looks set to continue in the next decade.

## Transborder threats

1.25 The increased movement of goods, services and people is exacerbating transborder security threats, including transnational crime and terrorism, pandemics and natural resource depletion.

1.26 Organised crime such as gambling, drugs and the sex industry is increasing along corridors of trade and economic growth. Transnational criminal networks are exploiting the increasing disparity between and within states. As some prospering states improve border controls and security infrastructure, transnational criminal networks move to states with weaker internal security. Fragile states can thereby become centres of operation for illicit activities such as the drug trade, people and sex trafficking, money laundering, and identity fraud. Laos, for example, with its porous borders shared with five neighbours, is considered to be at growing risk of becoming a destination for transnational crime.

1.27 Terrorist networks can also use fragile states with porous borders as bases in which to hide, train or from which to launch attacks against other states and interests in the region. Cambodia, for example, is an increasingly attractive haven for transnational criminal operatives as neighbours such as Thailand have tightened their border security

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<sup>13</sup> *Youth and Conflict*. Page 6.

<sup>14</sup> *Economic and Social Survey of Asia and the Pacific 2005*. Page 41.

<sup>15</sup> *Economic and Social Survey of Asia and the Pacific 2005*. Pages 219 and 223.

<sup>16</sup> *Economic and Social Survey of Asia and the Pacific 2005*. Page 224.

and cracked down on crime. Cambodia has a growing drug trade and the terrorist operative Hambali spent several months in the state a couple of years ago.

1.28 Linkages with international terrorism have increased in South-East Asia. Al Qaeda has links with the regional terrorist network Jemaah Islamiah and these networks are taking advantage of state weakness, sectarian violence and separatist movements born of local grievances and have formed links with local militant organisations. The separatist conflict in the Southern Philippines, for example, has acquired an international overlay, as the terrorist network Jemaah Islamiah has exploited the instability, deprivation and extremely weak state apparatus in that part of the state. Terrorist operatives have moved across porous borders in the region to form links with local insurgent groups the Moro Islamic Liberation Front (MILF) and Abu Sayyaf.

1.29 Increasing interdependence will also likely increase the relevance of the Central Asian Republics to the rest of Asia. The republics are characterised by stalled economies, social and political instability, links with jihadi extremists, and bountiful supplies of energy. This makes them not only a possible theatre for great-power competition, but also a potential exporter of instability in the form of transnational crime (including weapons and the drug trade) and militant extremism, particularly into the restive, Muslim-majority, and energy rich Chinese province of Xinjiang.

1.30 Environmental damage and natural resource depletion are also transborder by-products of rapid economic growth in the region. Concerns about increasing pollution and resource depletion will drive the growth of nuclear energy and a demand for clean energy. Water will be a significant issue in the medium term, and will promote cooperation and competition. The Mekong River Commission is an example of efforts at cooperation among the Mekong states Thailand, Laos, Cambodia, and Vietnam (with Burma and China as dialogue partners) to discuss the sustainable management of water resources. But water tensions exist already, for example, between China and Pakistan, Bhutan, and Nepal, and in Central Asia, as well as in the Mekong.

1.31 HIV/AIDS and other pandemics are clearly important transborder issues in Asia: paragraph 4.6 onwards.

### **Possible shocks**

1.32 The above is the likely context in which the aid program will operate in Asia in the medium term. It is important, however, to be cautious and modest about predicting the likely strategic lay of the land. Economic growth in the region and the other trends outlined above might stall or cease as shocks emerge. One of the most significant would be if a nuclear terrorist attack occurs in Asia Pacific. Such an attack—for instance in the United States—would have a major impact on global stability and the global economy.

1.33 Another potential shock would be if China's economic growth were to stall—for example as a result of a banking or financial crisis, triggered by bankruptcy of large, unviable, state owned enterprises. Alternatively—or maybe as a result of stalled growth—there may be political crises and internal turmoil. This is not implausible if social pressures arising from the disparity in wealth and internal pressures for political reform grow in China. An abrupt halt to China's now seemingly inexorable rise would have significant consequences—first and foremost economic—for the region.

1.34 India's growth might also stall. There are varying schools of thought on the relative future performances of China and India. One school maintains that while China's growth is the more dramatic, it is more vulnerable because of its political system and other internal pressures, whereas India's fundamentals, including its democratic process, are more sound. Another school holds that the Chinese system has proved itself reasonably agile and able to calibrate the political response required at all stages of its growth, which puts it in a better position than does the more lumbering political system of India. Both views are plausible, and either might come to pass. Of course, China's and India's trajectories are not binary: both could stall or rise.

1.35 Asia is not necessarily more exposed, or vulnerable, to exogenous shocks than other regions. Indeed, evidence suggests the robust and flexible economies of East Asia are quite well placed in terms of shocks.<sup>17</sup> On the other hand, when shocks occur, they can have a major impact on growth and poverty. The 1997 Asian financial crisis is estimated to have made 30 million people in Asia suddenly very poor and, according to the ADB, the Boxing Day Tsunami meant two million additional people joined the ranks of the 'new poor'.<sup>18</sup> Aid can make a big difference in the severity, cost and duration of such shocks. The UN notes that for every dollar spent on disaster reduction about US\$10 is saved by limiting the needs of subsequent relief, but research also shows that of all aid received for disasters only two per cent goes on prevention.

### Australia's national interest considerations

1.36 Events in Asia matter to Australia. Australia is part of the region and cannot insulate itself from the challenges the region faces: ever-increasing regional interdependence means these challenges directly affect Australia. A sharp deterioration in great power relations in Asia or a crisis on the Korean peninsula, for example, could destabilise the region, threaten prosperity and have significant security and economic implications for Australia. Fragile states can also destabilise the broader region, as refugees, violence, and transnational crime (such as people smuggling and trafficking), drug smuggling, and gun running spread across porous borders. Terrorist operatives can use weak states as bases in which to train and from which to attack other states in the region, including potentially Australia. Australia has of course already felt the brunt of terrorism in the region, with the Bali bombing in October 2002 that killed 202 people including 88 Australians, and the bombing outside the Australian Embassy in Jakarta in September 2004, with 11 victims. And pandemics in the region and environmental damage have consequences for Australia.

1.37 Our prosperity and security are inextricably bound up with the prosperity and security of Asia. Indonesia, East Timor and the Philippines most directly engage Australia's interests: they are nearest to Australia of the states in Asia and their instability has a great capacity to affect Australia. But it is also in Australia's interests that the rest of Asia prosper and be secure.

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<sup>17</sup> The World Bank notes that 'what is remarkable about East Asia is not that it experienced a crisis in 1997 but that it experienced so few crises over the preceding decades. By and large, developing countries have one year of negative per capita growth roughly once every three years. In East Asia the average is half that rate. Korea has had only three years of negative per capita growth since 1961.' See *Economic Growth in the 1990s—Learning from a Decade of Reform*. World Bank. 2005. Page 4.

<sup>18</sup> *Economic and Social Survey of Asia and the Pacific 2005: Dealing with Shocks*. ESCAP. Page 38.



1.38 So what role can the aid program play within a whole-of-government approach to promote prosperity and stability in the region? This role needs to be grounded in a realistic assessment—as to what an aid program can and cannot achieve. Aid will have little bearing on most aspects of great power relationships in Asia Pacific, but it can help find further opportunities for economic growth and shape the policy environment to drive further growth. It can also have an impact on state weakness and uneven growth among and within states, and help minimise possible threats such as transnational crime, terrorism, financial shocks, pandemics, and the effects of resource depletion and environmental damage.

## The response: making good development choices

2.1 The preceding section makes two points. First, strategic issues, growth and development are inextricably intertwined in Asia. Second, how well countries in the region manage these challenges has direct consequences for themselves, the region and Australia.

2.2 How Australia responds to these challenges is important. Making good choices is critical, especially in a region as large and varied as Asia. Aid cannot DO everything. Nor should it. This paper therefore recommends four principles to filter and prioritise Australia's aid response to the strategic challenges of Asia over the coming decade.

2.3 The first principle is that preference should be given to activities that contribute to sustained, high quality, growth in the region. Sustained high quality growth<sup>19</sup> is a precondition for prosperity, stability and security, and will do more than anything else to reduce poverty. As noted in a recent World Bank study of 14 countries: 'The pace of overall economic growth is the main factor that determines how quickly poverty declines' and that, on average, a one per cent increase in GDP per capita reduced poverty by 1.7 per cent.<sup>20</sup>

2.4 The second principle is that aid interventions in Asia needs to align with Australia's national interests. These interests are increasingly intertwined with the strategic and development challenges facing Asia by virtue of Australia's location and increasing economic integration in the region. Australian aid can complement the broad and constructive engagement the country has with Asia, including whole-of-government engagement, and broader economic integration.

2.5 The third principle is that aid should be increasingly strategic and leverage up its impact if it is to be effective over the coming decade. This is particularly true in a region as large and varied as Asia, where even total aid—let alone Australian aid—is relatively small (latest figures show, for example, that aid to Indonesia represents just 0.8 per cent of Indonesia's economy, or US\$6 per capita per year. The relative size of aid in other countries of Asia is similarly small).<sup>21</sup> Australian aid to Asia should increasingly focus on what it does best and where it can demonstrate comparative advantage.<sup>22</sup>

<sup>19</sup> There are various definitions of 'quality' or 'pro-poor growth'. See for example *The Quality of Growth*. World Bank Publication. September 2000 and *What is Pro-Poor Growth and why do we need to know?* DFID Pro-Poor Growth Briefing Note 1. February 2004. In essence, this paper uses the term 'quality growth' to mean growth that is environmentally and socially sustainable and reduces poverty.

<sup>20</sup> *Pro-Poor Growth in the 1990s: Lessons and Insights from 14 Countries*. World Bank (and others). June 2005.  
<sup>21</sup> *World Development Indicators 2004*. World Bank. Page 335. Similarly, ODA accounts for approximately just one per cent of gross investment in low and middle income countries in East Asia generally; 0.1 per cent of

2.6 The fourth principle is that, while being strategic and focused, aid should also be flexible and responsive to the rapidly changing environment of Asia. Many major events that now characterise the region were not and could not have been predicted ten years ago.<sup>23</sup> The same applies now.

2.7 Using those four principles to screen the wide array of development challenges in Asia produces a package of recommendations and options for Government. These can be grouped under three broad headings: the challenges Australia should focus on in the coming decade; changed modalities for Australian aid; and changed country and regional priorities.

## Recommendations on *what* Australia should do

3.1 The recommendations are options: not all could or should be applied in all cases or all countries. It is worth noting that many recommendations overlap and reinforce each other. Improved domestic economic governance—for example through more transparent and predictable application of domestic commercial law—can improve prospects for trade, foreign investment, and broader economic integration. This, in turn, can help sustain and lock in the pace of economic governance reforms.

### Consolidation of existing efforts

3.2 Australia should continue and consolidate its existing efforts in areas central to driving growth and reform in Asia.

#### *Economic governance*

3.3 In practice, this means Australia should continue its focus on **economic governance**. International literature and experience demonstrate that good governance—especially economic governance—is at the core of quality economic growth. Evidence for this is overwhelming, including for Asia. One example emerges from the latest World Bank research on growth which reports that:

A successful pro poor growth strategy should have, at its core, measures to achieve sustained and rapid economic growth. These include macroeconomic stability, well defined property rights, a good investment climate, an attractive incentive framework, well functioning factor markets, and broad access to infrastructure and education.<sup>24</sup>

3.4 Australia has worked to support several—but not necessarily all—of those drivers of pro poor growth. For example, Australia has a very good record of working in

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China's economy; and 0.7 per cent of the Philippine's economy. It does, however, represent 17.3 per cent of the GNI of Lao PDR; and 12.7 per cent of Cambodia's GNI.

<sup>22</sup> The usual tests for good aid effectiveness should, of course, continue to apply over the coming decade. Good development is essentially about reform and change and aid programs should, at all times, support that process. Aid should not substitute for partner government's own efforts nor should it substitute for the private sector, support reforms that would have happened anyway, or support reforms that will never be sustained because of intractable vested interests. The environment for aid is changing rapidly and aid modalities need to change too.

<sup>23</sup> See separate paper entitled *If the White Paper had been written in August 1995*.

<sup>24</sup> *Pro-Poor Growth in the 1990s: Lessons and Insights from 14 Countries*. Page 2.

areas of broad macroeconomic stability, public sector financial management and land tenure and property rights in Asia. But if sustained and sustainable economic growth was to be the primary lens through which we maximise the impact of Australian aid, the time may be approaching where we shift the current emphasis on civil service and public administration reform as such and give more explicit attention to reforms that improve the **environment for private sector growth**. There are now several effective, innovative examples of how aid agencies can achieve high development impact in promoting, or working with, the private sector that could serve as a model, including the World Bank's *Doing Business* approach and innovative work on what is termed 'output based aid'.<sup>25</sup>

### *Trade and regional economic integration*

3.5 Australia should also continue and its efforts with **trade and regional economic integration**. The justification for this is clear. First, trade and economic integration is highly correlated with growth.<sup>26</sup> Second, the evidence<sup>27</sup> suggests that the dynamic growth of China and India over the coming decade will be one of the single biggest drivers of the level and pattern of growth and development in the region— there are major opportunities but also major risks. Third, Australia has fundamental national and broad whole-of-government interests at stake in the trade and economic integration path Asia takes over the coming decade. Fourth, 'trade is an opportunity, not a guarantee'<sup>28</sup> for quality growth so there may be slippages and missed opportunities. Countries can easily fail to capture the economic and developmental benefits of trade. The public good nature of well designed aid means it can help respond to market and government failures and be a catalyst for reform.

3.6 Australia has a successful record of facilitating trade and economic integration in the region, including aid funded support for China's accession to the WTO. New and significant opportunities are arising for aid to play a catalytic role in deepening economic integration in the region. Many of these initiatives have a major focus on economic growth and integration, and aid may therefore well have an important—albeit supporting—role to play.

3.7 However the sheer number of regional and subregional initiatives—see for example paragraph 5.11 below—means that aid interventions need to be selective and very strategic. Aid is likely to be most valued and effective in those regional and subregional institutions which drive the process of domestic internal reform for countries in the region; involve institutional or regulatory reform; or involve capacity building. The proposed greater use of applied research, 'ideas' and evaluation of reforms (paragraph 5.5) would also complement these activities. Australia could work with the ADB, which is clearly giving much higher priority to the regional economic integration.

<sup>25</sup> See *Doing Business in 2005: Removing Obstacles to Growth*. World Bank. For output based aid see [www.qpoba.org](http://www.qpoba.org)

<sup>26</sup> *Globalisation, Growth and Poverty—Building an Inclusive World Economy*. World Bank. 2001.

<sup>27</sup> *Asia and China: Growing Together?* Keynote Speech by President of the ADB, H Kuroda, at the Institute for International Economics. 23 June 2005. As one example: China's imports from Asia have risen by an average annual rate of 31 per cent over the period 2001 to 2003 in US dollar terms.

<sup>28</sup> *Economic Growth in the 1990s: Learning from a Decade of Reform*. World Bank. 2005..

## *Rural development*

3.8 **Rural development** will remain a critical driver of growth for many countries in the region over the coming decade. Poverty will be concentrated in the rural sector through to 2025. World Bank analysis shows that:

increasing agricultural productivity is the most efficient path for many countries to reduce poverty and inequality; that agricultural growth has been more pro poor than industrial growth in India and in Indonesia; and that in China primary sector growth has about four times the impact on poverty reduction as secondary or tertiary sector growth. Rural and especially agricultural growth reduced inequality not only in rural areas but also between rural and urban areas.<sup>29</sup>

3.9 Good quality rural development is also a strong driver of employment opportunities for youth in developing countries, food security and protecting the natural resource base. This is particularly true in countries like East Timor where more than 80 per cent of the population is rural and the vast majority poor, but it is also in many other countries of Asia.

3.10 Australia has a great deal to offer here. The benefits of Australia's agriculture, forestry and fisheries research and development continue to raise productivity and improve the sustainability of farming systems in much of Asia. Australia's knowledge in water and river basin management and the prevention and treatment of soil salinity is widely recognised and adopted. Expertise in agri-business development and management, trade policy and practice, quarantine and phyto-sanitary standards and regulation, and rural finance are also widely accessed by Asian governments and the private sector. The coming decade is also likely to see rapid developments in genetic based research applications in agriculture. Australia would be well placed to support work here.

## **Significant scaling up**

4.1 Australia should also significantly scale up its existing engagement in those sectors, or forms of aid, which will increasingly drive growth and reform.

### *Scholarships for leadership and reform*

4.2 One specific recommendation is to scale up **Australian Development Scholarships as a vehicle for the next generation of leadership and reform in Asia**. The justification for this is clear. The dramatic changes expected in a dynamic Asia in the coming decade require continued reform—for the fast growing and reform minded countries of East and South Asia as well as the weaker and fragile states of Asia. But reform for reform to happen it needs reformers.

4.3 Many in Asia argue that the most effective and durable reform comes from having a critical mass of well trained and capable local leaders, who have exposure to international practices in positions of authority to make their own systems adapt and work better. Such reform from within is preferred to externally provided technical

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<sup>29</sup> *Pro Poor Growth in the 1990s*. Op cit. Page 42.

assistance from consultants. A constant theme of stakeholders in the region, including from multilateral banks, is that Australian Development Scholarships were possibly the most effective form of aid Australia delivered and that they should be expanded and made even more effective. Scholarships not only build capacity and the supply side of reform, they also build the *demand* side of reform, especially if they involve a critical mass of reformers.

**Box One: Education, scholarships, leadership, and aid in fragile states.**

'The typical Low Income Country Under Stress (LICUS) not only has a small share of its population with above primary education, it also has a small population. Hence, the pool of educated people may well be too small either to generate or to manage the radical adaptations that are necessary in the transformation from LICUS status...Aid spent on providing a cadre of well educated people has an expected pay off far in excess of its likely cost.'

*Development Effectiveness in Fragile States: Spillovers and Turnarounds.* Lisa Chauvet and Paul Collier. Mimeo 2004.

4.4 Of course, scholarships do not automatically or always produce leaders and reform. Indeed, poorly conceived scholarship programs can become a tool of patronage that just help perpetuate a self-serving and closed elite that holds onto power and blocks reform. And development scholarships from Australia should never substitute for scholars who would have come here under privately funded sources. It is also important that development scholars return to their countries to contribute to the growth and reform process.

4.5 It is therefore important that Australia continue to look critically at the way it manages its scholarship program to ensure it maintains the standards of developmental effectiveness, integrity, efficiency, and accountability. Australia has an established and effective record of scholarships for development, dating back to the Colombo Plan. More, however, can be done to improve the impact of scholarships and ensure they meet the contemporary development needs of modern Asia. For example, scholarships could be better targeted in numbers and focus to meet the leadership, reform and capacity needs of fragile states. More can be achieved to ensure the impact of returning scholars is not diluted by perverse institutional incentives operating in the country to which they return. The people-to-people links that are a feature of scholarships could be better matched and consolidated with institutional-to-institutional links. And more progress could be made in building and supporting a professionally and developmentally oriented alumni of scholars.

4.6 It is also important to recognise that the largest contribution to growth and development will come, ultimately and quite properly, from the quality and effectiveness of a developing country's national system of education, from the basic education system through to tertiary and adult education. Much of this drive and effort has to come from the developing country itself, because the challenges that need to be addressed are system-wide. But development agencies can and should support the reform of education systems (see also paragraph 4.15).

4.7 Significant scaling up of Australian aid could also occur in **health**. The justification for this is strong. Good health is an important development objective in its own right, is a strong contributing factor to economic growth, and has direct links with poverty reduction.

### *Pandemics*

4.8 There is a strong case for scaling up Australian assistance to combat **pandemics**. Pandemics have large human, social and economic costs and can undermine development (see Box Two). Pandemics also directly affect Australian national interests by imposing potentially large health, social and economic costs on Australia. A significantly scaled up aid response is also warranted because of the strength of well-designed aid when public good arguments<sup>30</sup> are involved in combating pandemics.

4.9 **HIV/AIDS** is probably the most obvious pandemic challenge in the region. Given its importance a separate paper on HIV/AIDS was commissioned for this White Paper process. However the following points are highlighted with respect to Asia. First, the path of HIV/AIDS in Asia will determine the global situation. As noted by the World Bank:

With almost half the world's population, Asia will determine the future of the HIV/AIDS pandemic. If prevalence rates in China, Indonesia, and India increase to numbers similar to those seen in Thailand and Cambodia, the rate of HIV/AIDS would double globally. Such growth would be devastating for individuals—and for the region's health systems, economies, and social fabric.<sup>31</sup>

4.10 Second, Asia faces important challenges. Estimates of the number of people living with HIV in East Asia grew by almost 50 per cent between 2002 and 2004—one of the fastest growing AIDS epidemics in the world.<sup>32</sup> And worrying situations are likely to develop close to Australia over the coming decade. The latest UNAIDS Epidemic Update notes that HIV prevalence among sex workers in parts of the eastern most Indonesian province of Papua had reached 17 per cent, more than five times the national average for Indonesian sex workers. That same report shows that nearly six out of ten sex workers in East Timor have never heard of AIDS, four out of ten do not recognise a condom when shown one, and zero out of ten consistently use condoms with their clients. The concurrence of poverty, fragile states, poor public health systems, and heroin and drug trafficking is a particular challenge in parts of Asia.

4.11 Third, there are some important positive situations. Countries such as Bangladesh and Phillipines are still seeing low levels of HIV prevalence, even among

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<sup>30</sup> In brief, it may not just be lack of a critical mass of scientific and public health management capacity that constrains developing countries from responding to pandemics—although they may well be factors. . . Rather, individual developing countries may not have a strong *incentive* to invest scarce resources in fighting pandemics if they believe the actions—or inactions—of neighbouring countries will drive the course of the epidemic anyway, or if there is a fear neighbours will simply become free riders on any solution. Well designed and coordinated aid programs can compensate for these constraints.

<sup>31</sup> *Addressing HIV/AIDS in East Asia and the Pacific*. Health Nutrition and Population Series. The World Bank. 2004. Page 1.

<sup>32</sup> *Global Fund*. Op cit. Page 11.

people at high risk of exposure to HIV, and have significant opportunities to avoid serious outbreaks. Thailand and Cambodia have been able to reduce prevalence rates.<sup>33</sup>

4.12 **Newly emerging pandemics** such as SARS can also have major health, financial, economic, and political repercussions in the region and beyond (Box Two). The link to zoonotic diseases appears particularly close in Asia. Bioterrorism is also a risk.

**Box Two: the effects of SARS**

Starting in rural China, SARS spread to five countries within 24 hours and to 30 countries on six continents within several months. One infected person traveled by plane from Hong Kong to Toronto: 438 people were later infected in Canada; 43 died; the Canadian Tourist Commission estimated the epidemic cost the nation's economy \$US419 million; and the Health Minister estimated SARS cost Ontario's health care system about \$US763 million. The economic impact of the six-month SARS epidemic on Asia Pacific is estimated at about \$US40 billion.

SARS also had substantial political consequences. Chinese Premier Wen Jiabao said in a Cabinet Meeting on the epidemic that 'the health and security of the people, overall state of reform, development, and stability, and China's national interest and image are at stake.'

*Preparing for the Next Pandemic*  
M Osterholm in *Foreign Affairs*, July–August 2005

4.13 A major influenza epidemic in the coming decade would have substantial health, development, and economic effects in the region and beyond. The Director of the Centre for Infectious Disease Research and Policy, and Associate Director of the United States Department of Homeland Security, notes:

Consider this sobering information: the most recent influenza pandemic of 1968–9 emerged in China when its population was 790 million; today it is 1.3 billion. In 1968 the number of pigs in China was 5.2 million; today it is 508 million. The number of poultry in China in 1968 was 12.3 million; today it is 13 billion. Changes in other Asian countries are similar. Given these developments, as well as the exponential growth in foreign travel over the past 50 years, an influenza pandemic could be more devastating than ever before...The reality of a coming pandemic...cannot be avoided. Only its impact can be lessened.<sup>34</sup>

4.14 An illustrative model for what could be done to respond to a major pandemic is canvassed in Box Three.

<sup>33</sup> *Global Fund*. Op cit. Page 20. And the example of Cambodia where HIV prevalence has declined from a high of 3.3 per cent of the adult population to 1.9 per cent shows that impact is possible if governments recognise the problem and effective action is well targeted.

<sup>34</sup> Michael Osterholm, Director of the Centre for Infectious Disease Research and Policy, in *Foreign Affairs*. Op cit.

### Box Three: responding to a major pandemic in the region

Many believe that a major pandemic—for example of influenza—is inevitable in the region and would have major health, social and economic consequences.

What can Australia usefully do now? A coordinated whole-of-government response, including the aid program, could save lives and avert huge economic losses. Specific initiatives would involve significantly strengthening disease surveillance in countries in the region so that outbreaks can be detected and responses launched earlier: countries cannot be strategic in the absence of good data and that requires improved surveillance. It also requires improved laboratory diagnostic capacity and training and equipping of national and regional response teams. Reinforcing health control measures at national borders is critical to reducing transboundary spread of disease. Support to international collaborative research, including efforts to develop vaccines, is also important to finding more sustainable solutions.

4.15 While a new focus is needed on pandemics, **continued attention is also needed for endemic and communicable diseases.** Malaria continues to be a major concern. One third of the world's TB cases are found in South-East Asia: nearly three million new cases and 700,000 deaths per year.<sup>35</sup> Multiple drug resistance and HIV/AIDS threaten to undermine gains made in TB control and tend to disproportionately affect the poorest and most vulnerable. After an absence of ten years, polio has re-emerged in neighbouring Indonesia, with 219 cases being reported in Java and Sumatra.<sup>36</sup>

4.16 For strategic gains to be made in health there needs to be increased engagement with **health system development.**<sup>37</sup> How governments in the region organise their financial and human resources to deliver public health is the strategic driver of longer term outcomes. Regional responses in Asia rest in many respects on the quality and depth of national responses and national capacities and there are significant weaknesses and gaps in Asia. Indeed, there are huge unmet health needs in Asia: an estimated US\$30 to US\$40 per capita is needed annually to finance the minimum health service package in Asia, but Bangladesh, Cambodia, Lao PDR, Pakistan, Mongolia, and Vietnam all spend less than US\$10 per capita. Scaled up assistance that address the root causes of *systems* failure would have widespread and strategic impact. It would also help address currently neglected and underfunded priorities including maternal and child health care in Asia.

4.17 Similar opportunities for significantly scaled up, and strategically wide impact, apply in the case of **education.** Again, the rationale is clear: like health, education is a benefit in its own right that creates a foundation for economic growth and has spill over benefits for health. Scholarships to study in Australia are the first pillar in human capacity development assistance. The second pillar is support for reform and strengthening of the

<sup>35</sup> *Global Fund Report*. Op cit. Page 32.

<sup>36</sup> *Polio vaccine scheme needs \$7 million* in *The Australian*. July 9–10 and August 16 2005.

<sup>37</sup> It is not always clear what sort of health systems countries are trying to build with their own resources and external aid. Sustainable financing of health care (with an appropriate public/private mix); human resource planning, development and management; and health commodity procurement and management, are key building blocks. Deficiencies in these areas are crippling health systems rather than technical aspects of addressing specific diseases. Expanding criminal activity in the manufacture and distribution of counterfeit pharmaceutical products is one example of an issue requiring regional collaboration that extends beyond the health sector. .



education system itself within the country. Mass education makes an important contribution to nation building and stability by enabling people to engage with law and justice systems and democratic processes. Education—including science, higher and technical vocational education—will be an increasingly important determinant in Asia of a country's capacity to engage and compete in a global economy over the coming decade. Improving the access and strengthening the quality and rigour of higher and tertiary education can help produce the next generation of public and private sector leaders. Support for higher and tertiary education is particularly important in fragile states, in which a lack of human capacity constrains economic growth, good governance through mismanagement and problems with policy implementation, and development more broadly. Education will also be an important part of the response to growing inequality between and within countries in the region, and between genders. Girls' education has been found to be one of the most effective and durable forms of aid investment possible.

4.18 There are significant, specific opportunities for larger scale initiatives in education at the specific country level. These relate to basic, higher and technical/vocational education and capacity building in East Timor, education systems reform in the southern Philippines (paragraphs 6.7 and 6.8), the option of a very large and bold initiative involving education, and girls' education across East and South Asia (paragraph 6.22).

## New areas for Australian engagement

### *Physical infrastructure*

4.19 With some notable exceptions<sup>38</sup> Australia has not concentrated on **physical infrastructure** in its aid program. However if Australia wishes to be engaged in the main drivers of future economic growth in Asia over the coming decade, then physical infrastructure should be looked at again. The evidence is clear: infrastructure bottlenecks are likely to choke off growth in Asia unless there is major change. One major recent study finds that East Asia alone has resourcing needs in infrastructure of US\$200 billion per year over each of the next five years: a total of one trillion dollars.<sup>39</sup> It is also clear that much of the multilateral—and even bilateral—aid flows to the region will GO TO INFRASTRUCTURE. It is not in Australia's interests to be passive onlookers of such large flows, if only because the country is a shareholder in multilateral development banks and should be intelligently engaged in their core business.

4.20 Australia is unlikely to be a dominant funder of infrastructure in Asia—the financial costs are large and it is not necessarily the most appropriate use of grant aid. But there are opportunities for innovative engagement in this sector where Australia can help shape and direct the much larger investments flowing in which will shape growth and development in the region. For example, transport and growth corridors are vectors for HIV/AIDS transmissions—both at the construction phase and after completion—and Australia has recognised expertise, comparative advantage and interests in reducing HIV/AIDS transmission.

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<sup>38</sup> The My Thuan and Friendship bridges; post Tsunami Indonesia; some major infrastructure investments in the Philippines; and some large mixed credit activities in the 1980s and early 1990s, including significant investments in rural bridges in Indonesia. If water and sanitation is classified as infrastructure, then significant investments have occurred in this sector.

<sup>39</sup> *Connecting East Asia*.

4.21 Australia has also demonstrated expertise in the economics and broader development impact of infrastructure: analytical work on the My Thuan Bridge, for example, has been used as a model by other bilateral funders of infrastructure in the region. Economic governance in infrastructure is also key: up to 30 per cent of investments in infrastructure are lost to corruption and poor governance,<sup>40</sup> while Australia has good systems for improving the efficiency, accountability and value for money of large scale investments. Finally, and importantly, construction and maintenance of key infrastructure such as roads is a major opportunity for generating long-term employment—especially among the poor and unemployed—in ways that can simultaneously reduce the import demand for capital equipment by up to 30 per cent.

### *Resources, especially clean energy*

4.22 Australian aid should also be directed at another new sector: **resources, especially secure sources of clean energy and more efficient use of energy resources**. The rationale is clear. First, the sheer size and scale of resource use in Asia over the coming decade is strategically important in its own right, driving everything from economic growth to environment and climate change. Energy consumption in China, for example, doubled between 1980 and 2000, and China is likely to displace the United States as the biggest energy user by 2050.<sup>41</sup> Between 1990 and 2025 China's total carbon emissions are projected to rise by more than the combined increase for the United States, Western Europe and Japan.<sup>42</sup> Much the same could be said for South Asia.

4.23 It is not just the magnitudes that demand attention. The efficiency and cleanliness of resource use do too. China, for example, requires about three times as much energy as the United States to produce US\$1 of economic output and emits nearly four times as much carbon dioxide per dollar of economic activity as the United States.

4.24 Secure access to energy has become a national security issue for many states in Asia and nuclear energy is increasingly seen as the answer by some. According to the World Nuclear Association, for example, China plans to build 27 nuclear plants to boost nuclear energy four-fold by 2020, and India intends to build up to 24 reactors over a similar period.<sup>43</sup>

4.25 In short, access to clean energy and its more efficient use is a major strategic issue affecting the pace and quality of economic growth and development in the region. Australia has significant expertise in promoting clean energy, is a major exporter of energy (as well as holding the second largest reserves in the world of uranium), and has a direct interest in avoiding greenhouse gas induced climate change or environmental damage in the region through effects such as acid rain.

4.26 This will inevitably involve a whole-of-government response from Australia. Within that response, opportunities for significantly increased Australian aid engagement in this strategically important sector could include much greater and more specific

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<sup>40</sup> *Connecting East Asia*. Page 117.

<sup>41</sup> *China Human Development Report 2002—Making Green Development a Choice*. UNDP and Stockholm Environment Institute. Oxford University Press. Page 55.

<sup>42</sup> 'Coal Reliant China clouds environmental outlook'. *The Australian Financial Review*. 8 July 2005. Page 81. . The article cites the Energy Information Administration as the source of the estimate.

<sup>43</sup> 'Glowing Outlook for Uranium' in the *Australian Financial Review*, 8 July 2005. Page 67.

engagement with the ADB and World Bank policy and lending operations in energy (paragraph 5.3) and/or a large long-term pipeline of development scholarships aligned with institution to institution links (paragraph 4.2). The establishment of the Asia Pacific Partnership for Clean Development and Climate is timely and a welcome opportunity to elevate the role of clean and efficient energy production in the aid program to Asia. This is particularly so given that the members of the Partnership include India, China, and South Korea from Asia and, with the United States and Australia, account for more than 40 per cent of the world's greenhouse gas emissions.

### *Political governance*

4.27 Another possible option for a new area of engagement is in **political governance**. Political leadership and governance clearly have direct and strategically significant effects on the rate and quality of economic growth: each of the economic histories of China, India, Indonesia, Vietnam, Cambodia, Laos, South Korea, Singapore, Philippines, Burma, and others over the last 50 years tell a vividly contrasting story about the central role of political governance in facilitating—or destroying—growth prospects. The importance of political governance on growth continues today. In July this year Moody's downgraded its outlook for the Philippines sovereign debt from stable to negative, and Standard and Poor also downgraded 'citing concerns over the direction of badly needed economic reforms in the light of the (political) turmoil'.<sup>44</sup>

4.28 Australian aid can assist the process of political governance without being unacceptably intrusive: the key is to have demand driven, not supply driven, responses. Some assistance can be quite direct, such as support for a country's electoral process as Australia has done in East Timor, Cambodia and elsewhere.

4.29 In the right circumstances, Australia could also lever up its impact on the reform agenda more broadly by working in partnership with the multilateral development banks. These banks increasingly recognise the relevance and role of political governance in reform but are prevented from being involved in more direct 'political' activities by their founding charters. There may well be circumstances where a partner government in a developing country may welcome Australian aid-funded analytical research or pilot testing of a reform process that is initially in the domain of political governance that could later be supported by larger funding through a World Bank or ADB program.

4.30 In other cases the most valued, highest impact, and most durable assistance may be activities which enable the countries themselves to push reform from within. The Australian aid program has a lot to offer here. Helping build a critical mass of reformers through a modernised and expanded scholarships program is one major initiative open to the Australian Government (paragraph 4.2). Another option is to provide substantial support to centers of excellence that generate high quality—but applied—research: putting quality data in the hands of reformers (or the public) can be a potent force for reform. Shifting the emphasis in aid from the *what* of reform delivered through technical assistance to the *how* of reform through the power of ideas and applied analytical research is another option (paragraph 5.5). It is clear that demand driven assistance can enable

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<sup>44</sup> 'Arroyo hangs on as middle class shops'. *The Australian Financial Review*. 14 July 2005. Page 12.

Australian engagement in strategically significant but otherwise politically sensitive institutions.<sup>45</sup>

### *Agents for change*

4.31 Young people are potential agents for change in demanding reform, including in fragile states. But they are also potential agents for instability, especially if unemployed (paragraph 1.22). The challenge for an aid program is to help shape young people into forces for political reform, not forces for political instability. A development focus on education and employment opportunities for **young people in fragile states** can help reduce the disaffection among young men that can be so destabilising, and thereby help promote governance and stability. This can be done by working directly and innovatively to help build a vibrant private sector, putting more emphasis on technical and vocational education, and giving more attention to employment intensive approaches to infrastructure investments and rural development.

4.32 There is also scope to promote the role of women as agents for change in situations of conflict and instability and to help drive demand for better governance, particularly in the Philippines where women have a successful record of driving change, including at the community level. Other possible agents for change might be the churches in countries like the Philippines and East Timor.

## Recommendations on *how* Australia should respond

5.1 Australia already has a number of comparative advantages in the way it approaches and delivers aid. Based on conversations with stakeholders in the region, these include: policy coherence and a whole-of-government approach to development issues in the region (trade policy aligns with aid and development policy etc); a long-term commitment to engagement in the region (evidenced also by the ten-year timeframe of this White Paper); and positive characteristics of aid delivery (primarily grant aid, involving competent technical expertise, managed through a single, professional, devolved, aid agency).

5.2 But if Australia is to have impact in a rapidly changing Asia over the coming decades, it needs to consider three changes in the way it delivers aid, as outlined in this section.

### Multilateral banks

5.3 First, Australia needs to be much more strategic and proactive in the way it engages with large **multilateral** development institutions in the region. Loan disbursements from the World Bank to Asia totaled US\$5.27 billion in 2004.<sup>46</sup> Loan approvals from the ADB to the region in 2004 provided a further US\$5.3 billion. Lending from these two institutions alone is 30 times larger than the US\$463 million

<sup>45</sup> Australia discussed with China about aid supported research and training activities with the Communist Party School in Beijing which trains China's elite. Discussions in Vietnam also indicate there would be no political impediment to Australia supporting research for the Office of the National Assembly.

<sup>46</sup> US\$2.7 billion to South Asia, of which US\$1.835 billion was from the highly concessional International Development Association (the IDA arm of the World Bank) and the balance from the regular IBRD arm of the bank; and US\$2.55 billion to East Asia and the Pacific, of which US\$1.7 billion was IBRD and the balance IDA. While lending to the Pacific is included in this grouping, actual levels are quite small.

Australian bilateral program to the region. Australia, an essentially grant donor with strong country presence and knowledge of the region, should be in a good position to leverage the policy and lending operations of such organisations.

5.4 But aid is more than development finance. Increasingly, effective development is about the transfer of ideas as much as it is about the transfer of resources. Many would say this seems to be particularly true in Asia, which has an insatiable appetite for learning the pragmatic lessons of reform. It is also true for fragile states where traditional or large financing packages may not be appropriate. Well-constructed and applied analytical research done jointly with the banks—particularly early in the banks' consideration of issues—can help shape the banks' subsequent approaches in the region. The banks are clear that they would welcome a much stronger analytical and advocacy role from Australia in the region (see also following paragraph).

## Analysis and ideas

5.5 The second change that Australia should consider in the way it delivers aid is therefore to be much more **proactive in the generation and dissemination of analysis and ideas related to development**. Australia has a good base here. Australian aid is seen as particularly innovative and prepared to test new ideas and approaches. Several Australian universities specialise in, or have close formal links with, countries in Asia. These countries argue that, notwithstanding its developed country status, Australia's reform experience over the past decades is instructive in areas as diverse as trade policy and industry restructuring, health financing, education policy, public sector reform, public financing, and public-private partnerships for infrastructure development. That these reforms occur within a federal system, and in a mixed economy, has resonance and lessons for reform minded Asia.

5.6 There is much Australia can do to generate analysis and ideas at a practical level. Australian aid could more actively undertake the type of applied operational research that the World Bank and ADB do and which can have such a large impact on ways of promoting development in the region.<sup>47</sup> More emphasis could be given to capturing and disseminating the lessons of particular reform efforts, including but not limited to the trial and pilot aid activities that occur in the region, but which often do not get scaled up.

5.7 The Australian Government may wish to establish a specialised research institute on development issues, similar to the UK Overseas Development Institute. Alternatively, the ten-year time frame of this White Paper could be an opportunity for developing longer term partnering links between AusAID and research institutions in Australia and overseas that address development issues. Another option could be to use the aid program as a means of fostering longer term partnering links between Australian research institutes and their counterparts overseas. Whatever option is chosen, increased use of research institutes could be designed to complement and reinforce the development benefits of an expanded role for scholarships in Asia.

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<sup>47</sup> Examples of high quality applied operational research include *Achieving the Twin Objectives of Efficiency and Equity: Contracting Health Services In Cambodia*. Indu Bhushan et al. ERD Policy Brief Series Number 6. Asian Development Bank. 2004. Examples from the World Bank include *Doing Business in 2005: Removing Obstacles to Growth* as well as the innovative work on output based aid ([www.gpoba.org](http://www.gpoba.org))

## Changing aid architecture

5.8 The third change Australia should consider in the way it delivers aid in the coming decade arises from the **rapidly changing environment for aid and overall aid architecture** in Asia.

### *Multilateral*

5.9 At the **multilateral** level, the coming decade will see major changes to the way the World Bank and ADB engage in the region. Both institutions are evaluating their future role, especially since some large middle income borrowers can access international capital markets readily and may not need to borrow from banks. Both institutions will need to develop how they engage with fragile states, especially when traditional lending products are not appropriate. And both will need to accommodate the increasingly active role being played by India and China as *donors* rather than *borrowers* to banks.

5.10 The role and significance of other multilateral institutions on Asia's economic and development path will also change over the coming decade. Many would argue that in a dynamic and globalising region like Asia, decisions made—or *not* made—under the auspices of the WTO over the coming decade will have a greater impact on growth and development in Asia than will traditional development financing institutions. And others believe the International Monetary Fund's (IMF) role in development in Asia may decline somewhat over the decade as more countries build strong foreign exchange reserves.

5.11 Aid architecture in the region over the coming decade will also be affected by new institutions such as the Global Fund to fight AIDS, TB and Malaria, the Global Alliance for Vaccine Initiative, and the Gates Foundation. The initiatives of these institutions are to be welcomed, but new challenges arise when their potentially large funding flows<sup>48</sup> occur outside of traditional donor coordination mechanisms or without necessarily having strong capacity building support structures to make use of such funds. There is much Australia could do to work alongside these large, well funded, and innovative foundations. Examples include helping partner governments design and appraise their proposals to such funding bodies; building capacity for the operation of approved funding; and plugging the critical gaps that often emerge in interventions and which undermine broader development effectiveness.

### *Regional*

5.12 Important initiatives likely to continue at a **regional and subregional** level in the coming decade include the East Asia Summit, Asia Pacific Economic Cooperation (APEC) and the Mekong subregion cooperation. Several regional arrangements have emerged since the Asian crisis, aimed at preventing and enabling better responses to future crises. These include the Association of South East Asian Nations (ASEAN) +3 group (ASEAN plus China, Japan and South Korea), which is becoming the key vehicle for policy dialogue and cooperation in Asia - though the East Asia Summit might evolve into this role over coming years; the Chiang Mai Initiative established by ASEAN+3 for cooperation in crisis financing; the G-20 which includes the major East Asian economies and is a forum for driving the international economic and financial agenda; and the Asian Bond Fund to deepen regional capital markets and increase countries' capacities to

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<sup>48</sup> For example, the recently established Global Fund has \$US6.9 billion proposals already approved.

borrow in their own currencies.<sup>49</sup> An Asian Monetary Fund to promote regional financial and economic stability has also been mooted several times and no consensus to establish such an institution has been reached.<sup>50</sup>

### *Bilateral*

5.13 At the **bilateral** level, several changes can be expected over the coming decade. Amongst traditional Western donors, there will be a consolidation of donor coordination and harmonisation, as per the Paris Declaration on Aid Effectiveness. This welcome move may occur just as some of the traditional European donors think about exiting programs to countries like Vietnam. On the other hand, new non OECD donors will continue to emerge in Asia. China already is emerging as a potentially significant aid donor<sup>51</sup> and South Korea has been an aid donor for some time. Thailand is likewise emerging as a bilateral donor and Vietnam became a donor to the World Food Program in 2005. These trends are likely to increase over the coming decade.

### *Non traditional*

5.14 Asia will also see dramatic changes in the nature of development and broader capital financing over the coming decade. Foreign direct investment is likely to continue to be a major source of finance<sup>52</sup> for the region, although concentrated in certain countries and bypassing fragile states and poorly managed countries. However **non-traditional sources of development**—for example remittances and migration—will also be increasingly important. In 36 countries worldwide already, remittances are greater than all other sources of financial capital combined.<sup>53</sup> This is particularly true for the Philippines, where almost one-quarter of the domestic labour force works overseas, worker remittances total around US\$7 billion per year, and remittances represent nine per cent of GDP and are six times larger than foreign direct investment.<sup>54</sup> Remittances are also important for other countries in Asia such as Bangladesh, Indonesia, Nepal and Sri Lanka.

5.15 While large and growing, the economic impact of remittances is ambiguous.<sup>55</sup> Large flows may dull the demands for reform by poor communities on their national governments: some communities in the Philippines are more dependent on the quality of economic growth and economic governance in the United States, Japan, and Hong Kong than they are of their own country. Such large cross border flows of people and money

<sup>49</sup> Martin Parkinson, Steve Kennedy and Gordon de Brouwer, 'Economic growth stresses and opportunities in the Asia/Pacific, Address to the Leading Australia's Future in Asia Program. ANU. 28 June 2004. Page 15. Peter Costello, 'Australia and the Asia-Pacific: Moving forwards as partners, Address to The Macroeconomic Policy and Structural Change in Asia Conference, Sydney, 24 February 2005.

<sup>50</sup> Gordon de Brouwer, 'Institutions to promote financial stability: Reflections on East Asia and an Asian Monetary Fund', Treasury Working paper, February 2004, September 2004. Page 21.

<sup>51</sup> *Dragon in Paradise: China's Rising Star in Oceania*. John Henderson and Benjamin Reilly. *The National Interest*, Summer 2003.

<sup>52</sup> Asia and the Pacific region recorded more than US\$166 billion in foreign direct investment in 2004.

<sup>53</sup> *The Future of Aid 1*. World Bank Public Policy for the Private Sector. March 2005. And by 2020 remittances from developing countries could reach US\$200 billion, dwarfing ODA, as workers fill the demographic deficit of richer, aged, OECD countries.

<sup>54</sup> *Migration and Foreign Remittances in the Philippines* Burgess and Haksar. *IMF Working Paper WP/05/111*. June 2005.

<sup>55</sup> *Remittances As Development Finance*. Mimeograph available from OECD Development Assistance Committee website. See also *Migration and Foreign Remittances in the Philippines*.

also raise security questions and facilitate the spread of HIV/AIDS. Some development agencies anticipate the increased role of remittances in development generally and are working on how they can improve the development impact of such flows.<sup>56</sup> Australia could do more here too. A good start would be to gear up research on and the analytical base of trends and consequences of remittances in the region.

### *Australian aid*

5.16 All of this has implications for Australian aid. The rapidly evolving 'aid architecture' in Asia suggests Australian aid must continue to be flexible and opportunistic if it is to retain its relevance and impact in the region. But flexibility needs to be balanced against the risk of an aid program being simply reactive and dissipating its efforts across the welter of challenges that will continue to emerge in Asia. Several informed stakeholders in the region have argued that if Australia is to maximise its development impact it must identify key priority issues and stick with them. Development is a long-term process, and reform takes longer than a typical three-year project horizon.<sup>57</sup> Above all, Australia was urged to avoid the temptation of chasing development fads.

5.17 How Australia might balance this need for strategic focus in a region as large as Asia, while maintaining flexibility in a rapidly changing environment is addressed in the next section.

## Country strategies

6.1 Previous sections have looked at the *what* and *how* issues of a modern development program to Asia. This final section looks at *where* issues. This does not mean individual country-by-country recommendations for each country in Asia—space limitations prevent that. In any event, recommendations made now about country priorities will inevitably change in a region as vast and varied as Asia: reformist governments—or state collapse—in North Korea or Burma over the coming decade would likely see a rapid scaling up of Australian assistance to those countries and a reordering of country allocation priorities. With these comments in mind, these recommendations are made.

### Indonesia

6.2 First, **Indonesia** should continue to be Australia's major development partner in Asia. The reason is obvious. Indonesia has major development needs: for example just over half of the population lives on less than US\$2 per day; less than 20 per cent of households have access to piped water; and only 40 per cent of those eligible are enrolled in senior high school.<sup>58</sup> That is reason enough for an active aid program. But these deep development needs are overlaid by Australia's own national interests which are closely intertwined with Indonesia being stable, prosperous, and well governed. The path

<sup>56</sup> See *Remittances As Development Finance*. Mimeograph available from OECD Development Assistance Committee website. See also *Sending Money Home? A Survey of Remittance Products and Services in the United Kingdom*. DFID and Banking Code Standards Board. 2005.

<sup>57</sup>The 2004 *Review of ADB's Poverty Reduction Strategy* notes, for example, that on average 'roads have a seven-year lag from an increase in expenditure; expenditure an 11-year lag, and research and extension 13 years before actual impacts can be achieved'.

<sup>58</sup> *Indonesia: New Directions*. . World Bank CGI brief. . January 2005. . Pages 8 and 73.



Indonesia follows over the coming decade will affect not just the fourth largest country in the world, and Australia's nearest neighbour, but the pattern of development in South-East Asia generally. It is therefore in Australia's national interest to have active, broad engagement in the development of Indonesia. The issue is sufficiently important that there is a separate, stand alone, chapter prepared on Indonesia for the White Paper.

## East Timor

6.3 Despite obvious differences, similar principles apply in **East Timor**: there is a conjunction between deep development needs, proximity and broad Australian national interests. More specifically, East Timor is a Least Developed Country with a non-petroleum GDP per capita of just US\$366; a well regarded and prudent approach to managing potentially large oil revenues but severe institutional and capacity constraints; and the world's highest fertility rate of 7.8 children per woman.<sup>59</sup> East Timor also faces the potentially explosive challenge of youth employment, with all the implications this has for social tension and political instability near to Australia.

6.4 Development need, proximity, and breadth of national interest would therefore again suggest that Australia has a broad spectrum, long term, and substantial program to East Timor. A strategic vision for this program over the coming decade would involve three pillars. The first pillar is a focus on maintaining stability in East Timor through support for its institutions of governance and the police. The second pillar would be developing human capacity in East Timor—an area of acute need and a significant constraint to economic growth and development on all other fronts. This would include support for basic, secondary and vocational education, as well as continuing to offer scholarships to Australian institutions. The third pillar involves improving viable youth employment by working more directly and innovatively to help build a vibrant private sector and giving more attention to employment intensive approaches to infrastructure investments, especially in rural environments.

## Philippines

6.5 Development need, proximity, and national interest—especially security interests— would suggest that Australia give much more attention to the **Philippines—especially Southern Philippines**. Fourteen of the 20 poorest provinces in the Philippines are in Mindanao, and the incidence of poverty—already the highest in the Philippines—has increased from 56 per cent in the early 1990s to more than 70 per cent in 2000.<sup>60</sup> This development challenge also overlaps with important security challenges: one World Bank research paper concludes that the Mindanao conflict, having persisted for five centuries, is now the second oldest on earth after Sudan; that there have been more than 120,000 conflict related deaths in Mindanao since the 1970s; and an estimated \$US2 to \$US3 billion in direct economic costs.<sup>61</sup> The insurgent groups Abu Sayaff and the Moro Islamic Liberation Front have links with Jemaah Islamiah, and Abu Sayaff has links with Al Qaeda. The promotion of stability in Southern Philippines is essential to attract investment and reduce the linkages with regional and international terrorism.

<sup>59</sup> Source: World Bank at [www.worldbank.org/timorleste](http://www.worldbank.org/timorleste)

<sup>60</sup> *The Mindanao Conflict in the Philippines: Roots, Costs, and Potential Peace Dividend*. Salvatore Sciavo—Campo and Mary Judd. The World Bank. Social Development Papers: number 24. February 2005.

<sup>61</sup> *The Mindanao Conflict in the Philippines*. Op cit. Page 5.

6.6 Four specific interventions would make a strategic impact in the Southern Philippines—albeit over a long-term horizon.

6.7 The first is education, which is the foundation of development, good governance, and employment—all of which CAN help reduce a sense of alienation and the appeal of terrorism. The Philippines has many challenges here: as just one example it has slipped to a ranking of 42 and 43 out of 46 countries in mathematics and science.<sup>62</sup> Particular challenges arise in Southern Philippines: enrolment rates for secondary schools in the Autonomous Region of Muslim Mindanao (ARMM) were just 32 per cent, and fewer than two in ten children who enter grade one in ARMM complete high school.<sup>63</sup>

6.8 Australia already has a good model for strengthening and broadening educational opportunities for Muslim children in Southern Philippines, including improving the professionalism of teachers and upgrading physical facilities of schools. The approach adopted under the AusAID-supported Basic Education Assistance to Mindanao (BEAM) is so successful that it is being scaled up and rolled out nationally. More assistance in this area would seem justified.

6.9 The second area involves a focus on women as potential peace builders. Like young people, women can be agents of change in society, demanding reform and an end to conflict. Such an approach could draw on the role of women's groups in helping to end hostilities in Bougainville and Solomon Islands, and involve support for women's groups to create a demand for long-term peace and better governance in Mindanao.

6.10 The third area involves creating viable employment opportunities, thereby giving young men a stake in their own society. This, of course, is a long-term prospect and challenging, especially given lack of investment in the area and the weak and generally declining competitiveness of the Philippines (Table Two). And there are limits to what an aid program can do to create employment. The promotion of stability—a precondition for investment, economic growth and employment creation—is one area in which aid can assist.

6.11 The fourth area involves continued support for the peace process in the Southern Philippines, to lessen the instability affecting many lives and being exploited by external terrorist operatives. And continuing to build local security infrastructure, including policing, counter-terrorism and border security capacity, will help promote stability and is in Australia's direct security interest.

6.12 The challenge for Australia is how to engage in this part of the Philippines which, in many ways, represents a failed state where basic security of aid personnel is at question. This also offers real opportunities for innovative designs and approaches: more will have to be done with and through local counterparts and NGOs, and less through expatriate consultants—an approach that, in itself, could be effective.

6.13 There is also scope to help build demand for better governance in the Philippines more broadly, through supporting potential agents for change such as women's groups.

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<sup>62</sup> *Education Reforms in East Asia: Policy Process and Impact*. East Asia Decentralises. World Bank. Page 181.

<sup>63</sup> *Education Reforms in East Asia*: Op cit. Pages 193 and 194.

## Mekong countries

6.14 Further North are the **Mekong countries**. To have impact in this region over the coming decade a development strategy will need to take into account the following. First, the region is highly diverse and changing rapidly: in a decade's time there will still be a need for a development program with Cambodia, and Lao PDR, but this is unlikely to be the case with Thailand. The engagement strategy will also need to keep pace with the rapidly changing nature of Vietnam. Second, Australia is just one of a number of developed countries active in the region, so how to work with others, and have impact ourselves, will be different to working in, say, Melanesia. The third factor is the geographical proximity of these countries to fast growing China and India, and the range of social and economic consequences likely to arise over the coming decade from the dynamic changes in those two countries.

6.15 Australia has a broad range of development and national interests at play in these countries. But if Australia is to have identifiable impact in this region it must be increasingly selective, choose a few core areas, stick with them, and then work assiduously with bilateral and multilateral agencies to leverage up our impact. The self reinforcing package of interventions outlined in paragraphs 7.4 and 7.5 would maximise Australia's impact. Australia must avoid having a range of isolated or fragmented activities that last only a few years and are then replaced by activities in new sectors.

6.16 One specific initiative where Australia could help shape areas of major strategic impact is the **Greater Mekong Subregion** (GMS). This grouping of six countries<sup>64</sup> covers some 300 million people most of whom have a per capita income of US\$1 per day.<sup>65</sup> The ADB is an active supporter of this grouping and helps facilitate activities in agriculture, energy, the environment, human resource development, investment, telecommunications, tourism, trade, and transport. The GMS offers an entry point to a region that is large, poor, facing major internal and cross-border challenges with the potential to affect Australia (such as environmental problems and transnational crime), and where well designed aid interventions from Australia could have disproportionately large impact.

## China, India and South Asia

6.17 Should Australia be providing aid to **China and India** in the coming decade? Many would argue that, with their size and rapid growth, aid to these two giants is no longer appropriate. After all, China's GDP is already larger than that of Italy, will overtake that of France this year, and will probably overtake that of Germany by 2007.<sup>66</sup> Similarly, India's economy is projected to overtake Japan's in the next five years to become the third largest in the world.<sup>67</sup> At a simplistic level it is hard to see how resource

<sup>64</sup> Cambodia, China, Lao PDR, Myanmar, Thailand, and Vietnam.

<sup>65</sup> ADB website: Greater Mekong Subregion.

<sup>66</sup> Goldman Sachs Global Economic Paper. Op cit. China is also projected to be the third largest economy after the United States and Japan by 2015 and, even with growth rates slowing to 3.5 per cent by the mid 2040s, the world's largest economy by 2041. While China and India's emergence as global—not just regional—economic powers is impressive, it does not mean they will come to the table as 'wealthy' as the countries they displaced. Even by 2050 China's GDP per capita is projected to be just US\$31,357 (2003 constant dollars) and India's just US\$17,366 compared to that of the United States of US\$83,710 and Japan's of US\$66,805.

<sup>67</sup> *A Tripolar World: India China and the US*. Arvind Virmani. Indian Council for Research on International Economic Relations. May 18 2005.

transfers through Official Development Assistance (ODA) can make a difference in such large economies: China's foreign exchange reserves are now reportedly growing at US\$570 million per day or US\$24 million per hour<sup>68</sup>—not a lot short of what Australia provides per year in aid. Indeed, China and India are active providers of bilateral and multilateral aid in their own right.

6.18 There are, however, two reasons why Australia should continue to have a development program with China and India—albeit one that is more forward looking and appropriate to the changing and contemporary realities of these countries.

6.19 The first is development need. Despite their rapid growth, China and India account for 40 per cent of the developing world's population.<sup>69</sup> An estimated 212 million people lived below the US\$1 a day poverty line in China in 2001<sup>70</sup> and China still has an estimated 594 million below the US\$2 a day line. China also has major social challenges to confront, one symptom of which is the estimated 156,841 women committing suicide every year: 56 per cent of all female suicides in the world.<sup>71</sup>

6.20 India has similar challenges. As of 2001, per capita gross national income was just US\$460, and more than one-quarter of India's population still live below the country's poverty line. As the World Bank notes: 'This means that, with the world's second largest population—over one billion—India is home to over one third of the world's poor people.'<sup>72</sup>

6.21 In short, East and South Asia is still the epicenter of poverty and development need in the world.

6.22 However an even more telling reason for continuing—but modernising—Australia's program to China and India is Australia's own national interest. A continued focus by China and India on economic reform, broad based and sustainable economic growth, and social and political stability will directly affect the prosperity and stability of one-third of the world's population living within their borders. It will also be a principal determinant of the pace and pattern of economic growth and stability in the region. It is therefore in Australia's national interest to use every instrument available to it—including the aid program—to help sustain the momentum of positive reform by those two giants. It makes no sense for Australia to disengage from the two largest drivers of growth and security in the region over the coming decade.

6.23 Five things need to occur if Australia is to make an impact on the directions China and India might take in the coming decade. First, any development program must be highly selective and essentially built around one, or at most two, central themes or flagships known to be of top priority to the leadership group of those two countries. Second, the flagship must be large enough in size; innovative enough in scope; and long

<sup>68</sup> *Money's On August Revaluation in the Australian Financial Review*. 19 July 2005. Page 11.

<sup>69</sup> *Economic Growth in the 1990s*. Op cit. Page 7.

<sup>70</sup> *World Development Indicators 2004*. Page 3.

<sup>71</sup> *China 2001–2010: Political Economic and Social Issues of Reform and Transformation*. FitzGerald, Davies and Tang. Page 50.

<sup>72</sup> India is still home to the world's largest number of illiterate people and accounts for 20 per cent of the world's out of school children and for 20 per cent of the gender gap in elementary education. Maternal deaths in India account for almost 25 per cent of the world's childbirth related deaths.<sup>72</sup> Similar challenges arise in the rest of South Asia.

enough in duration, to gain the attention of the leadership groups in these countries, particularly so with India.<sup>73</sup> (Having said that, it is also clear that the aid budget is finite and priorities have to be set. The convergence of development needs, geographical proximity, and the breadth and depth of national interests at stake suggest that Indonesia, East Timor and the Philippines will usually get first priority from Australia.) Third, a flagship must be as much about ideas as about finances. Fourth, all components of development cooperation, including scholarships, analytical research and think tanks, Australian engagement with the World Bank and the ADB, must be managed so they work in harmony and reinforce each other. Fifth, a traditional donor-recipient model needs to rapidly change to a more partnering approach to reflect the capacity and sophistication of China and India.

6.24 Numerous options are available to the Australian Government. The boldest—yet possibly the most cost effective and high-impact—is sketched out here.

*A bold proposal: a single flagship for China and South Asia for the coming decade*

Australia chooses one strategically important issue that is a core priority for development across East and South Asia and which aligns with its comparative advantage and national interests. This might be the technical, scientific and policy aspects of clean energy and greenhouse gas emissions. It might be an aspect of economic policy and governance, such as public-private partnerships for infrastructure funding. It might be girls' education and/or professionalising basic education across the region through to Pakistan. It might be work on pandemics, including HIV/AIDS or TB.

Over time, Australia consolidates its funding efforts around this flagship. By way of illustration, if all of Australia's current aid program to China and South Asia were consolidated, there would be a flagship intervention worth around AU\$94.4 million, or AU\$940 million in current dollars over ten years. This, by itself, would have more impact than a series of fragmented bilateral programs.

The impact would be enhanced by the overlapping and reinforcing components that would come with a scaled up and single focus initiative: a large scholarships program would build a critical mass of leaders in the region trained in Australia and networking with each other. The returning scholars would link up with research institutes, think tanks, and broader whole-of-government initiatives that AusAID was supporting under the flagship. The ideas and reforms being generated by this interaction would also feed into, and itself be influenced by, the analytical, policy and operational programs of the World Bank and ADB in that area.

Such a model gives strategic focus, but also enables flexibility to respond to changing circumstances. For example the degree of focus, and the intellectual leadership role taken by Australia under this flagship model,

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<sup>73</sup> The level of Australian aid and broader engagement with India has gone through cyclical peaks and troughs over the decades. Separately, India has recently decided to limit its aid relations to countries with larger programs, to reduce transaction costs and fragmented efforts. Any decision to re-engage with India would need to take this into consideration.

would enable a range of ongoing, well grounded, new initiatives to be developed for consideration by the Australian Government, each of which could meet the changing needs of the time or the country concerned. If necessary, a separate but relatively small rapid response facility could be available to allow Government to pursue initiatives outside of the single flagship—but without detracting from or diluting it.

6.25. Numerous and less radical permutations are also possible. Government might choose to have, for example, two larger, longer term flagship programs to India and China: one on the high tech side dealing with clean and efficient energy/global warming and the other on the humanitarian side dealing with girls' education. Alternatively, one flagship could be economic governance and reform, and the other HIV/AIDS. The key is to have a focus, and then stick with it. A ten-year focus on two important streams would have impact, and balance and introduce further substance and ballast into the bilateral relationship with these two countries. Such a program could also be supplemented by a regional program for the other countries of Asia (Sri Lanka, Bangladesh, Pakistan, Nepal, Bhutan, and Maldives).

## Resource implications

7.1 Moving Australia's aid program upstream in the way outlined in this paper has resource implications for AusAID, other Australian Government departments, and Australian research institutions and universities. Aid is a finite resource and its development effectiveness needs to be regularly assessed and the lessons learnt better identified, disseminated and digested by development agencies, partner governments, and other stakeholders. If development shifts to a more upstream and analytical approach over the coming decade, there will also be resource implications for AusAID staff. This might include the need to develop even stronger analytical and technical skills—or ready access to those skills—to be able to engage productively with national counterparts, research institutions, the World Bank, and ADB.

## Conclusion

8.1 The strategic starting point for this paper is that Asia is large, varied and changing rapidly. Growth will be an essential pre-condition—but not a guarantee—of poverty reduction, as well as stability in the region and beyond. Australia's national interests are inextricably bound up in the path of economic and social development of Asia over the coming decade. Australia's aid program, as part of a whole-of-government engagement in the region, can help shape the response to the challenges of the coming decade.

8.2 Achieving impact in such a large and varied region as Asia is a challenge. Several recommendations are made.

8.3 First, in terms of sectors, Australia should further consolidate its efforts in economic governance, emphasising links to service delivery and the environment for the private sector. Opportunities exist for significant scaling up of existing work in health, education and rural development. And if Australia is to help shape some of the main drivers of change in Asia in the coming decade, it should also consider new fields like physical infrastructure and political governance.

8.4 Second, the ten-year timeframe of the White Paper is an opportunity for Australia to be much more strategic and forward looking in the way it delivers aid in the region. Australia should invest more attention and resources into its relations with the multilateral development banks to help shape the way these much larger institutions engage in Asia. Linked to this, Australia should give even greater priority over the coming decade to generating ideas and applied research about development, which can empower reformers in Asia to themselves push forward. This should be complemented with an expanded scholarships program, as well as stronger institution-to-institution links, to help build a critical mass of reform from within. And Australia should look carefully at the rapidly evolving aid architecture in Asia and work more closely with institutions that will shape the economic, social and development agenda in Asia over the coming decade.

8.5 These components—expanded scholarships, improved institution-to-institution links, generating ideas and research, working more closely with multilateral development banks and new institutions—complement and reinforce each other. They work best as a self reinforcing package. And, with adaptation to individual country circumstances, the package works well in fast growing large economies, smaller fragile states, and the range of countries in between.

8.6 Third, Australia should be focused and strategic in its choices about operating at a country level. Indonesia, East Timor, and, to an extent, the Southern Philippines share the characteristics of particularly strong development needs, proximity and a dense web of Australian national interests. That would suggest tailored country programs that might be reasonably large (Indonesia), broad based (East Timor) or innovative (southern Philippines). As the spotlight moves further North and West—through the Mekong countries and into the larger domains of China and South Asia—the need for strategic focus becomes even more pressing. There are ways of getting focus and impact in these regions, but this involves being increasingly selective and sticking with an area for longer periods. It also involves working creatively with large stakeholders such as the multilateral banks.

8.7 The package of approaches in this paper will give focus, coherence and strategic direction to Australia's aid program to Asia over the coming decade. But it will also enable the program to be sufficiently flexible and responsive to the varied, and rapidly changing, countries of Asia.

## Glossary

ADB	Asian Development Bank
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
BEAM	Basic Education Assistance to Mindanao
GMS	Greater Mekong Subregion
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LICUS	Low Income Country Under Stress
MILF	Moro Islamic Liberation Front
ODA	Official Development Assistance
WTO	World Trade Organization