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Development Partnership for Escaping the Global Poverty Trap

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In the Least Developed Countries (LDCs), realising MDG Goal 8 should focus on making the new partnership framework based on making the PRSPs work better. Many of the LDCs are stuck in an international poverty trap, and the new framework, as it is currently being implemented, will not be sufficient to enable them to escape. Key priorities now are: creating pragmatic developmental States, not welfare States; genuine national ownership and policy autonomy; more – and more effective – aid and debt relief; a new form of international commodity policy; and removing the glass ceiling that blocks the development of the more advanced developing countries.

The Importance of Goal 8

" ..in addition to our separate responsibilities to our individual societies, we have a collective responsibility to uphold principles of human dignity, equality and equity at the global level…" So states the Millennium Declaration on its first page. The eight Millennium Development Goals (MDGs) are essentially a way of measuring and monitoring progress towards this commitment. The first seven focus on outcomes, identifying standards of well-being to be achieved within the next 15 years and concern both the nature of the lives individuals lead and the environment in which they live. The last – Goal 8 – focuses on relationships, identifying various aspects of the global partnership for development that should be forged to support the realisation of these standards.

The introduction of the MDGs presages some major shifts in international development practice. Firstly, they are based on a purposive conception of international society: as an association of States joined in a cooperative venture to promote some common ends. This idea differs fundamentally from that of States joined in association through their common respect for a set of rules that governs relationships among them. In the latter concept, the rules – which set certain restrictions on how States may pursue their own diverse purposes – are intrinsically important, regardless of outcomes.

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[1] This article draws on evidence presented in *UNCTAD ,The Least Developed Countries Report 2000: The Challenge of Financing Development in the LDCs*, and *UNCTAD, The Least Developed Countries Report 2002: Escaping the Poverty Trap*. Facts and figures are from these reports unless otherwise stated.

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Secondly, the outcomes that matter are not the growth of national economies (which was the largely-ignored development goal of the First and Second United Nations Development Decades), but rather the nature of peoples' lives. This shift consolidates further the human development agenda promoted by UNDP and the Human Development Report.

Thirdly, the common ends entail a further shift – from a maximal future horizon in which development means catching up with the living standards of the richest countries to one in which certain minimum standards of decent living are achieved. This minimalist approach is apparent, for example, in the target of reducing the proportion of people living on less than a dollar a day by half by 2015 – and thereby identifies the typical standard of minimally adequate consumption in the poorest countries as the global standard of poverty eradication.

The MDGs are not totally unproblematic. Employment issues are marginal to the list of goals, targets, and indicators. Global environmental goals are also inadequately represented. Further complicating matters, globalisation has raised expectations; what people consider minimally acceptable norms of human dignity is shifting upwards to the standards of living in the richest countries. Although achieving the $1-a-day target is now urgent in the poorest countries, it is becoming increasingly irrelevant as a standard for most others.

One of the most urgent tasks is further work on the nature of Goal 8, "Developing a Global Partnership for Development"; achieving the other goals stems largely from how that partnership evolves.

Goal 8 explicitly recognises that Global Development Goals cannot simply be achieved through National Development Means – an element missing in the initial list of International Development Targets put forward by the OECD/DAC in its 1996 report *Shaping the 21st Century: The Contribution of Development Cooperation*, on which the MDGs build. The addition of Goal 8 – the biggest change from the original OECD/DAC list – rectifies this deficiency. But the Goal 8 indicators are weak and need further refinement. It is also troubling that the commitment to "an open, *equitable*, rule-based, predictable and non-discriminatory multilateral trading and financial system" in the Millennium Declaration (para.13, emphasis added) is transformed in the MDGs into target 12: "develop further an open, rule-based, predictable, non-discriminatory trade and financial system". This transformation indicates a certain degree of hesitancy about making the rules of the global trade and financial system serve even the very limited global equity objectives of the MDGs.

Focusing on the 49 countries identified as "least developed" – the LDCs – by the United Nations, owing to their low GDP per capita, their weak human resources and

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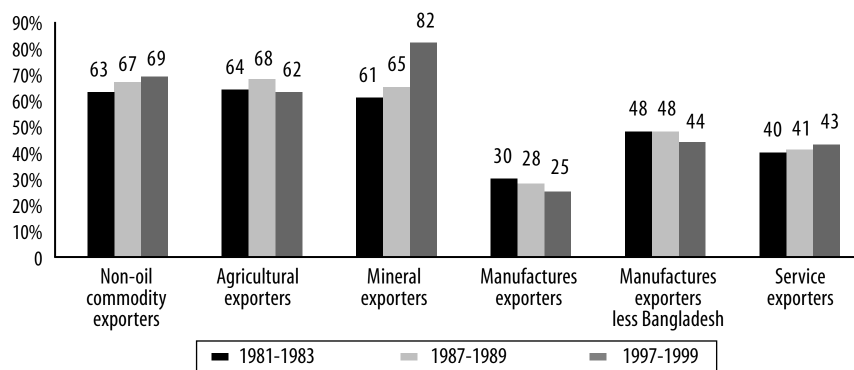
their vulnerability, this article argues that realisaing Goal 8 essentially means making the new partnership framework based on the PRSP approach work. Although the key principles underlying this framework are the right ones (increased national ownership and policy autonomy, reduced donor coordination failures, increased policy coherence between aid, trade preferences and debt relief), initial policy changes are insufficient to suggest that it will work. Current implementation weaknesses thus need to be urgently addressed. The article sets out ways to move forward to elaborate and implement the new partnership framework in a way that will support the eradication of extreme poverty in LDCs. These proposals are based on the view that eradicating extreme poverty in these countries depends on helping them to escape the international poverty trap.

The Challenge of Poverty Reduction in the LDCs

According to *The Least Developed Countries Report 2002*, four out of five people in these countries lived on less than $2 a day during the second half of the 1990s and half of the population on less than $1. The number of people living on less than a dollar a day has more than doubled over the least 30 years – from 138 million in the second half of the 1960s to 307 million in the second half of the 1990. Trends have been particularly bad in African LDCs; estimates indicate that the share of the population living on less than $1-per-day has risen from 56% in the second half of the 1970s to 65% in the second half of the 1990s. Moreover, the highest rates prevail in those that depend on primary commodity exports. And, in these countries, poverty is climbing: the percentage of people living on less than $1 a day in non-oil commodity-exporting LDCs rose from 63% in 1981-83 to 69% in 1997-1999. Poverty rates are rising particularly in mineral-dependent economies (see Chart 1).

Chart 1. The incidence of poverty in LDCs grouped according to export specialisation, 1981–1983, 1987–1989 and 1997–1999
(Share of total population living on less than $1 a day)



Source: UNCTAD, *The Least Developed Countries Report 2002*, chart 36 A.
Note: LDCs are classified according to their export composition in the late 1990s.

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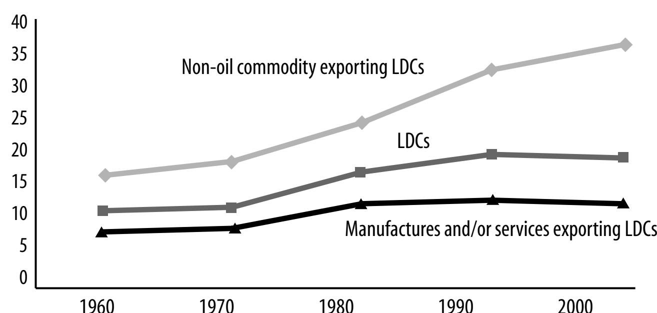
This is happening because many LDCs are unable to sustain economic growth. There are exceptions, such as Bangladesh. But most LDCs have experienced either economic stagnation, or economic regression – or short spurts of economic growth followed by some sort of economic collapse. Consequently, the LDCs have not been sharing in global economic growth – particularly those LDCs that have not diversified into exports of manufactures and/or services. Average real income per capita of non-oil commodity-exporting LDCs in 1999 fell below that of 1970. During the same 29 years, average real per capita income doubled in the world's 20 richest countries. In short, weighted by population and PPP adjusted, these 20 countries had an income per capita 35 times that of the commodity-exporting LDCs in 1999 – double the gap of 1960 (see Chart 2).

Chart 2. Trends in the income gap between the world's 20 richest countries and LDCs, 1960–1999



Source: UNCTAD, *The Least Developed Countries Report 2002*, chart 35.

a The income gap is the ratio of the average GDP per capita (in 1985 dollars adjusted for purchasing power) in the world's 20 richest countries to that in the LDCs and LDC subgroups. The sample of the world's 20 richest countries varies over time. The averages are weighted by population.

Some argue that the failure to share in global growth is the fault of these countries themselves, highlighting particularly the effects of poor governance and corruption. These factors cannot be ignored. But the basic problem is that most of these countries are stuck in an international poverty trap.

The trap has been created largely by the effects of generalised poverty on the domestic resources available to finance investment in public goods, including governance. Where the majority of the population earn less than $1 or $2 a day, a major part of GDP must be devoted to procuring the necessities of life. Few domestic resources are left for vital public services – education, health, administration and law and order. Low income leads to low savings; low savings leads to low investment; low investment leads to low productivity and low incomes. From 1995–1999, average per capita income in the LDCs – measured in terms of current prices and official exchange rates rather than 1985 PPP dollars – was $0.72 a day; average per capita consump-

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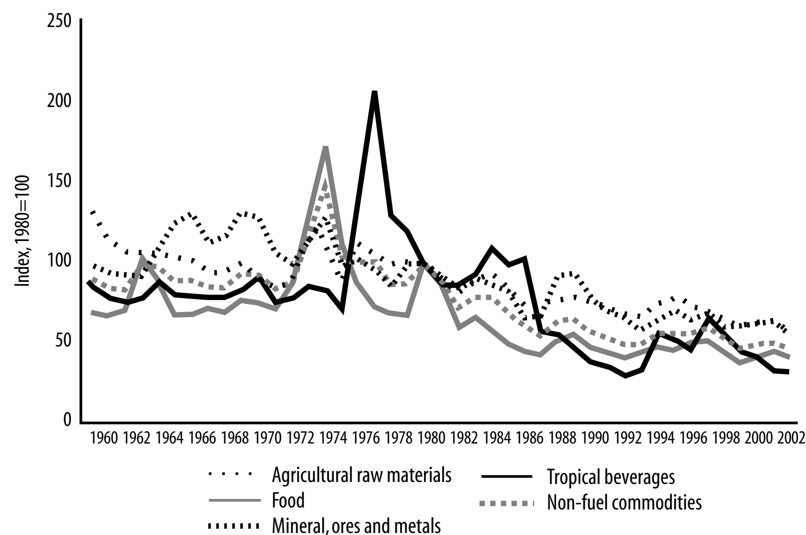
tion was $0.57 a day. On average, then, only $0.15 a day per person remained to spend on private capital formation, public investment in infrastructure and running vital public services.

State capacities are necessarily weak. Pervasive poverty also leads to environmental degradation, as people have to eat into the environmental capital stock simply to survive. This, in turn, undermines the productivity of the key livelihood assets on which many depend.

The poverty trap can be described as international because international trade and finance relations reinforce the cycle of economic stagnation and pervasive poverty within the LDCs. This is particularly apparent in those that depend heavily on primary commodities (see Chart 3). In these countries, the ability of international trade to act as an engine of growth and poverty reduction is being short-circuited by falling world commodity prices. At the end of 2001, real non-fuel commodity prices had plunged to one half of their annual average for the period 1979-1981. Large increases in export volume thus do not translate into large increases in export revenue and the capacity to buy imports. Associated with slow export growth, and also with the large external shocks due to commodity price instability, there has been a build-up of unsustainable external debt in the non-oil commodity exporters. Finally, as debts – mainly owed to official creditors – build up, aid disbursements have increasingly been allocated, either implicitly or explicitly, so as to ensure that official debts are serviced. In this aid/debt service system, the developmental impact of aid has been undermined; the "debt-tail" has been wagging the "aid-dog".

Chart 3. World free market prices for non-fuel primary commodities and primary commodity sub-groups, 1960-2002



Source: *The Least Developed Countries Report 2002*, chart 38.

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The New Partnership Framework for Development in Low-income Countries

To achieve the Millennium poverty reduction goal in the LDCs, it is necessary to enable the LDCs to escape the international poverty trap. This can occur if they are part of a strong global development partnership. A general framework for partnership is set out in the Brussels Programme of Action, agreed at the end of the third U.N. Conference on the Least Developed Countries in May 2001. However, what is happening on the ground in the LDCs is driven by the new partnership framework for low-income countries introduced in the late 1990s by IMF and the World Bank.

The centrepiece of this framework is the preparation and implementation of Poverty Reduction Strategy Papers (PRSPs). This idea was originally introduced as a mechanism for ensuring that debt relief for Highly Indebted Poor Countries (HIPCs) was channelled into increased social expenditures on health and education and on poverty reduction. But as the OECD has succinctly observed in its *Development Cooperation 1999 Report*, "The decision to place the implementation of the enhanced HIPC Initiative into the larger context of the new development partnership paradigm has in effect leveraged political support for debt relief into a reform of the whole of the concessional financing system" (p.21).

In addition, concern for systemic policy coherence widened the concept of development cooperation for low-income countries beyond concessional financing to include ways in which international trade could work to support poverty reduction, issues of technology transfer and also, though much less well-developed thus far, the question of how to encourage private capital flows to low-income countries. Taken together, these factors amount to a silent revolution that, although still in the making, is the biggest change in international development cooperation since the introduction of structural adjustment policies at the beginning of the 1980s.

The new partnership framework for development in low-income countries has eight key elements:

- Poverty reduction has been adopted as the central explicit goal of international cooperation.

- National governments are being asked to take responsibility for poverty reduction in their countries and to develop nationally-owned poverty reduction strategies.

- Donor countries and the World Bank and IMF are expected to shift away from the traditional donor-driven approach and to stand back to enable these nationally-owned strategies to emerge.

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- National governments are equally expected to shift from top-down approaches to development policy formulation and to develop a participatory approach to the formulation and implementation of poverty reduction strategies within their countries.

- IFIs and bilateral donors intend to focus aid selectively on those countries whose strategies they consider satisfactory.

- Bilateral donors are expected to reduce the coordination failures that undermined aid effectiveness in the past by aligning their aid behind these IFI-approved national strategies.

- Enhanced debt relief will be provided to countries with satisfactory poverty reduction strategies to reduce external debts to levels at which they are sustainable.

- Improved market access to developed country markets will be provided for the least developed countries; trade-related technical cooperation will also be furnished to enable them to build up supply capacities and increase their exports.

- Special consideration will be given to ensure access to technologies that are important to ensure basic general health.

Introduced in part as a means of overcoming aid fatigue and mobilising political commitment to increased aid flows to poor countries, the PRSP is important because it embodies the key principles of this partnership framework for development. It is simultaneously a mechanism to increase national ownership of policies; to introduce a participatory approach into development policy; to increase donor coordination; to enable aid selectivity; to ensure that debt relief is properly used by governments; to help create new opportunities for market access; and, perhaps most basically, to ensure a focus on poverty reduction as the central goal of national policies.

In practice, realising Goal 8 means elaborating and implementing the new partnership framework so that it actually works in low-income countries for sustained development, poverty reduction and the realisation of the other MDGs. The critical policy issue now for reaching the Millennium poverty reduction goal is whether the new partnership framework is implemented so as to enable them to escape the international poverty trap – and if not, what can be done to improve the situation.

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Weaknesses in Initial Implementation of the New Partnership Framework

Some analysts argue that it is too early to make any judgment; the new framework has not been implemented long enough to yield any results. However, even if it is not yet possible to see outcomes, one can already discern what is happening to the national and international policies that underlie these outcomes. For the LDCs, these indicate the emergence of a significant gap between the ideal promised by the new partnership framework and the reality unfolding in practice. This gap implies that the new framework, as currently implemented, is *not* going to work. Consequently, the goal of eradicating extreme poverty will *not* be met in the LDCs.

Implementation problems are evident in both national and international policies.

National policies

In many ways, the new PRSPs replicate the old structural adjustment programmes. The PRSPs still give priority to short-term stabilisation over long-term development, with tight credit ceilings and restrictive fiscal policies. They also continue to broaden and deepen past structural reforms extending the privatisation and liberalisation agenda. The two major new elements are the following:

- public expenditure is to be more closely tracked; and
- it is to be more pro-poor, in the sense of being channeled into basic health, education and local infrastructure projects.

However, because of the continuing tension between policy conditionality and ownership, those who formulate and implement the PRSPs face a dilemma. They know from past experience that if aid flows are cut off and debt relief delayed, the incidence of poverty is bound to rise. In these circumstances, they are finding it difficult to risk moving beyond the past adjustment policies. Whatever their own views on the past efficacy of these policies, they believe that a PRSP which continues these policies is least likely to be considered unsatisfactory by the IMF and World Bank Boards. Thus, if they continue with these policies – even if these are not the best ones to reduce poverty – they are unlikely to suffer from interrupted debt relief and aid flows.

The congruence between old SAPs and new PRSPs would not matter if the weak economic performance of the past stemmed from inadequate ownership and, therefore, poor implementation. But this diagnosis does not bear up. There has actually been a major change of policy in the direction of economic liberalisation in the low-income countries. For example, the World Bank, in its pre-Monterrey estimates of the aid

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inflows required to meet international poverty reduction goals, designated 65 low-income countries as "uphill". These are the countries that will find it hard to achieve the goals on the basis of past trends. Of these 65, 43 (i.e. two-thirds) had what the World Bank regards as "good policies" in place.

The problem therefore is not lack of ownership, but the policy model. Under structural adjustment programmes, there have certainly been improvements in macroeconomic environment, notably in reducing excessively high rates of inflation and correcting overvalued exchanges rates. Exports have also increased. But domestic investment and savings rates have not generally increased much; private capital inflows have not been attracted; and although the decline in market share in traditional exports has been halted, there has been no progressive structural change towards more dynamic exports. In fact, rather than an upgrading of primary commodity exports, there has been a collapse of local processing and, in some cases, a decline in quality.

The new poverty reduction strategies seek to make structural adjustment more pro-poor despite the fact that past adjustment policies generally have not delivered – and cannot deliver – accelerated and sustainable economic growth at rates sufficient to dent poverty significantly. While the policy model may achieve macroeconomic stabilisation, it is wrong for promoting sustained growth and poverty reduction in countries where productive capacities, markets and the entrepreneurial class are all underdeveloped and where the majority of the population live on less than $1-per-day.

There is a danger now that, with the new adjustment-oriented poverty reduction strategies, countries will end up with the worst of all worlds. The new policies will increase exposure to intensely competitive global markets – without facilitating the development of the productive and supply capacities necessary to compete. At the same time, there will be increased arm's length regulation and administrative guidance of social welfare through international development cooperation. Finally, bilateral donors will be dissuaded by the IFIs from increasing aid flows because such increases, which are particularly focused on non-tradeables, are deemed incompatible with the macroeconomic framework.

International Policies

There is no reason why one should expect better results in the future if the national policies remain the same as those in the past. Better results than those of the past are also unlikely because international policies have not been modified sufficiently to support accelerated national economic growth and poverty reduction.

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Although the enhanced HIPC Initiative has brought some benefits, debt relief has not been sufficient to provide the basis for a durable exit from the debt problem. The forecasts on which the expectation of medium-term debt sustainability have been based are far too optimistic. Debt relief has also opened little fiscal space for poverty reduction. Of the 20 HIPC-LDCs that had reached decision-point by mid-2002, four countries are predicted to have annual debt service payments due in 2003-2005 that will actually exceed the debt service paid in 1998-2000. In another six countries, these payments will be reduced by less than $15 million. In only three countries will annual debt service payments due in 2003-2005 be more than $50 million lower than those paid in 1998-2000. Further, it has been impossible to bring all creditors into the process. With falling commodity prices, the enhanced HIPC Initiative is on a knife-edge, and the fledgling PRSPs will be derailed if debts and arrears accumulate again.

On a positive note, the sharp decline in aid flows to the LDCs that began in the early 1990s was halted during 1998-2000. OECD/DAC estimates of net ODA disbursements to LDCs indicate that these countries received $12.5 billion in the year 2000 – slightly more than in 1999. However, in 1998-2000, 25% of total bilateral aid commitments to LDCs went to emergency assistance and debt relief. The new commitments made at the Monterrey Conference on Financing for Development are also encouraging. But in nominal terms, aid inflows to LDCs were 26% lower than their peak in 1994. Moreover, in real per capita terms, net ODA disbursements to the LDCs were 46% lower in 2000 than they were in 1990.

Further, donors are only slowly adapting their aid delivery procedures to the new PRSP approach. Aid flows are very unstable and unpredictable. Donor alignment with national poverty reduction strategies – through increased budget support, improved reporting, and a shift to recipient country budgeting timetables and categories – is also taking place very slowly. The PRSPs will certainly not work if "business as usual" continues in the way donors deliver aid.

A particularly disturbing feature of PRSP implementation is that it focuses on improving the poverty-reducing efficiency of public expenditure and aid inflows rather than on exploring the gains that can be achieved by expanding the resource envelope of poverty reduction through increased external assistance. Thus, countries are currently expected to submit PRSPs that are "realistic" in terms of external financing projections that they prepare behind a "veil of ignorance" as to donor intentions. When poverty reduction financing gaps emerge, the projected pace of poverty reduction is scaled back to ensure that the PRSP is "realistic" and thus deemed worthy of donor support.

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Turning to trade, it is difficult for many poor countries to take advantage of the special preferences afforded to them, often because of supply capabilities, or rules of origin, or lack of security of preferences. For example, before the EU's Everything but Arms Initiative, 99% of products from non-ACP LDCs were covered by the Generalised System of Preferences (GSP), but only 34% of those imports eligible for preferential treatment were imported on preferential terms. The rest paid Most Favoured Nation duties.

Further, the international trade policy agenda has ignored the effects of falling and unstable commodity prices on growth and poverty in the poorest countries. The old international commodity policies have withered away. What exists now is, in developmental terms, a perverse international commodity policy in which rich countries are subsidising their own agricultural production.

What Can Be Done?

The foregoing suggests that the new partnership framework is not being implemented so as to enable LDCs to escape the poverty trap and to achieve the target of reducing the $1-a-day poverty by half by 2015. A number of actions are necessary now to rectify this situation. Key priorities are:

1. Creating pragmatic developmental States
2. External support to enable genuine national ownership and policy autonomy
3. Re-enhanced debt relief
4. Increased development aid in line with international norms and commitments
5. A comprehensive approach to increasing aid effectiveness
6. Renewal and recasting of international commodity policy
7. Removal of the glass ceiling that blocks further development of the more advanced developing countries.

Creating Pragmatic Developmental States

Effective national policies and institutions are the bedrock of poverty reduction. Governments themselves must forge these. But in low-income countries where extreme poverty is all-pervasive, poverty reduction takes place through sustained economic growth and development that raises average household incomes. There is thus a need to shift away from poverty reduction strategies that extend old structural adjustment programmes to strategies that are development-oriented.

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Private enterprise should play the key role in achieving the objectives of development-oriented strategies. But the development process should be catalysed and guided by a pragmatic developmental State, which through good governance of markets, harnesses the profit motive for the purposes of national development and poverty reduction. Indeed, the meaning of a national commitment to good governance, identified in Goal 8 as a central element of a global partnership for development, is best seen in terms of creating a pragmatic developmental State and promoting a relationship between markets and States that is appropriate for very low levels of development.

Policies through which a government guides the process of capital accumulation and learning are best developed and implemented through institutions that enable private sector perspectives to be incorporated, and through policies that channel activities and energies rather than limit them. Sectoral policies, for example, should arise from joint efforts between the public and private sectors that together formulate a vision and reach consensus on the ingredients necessary to realise that vision. These would cover, for example, issues of technology choice; what institutions are required to support technological development; what are the aggregate requirements in terms of labour skills; and how financial resources can be ensured for the expansion of the sector. Policies should also focus on overcoming specific problems that impede the achievement of national development objectives – notably, missing markets and the lack of an entrepreneurial base; imperfections in technology and capital markets; risks of exporting; and dynamic complementarities between firms and sectors that render competitiveness and productivity systemic rather than simply dependent on firm-level capabilities.

Creating capable and effective States goes hand in hand with creating a dynamic entrepreneurial class willing to commit its resources to domestic investment in production rather to luxury consumption or to holding private wealth abroad. These two institutional issues must be addressed in a developmental approach to poverty reduction. States need to develop skills and learning capabilities not only for policy formulation and implementation, but also for ensuring respect of property rights and contract enforcement, mobilising revenue and managing public expenditure. An equal challenge is strengthening the domestic entrepreneurial class; there are simply not enough businesses with the capacity to compete internationally. Existing entrepreneurial skills often focus on short-term trading and housing rather than long-term production. Particular efforts should be made not simply to create an investment climate in which the costs and risks of doing business are reduced, but also to ensure that the structure of profitability and the availability of investment funds are biased towards productive investments that can create employment.

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Support to Enable Genuine National Ownership and Policy Autonomy

The ability of LDC governments to formulate and implement development-oriented poverty reduction strategies depends critically on external support that enables genuine national ownership and policy autonomy. Steps are being made in this direction, but there is need for:

i) a re-thinking the nature of policy conditionality;

ii) better technical cooperation to rebuild State capabilities;

iii) greater donor alignment behind PRSPs; and

iv) attention to WTO rights and obligations.

The issue of policy conditionality is pivotal; aid donors have a fiduciary duty to ensure that aid is not misused. But a tension exists between policy conditionality and ownership because policy conditionality is linked to the implementation of a particular policy model. This is undermining domestic democratisation because of the need to satisfy both internal constituencies and external donors. In addition, making access to aid conditional on national policies that are considered effective in promoting sustained growth and poverty reduction, but that are ineffective in practice in the LDC context, has proved a recipe for frustration and failure.

The tension can be reduced if there is much greater flexibility on the part of the World Bank and IMF regarding what constitutes "good policies". A more radical approach would be to delink conditionality from the implementation of specific policies. In this regard, it may be possible to make domestic resource mobilisation the heart of conditionality, and to link aid inflows to reasonable targets for domestic savings effort. This could satisfy the donors' legitimate concern that aid is linked to country-level effort, and also provide the basis for a genuine financial partnership.

One difficult issue that must be addressed is the relationship between policy conditionality and the MDGs. The relationship between the MDGs and the PRSP approach is as yet not totally clear. On the one hand, inscribing MDG targets and indicators into national PRSPs will ensure a strong focus at the national level on achieving the agreed global goals. Indeed, the IMF and World Bank, which must endorse the PRSP as satisfactory, have insisted that the MDGs become integral elements of the PRSPs. This presumably reflects a desire to protect national policy autonomy. However, at the very least, the tailoring of global targets to local circumstances is necessary for national ownership of the MDGs. Making the adoption of MDG indicators an object of policy conditionality will be an unwelcome imposition.

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It also could prove counter-productive, as it may distract attention away from key issues of promoting investment, exports and productivity that in the end will be necessary for sustainable poverty reduction.

Greater donor alignment behind national poverty reduction strategies is also necessary for national ownership and policy autonomy. This implies greater budget support; project aid should fit in with national strategies. Renewed attention must also be given to the way in which technical cooperation works. This is a vital aspect of building capable States. New approaches are also required to shift focus from the transfer of Northern knowledge to the acquisition of information that will generate national knowledge appropriate to the circumstances of the developing country itself.

A final aspect of genuine national ownership and policy autonomy concerns the nature of WTO rights and obligations. Many of the financial, fiscal and macroeconomic policies that can help create the conditions for faster capital accumulation and productivity growth through learning in the LDCs are not constrained by WTO obligations. It is important that the LDCs familiarise themselves with their rights and that technical assistance help them to do so. It is also important that WTO rules as they evolve in what is now described as the “Doha Development Agenda” enable the adoption of national policies that, in turn, enable countries to break out of the poverty trap.

Re-enhanced Debt Relief

However competent governments become in fostering development, and whatever policy space they are given to develop their own poverty reduction strategies, escaping the poverty trap will also require reducing the very tight financial resource constraints that continuously undermine economic growth and poverty reduction. The first priority here should be debt relief that goes beyond the current HIPC framework.

Even the enhanced HIPC Initiative has left the HIPC countries deeply in debt, and the outstanding debt problem continues to undermine development efforts. This takes place through various channels. Debt service payments absorb foreign exchange, thus reducing import capacity; they adversely affect government budgets, reducing domestically-driven public investment in physical and human infrastructure. The debt overhang creates uncertainty for domestic and foreign investors and also adversely affects country credit ratings and perceptions of country risk, limiting the access of potentially profitable firms within indebted countries to international capital markets.

Two fundamental problems characterise the history of debt relief for low-income countries. Firstly, creditors have continuously sought to grant the minimum amount

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of relief that they considered necessary to ensure that the remaining debt-service burden could be paid without recourse to further relief. Secondly, there has been a persistent tendency to underestimate the amount of debt relief required to provide an exit from the problem. There was thus a progressive increase in the scale of debt relief to low-income countries provided through the Paris Club from the late 1980s on. The HIPC Initiative has extended this process. For the debtor countries themselves, this has had particularly bad effects, as they are never given the basis for a fresh start. Instead, they become continuously dependent on exceptional financing – which comes in the form of either arrears accumulation or formal debt relief. Dependence on such "virtual" financial flows creates much uncertainty. Such flows are not additions to financial inflows, but reductions in the difference between debt service payments that are contractually due and debt service payments that are actually paid. Nor is the scale of these "virtual" flows generally recognised. For example, if such "virtual" financial flows were not supplementing the real flows, the aggregate net transfers to LDCs as a whole would have been only 25% of their actual level in 1994-98.

It would be possible to seek to achieve poverty reduction goals through increased aid and without further debt relief. Increased aid inflows would allow countries to cover their debt service needs. But such an approach would perpetuate the aid/debt service system of the 1990s in which a proportion of aid acts as "defensive lending" to ensure continued repayment of past loans. This system undermines aid effectiveness because aid cannot be fully used for developmental purposes. It leaves governments "cash-poor" and "project-rich". The system is an integral part of the international poverty trap. Breaking it so that countries are both less aid-dependent and less indebted will support the goals of both increased aid effectiveness and improved State capacities.

Debt relief needs to be re-enhanced enough to give countries the opportunity to begin afresh with a real chance to achieve the MDGs. Debt relief also needs to be put into a predictable framework, rather than subject to an arbitrary process of topping-up. It is most likely that linking debt relief to the achievement of the MDGs will entail debt cancellation for most low-income countries. Renewed attention must therefore be given to financing re-enhanced debt relief.

Increased Development Aid in Line with International Norms and Commitments

Re-enhanced debt relief will not work to support the Millennium poverty reduction goal unless substantially increased external finance is provided on terms that do not lead to the build-up of new debt problems, but rather, furnish the basis for increased investment, exports and productivity.

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The need for substantial increases in external finance arises because domestic savings are very low. They cannot rise because of weak corporate sectors and widespread poverty in which many people live hand-to-mouth, often only partly inside the money economy. In the medium term, if growth can be sustained, one may expect significant increases in domestic resource mobilisation that will, in due time, reduce dependence on external finance and usher in the possibility of a more self-sustained growth process. But external finance is essential in the early stages of development to break out of the poverty trap.

Some analysts argue that the key to financing poverty reduction lies in promoting private capital inflows and particularly inward FDI, which is perceived as a non-debt-creating flow. But foreign investors and lenders are deterred from many LDCs because of these countries' vulnerability to shocks and also their high levels of external debt. In addition, the costs of asset development in LDCs rise steeply, particularly in the absence of strong business support services and physical, social and administrative infrastructure. Added to the paucity of commercially viable business opportunities, there are the imperfections of international capital markets.

In 2000, the LDCs received just 2.1% of net FDI inflows to all developing countries. Moreover, 86% of FDI inflows to the LDCs were concentrated in ten countries – of which the four oil-exporting LDCs absorbed about 50%. The LDCs also remain excluded from international bank finance and bond issues. Private debt flows to LDCs have been negative for every year since 1995 except 1999, indicating that repayments of existing debt to private creditors have exceeded new loan disbursements.

As an overall goal, it is advisable for developmentalist LDCs to encourage a progressive transition during which sustained growth and poverty reduction become increasingly founded on domestic resource mobilisation, the attraction of developmental FDI and the tapping of international financial markets. With this in view, efforts should certainly be made to attract FDI and to enhance its developmental impact. However, policy-makers in LDCs should not have false expectations that FDI can lead the development process. Nor should donors see the signs of rising private capital flows into a number of LDCs as an opportunity for reducing ODA. Instead, it is now necessary to increase aid inflows so that these countries can break out of the poverty trap.

Although aid requirements for achieving the Millennium poverty reduction goal should be estimated at the national level, various international costings already carried out use the resource envelope implied by current international commitments and norms – the 0.15% or 0.2% of donor GNP (or GNI) agreed by most donor countries as ODA to the LDCs at the 1990 UN Conference on Least Developed Countries

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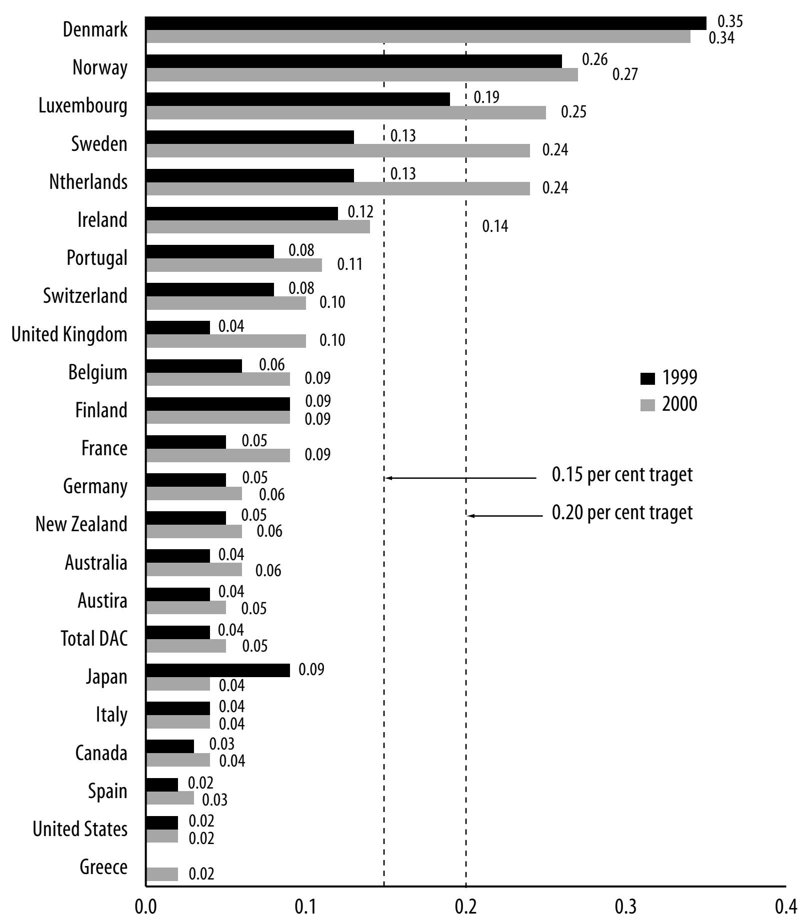
in Paris and reaffirmed at the 2001 Brussels Conference. However, these commitments are not being met. In 2000, only five donor countries surpassed the 0.20% target of GNI (Denmark, Norway, Luxembourg, Sweden and the Netherlands). For all the other countries, aid flows were below the 0.15% target. (See Chart 4)

Chart 4. Net ODA disbursements to LDCs from DAC member countries, [a] 1999 and 2000
(As percentage of donor's GNI)



Source: UNCTAD secretariat estimates based on OECD *Development Co-operation 2001 Report*.
[a] Including imputed multilateral flows, i.e. making allowance for contributions through multilateral organizations, calculated using the geographical distribution of multilateral disbursements for the year of reference.

Adoption of a Comprehensive Approach to Increased Aid Effectiveness

Increased aid will not work to reduce poverty unless measures are also taken to increase aid effectiveness. In this regard, a "one-eyed approach" to improving aid effectiveness prevails. This approach is based on the premise that aid will be effective only if it is provided to recipient countries that have good policies. This is obviously

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correct – as long as the "good policies" are not actually bad policies. But aid effectiveness depends on donor policies as well as those of aid recipients. The former are currently ignored. Thus it is believed that selectivity – focusing aid on countries with good policy environments (the "deserving poor") – is a sufficient condition for enhanced aid effectiveness.

An important issue, which is certainly recognised in the indicators for Goal 8, is progress towards untying aid. This reflects the decision to untie aid made at the 2001 Brussels Conference on LDCs.[2] How the untying of aid works in practice will require close monitoring. LDC governments should also receive support that enables them to procure more effectively. Apart from the untying, there is a need for greater predictability in aid, as well as longer-term aid commitments. Currently, aid instability is the largest source of economic shocks to LDCs. But no international initiatives exist to increase aid stability and predictability.

Increasing the developmental effectiveness of aid will also require further attention to the sectoral allocation of aid. The decline in aid has been accompanied by the continuation of a long-term shift in bilateral aid commitments away from production and economic infrastructure towards social sectors. The latter constituted just 13% of commitments from 1980-1984, but 34% from 1998-2000. Thus, the decline in aid has been particularly marked for production sectors. A major concern is aid to agriculture, the main source of livelihoods for most people in the LDCs. In real terms, external assistance for agriculture in the LDCs was one-half its level in the 1980s. Increasing aid for economic infrastructure and financial and technical support for productive activities should be seen as priority now, along with increasing the proportion of aid going into the basic education, primary health care, nutrition, safe water and sanitation targeted in Goal 8.

A simple institutional proposal for increasing aid effectiveness is the establishment of aid performance monitoring at the recipient country level. Currently, the major official source of aid performance data and performance evaluation is the Development Assistance Committee of the OECD. Instituting aid performance monitoring systems at the recipient country level would complement this activity by gathering and evaluating information in a way more closely related to aid effectiveness within the countries themselves. Such a system has already been set up in Tanzania, where an Independent Monitoring Group tracks aspects of both government and donor performance in relation to aid in specific agreed areas. This could provide a model for generalisation as part of developing a global partnership.

[2] However, food aid was excluded from untying. So was technical cooperation – because some donor countries argued that their consultancy service industries were not strong to withstand the effects of full international competition.

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Renewal and Recasting of International Commodity Policy

The key missing link in the current international approach to poverty reduction is the absence of any kind of international commodity policy. There is an urgent need now to reconsider how such a policy could be reformulated with a view to supporting poverty reduction. This does not mean a return to the old-style international commodity agreements. They did not succeed and there is little political will to return to them. What is required is a pragmatic approach involving national and international efforts. This could include:

- A compensatory financing facility to offset the effects of commodity price shocks;
- Exploring institutional innovations that can enable the adoption of commodity risk management instruments in poor countries;
- International efforts such as the transparency initiative ("publish what you pay") to ensure that oil and natural resource companies declare what they are giving to governments;
- Linking debt repayment schedules to world commodity prices;
- Speedy reduction of agricultural subsidies in the rich countries, which are particularly contributing to extreme poverty in the poor countries.

Dealing with low prices will also necessarily entail efforts to rationalise supply in saturated international commodity markets. Measures that may be explored include agreements on minimum quality standards and increased technical and financial support for horizontal and vertical diversification. The Integrated Framework of Trade-Related Technical Assistance could play an important role in the last task. Market access issues, including tariff peaks, that block diversification must also be addressed.

Removing the Glass Ceiling Blocking Development in the More Advanced Developing Countries

A final aspect of increased policy coherence entails thinking about the problems and prospects of the poorest countries not simply as a North-South relationship, but in terms of the relationship between the poorest and the more advanced developing countries and emerging markets. One key to economic growth and poverty reduction in the poorest countries is economic growth and sustained industrialisation in the more advanced developing countries. It will be difficult for the poorest countries to get onto the development ladder and move up its rungs if the more advanced developing countries face a "glass ceiling" that blocks their own development.

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Under current international policy arrangements, the benefits of affirmative action measures designed for the LDCs are being undermined by a supposedly level playing field for all the other countries that is actually tilted against developing countries. Various asymmetries in the international system (see the article by Martin Khor in this volume) are making it difficult for the more advanced developing countries to deepen industrialisation, move up the technological ladder, and graduate out of producing the simpler goods exported by poorer countries. This tends to make the relationship between the LDCs and more advanced developing countries competitive rather than complementary.

The policy challenge is to structure the relationships of both more and less advanced developing countries *with* developed countries in a way that enables the emergence of complementary synergies *between* the more advanced developing countries and the less advanced developing countries. All groups of countries can gain. In the end, addressing the socioeconomic marginalisation and extreme poverty of the low-income countries will require not only differentiated treatment for them, but international measures to reduce the current polarisation of the global economy and to facilitate the emergence of a "middle class" of world States that can serve as regional growth nodes.

No single group of the measures proposed throughout this article can work alone to dismantle the global poverty trap. Taken together, though, they can steer the world away from a perpetuation of extreme poverty in the countries where the achievement of the MDGs will be hardest.