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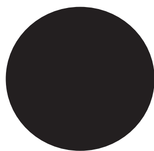

# The Promise of Monterrey
## Meeting the Millennium Development Goals

*Shalendra D. Sharma*

In September 2000, at a historic summit attended by 147 heads of state, the United Nations unanimously adopted the Millennium Declaration. The delegates pledged to work toward a world that would promote peace and social justice, eradicate chronic poverty, and support sustainable development. These fine words were then distilled—after consultation with the International Monetary Fund (IMF), the World Bank, the Organization for Economic Cooperation and Development (OECD), and the U.N. General Assembly—into seven millennium development goals, or MDGs. These were: 1) eliminate extreme hunger and poverty; 2) achieve universal primary education; 3) promote gender equality and empower women; 4) reduce child mortality; 5) improve maternal health; 6) combat HIV/AIDS, malaria, and other diseases; and 7) ensure environmental sustainability.

In December 2000, U.N. secretary general Kofi Annan was authorized by the General Assembly to prepare a "road map" for achieving the goals laid out in the Millennium Declaration. The Office of the Secretary General issued its consensual road map in September 2001. The road map included an eighth goal—to develop a global partnership for development—and outlined seven "mutual responsibilities and obligations" of the U.N. member states. In December 2001, the U.N. General Assembly formally adopted resolution 5695 approving the eighth goal, and at the U.N.'s inaugural International Conference on Financing for Development in Monterrey, Mexico, in March 2002, 50 heads of state and over 200 ministers from developed and developing countries agreed on a new compact that stressed mutual responsibilities with respect to the initiative. The Monterrey Compact called on the developing countries to deepen their economic reform programs and improve governance, and on the developed countries to step up their support by providing more aid to developing countries and opening their markets.

In accepting the eight MDGs, each country committed itself to attaining ambitious, measurable "targets" by the year 2015. There are some 48 indicators, each associated with a specific target, by which progress is to be gauged. U.N. "country teams" are to help integrate millennium goals into national development frameworks. The Office of the Secretary General is required to submit an annual report to the General Assembly on progress achieved toward implementing the Millennium Declaration.

The postwar period has seen an array of grandiose plans and programs aimed at solving the problems of poverty, inequality, and economic underdevelopment. Despite the dedicated efforts of many people and the expenditure of huge sums of money, the results have been disappointing. In this "elusive quest for growth," there have been a few unexpected achievements, and a great many failures.[1]

Will the millennium project be any different? While the Millennium Declaration has been applauded for its bold and ambitious vision, the initiative, by creating

unrealistic expectations, is set up for failure. Many of the millennium development goals are beyond the reach of most countries. The fear is not only that the millennium project will become the latest casualty in a long list of unrealized U.N.-sponsored programs, but that its failure may lead to the "development fatigue" that we have seen before when rich donor countries lose heart and interest.

At a minimum, achieving the millennium development goals will require unprecedented international cooperation and national commitment. Indeed, a shared stewardship between developed and developing nations is of paramount importance if the widening gap between rich and poor—between the 16 percent of the world's people who live in the most affluent countries and control 81 percent of total global income, and the 84 percent who share the remaining 19 percent—is to be narrowed. However, the history of North-South relations is replete with examples of competing agendas and interests that have undermined past efforts. Moreover, the assumption that developing countries will be able in short order to substantially improve their domestic governance, adopt policies that promote equitable economic growth, and demonstrate a determined commitment to the millennium goals is, to say the least, overly optimistic. This is especially true for the 40 or so least developed countries (LDCs), which face the daunting challenge of simultaneously building their political-institutional capacities while generating sustained levels of economic growth.

Nevertheless, the quest for sustainable and equitable development must continue. The negative externalities associated with poverty and hopelessness—conflict, violence, and terrorism, among others—are simply too costly to ignore. There are some 1.3 billion desperately poor people (about one-fifth of the world's population) who barely exist under the official poverty line of $1 per person per day; as many as 3 billion people live on less than $2 per day. The lives of such people are likely to improve immeasurably even if the targets associated with the millennium development goals are only partially met.

*What Works: Eight Lessons*

The task now is to translate vision into action, and here we have six decades of experience to guide us. What works and does not work when it comes to development? Two generations of experts have provided us with enough information to develop a "best practices" manual.

***First***, if experience has taught us anything, it is that the most powerful force for the reduction of poverty is sustained and robust economic growth. The evidence shows that the countries that have been most successful in reducing poverty are those that have grown the fastest, whereas those whose economies have stagnated have seen increases in poverty levels. Put simply, the poor generally benefit from rising aggregate income and suffer from economic contractions. The experiences of sub-Saharan Africa and China are illustrative. While the rest of the world's economy grew at an annual rate of 2 percent from 1960 to 2002, sub-Saharan Africa's growth rate was dismal. From 1974 through the mid-1990s, the region experienced negative growth.[2] As a consequence, hundreds of millions of people in Africa have become poor: one-half of all Africans now live below the poverty line. Sub-Saharan Africa's per capita gross domestic product (GDP) is now less than it was in 1974—having declined by over 11 percent. In 1970, one in ten of the world's impoverished lived in Africa. However, by 2000 the number was closer to one in two. This translates into 360 million people in 2000, compared to 140 million in 1975. Tragically, much of Africa today is caught in a vicious "poverty trap"—in which a country is simply too impoverished to achieve sustained economic growth. On

## Millennium Development Goals and Targets

**Goal One**: Eradicate extreme hunger and poverty

*Target 1*: Halve, between 1990 and 2015, the proportion of people whose income is less than $1 a day

*Target 2*: Halve, between 1990 and 2015, the proportion of people who suffer from hunger

**Goal Two**: Achieve universal primary education

*Target 3*: Ensure that, by 2015, children, boys and girls alike, everywhere complete primary schooling

**Goal Three**: Promote gender equality and empower women

*Target 4*: Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015

**Goal Four**: Reduce child mortality

*Target 5*: Between 1990 and 2015, reduce by two-thirds the under-five child mortality rate

**Goal Five**: Improve maternal health

*Target 6*: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio

**Goal Six**: Combat HIV/AIDS, malaria and other diseases

*Target 7*: Have halted by 2015 and begun to reverse the spread of HIV/AIDS

*Target 8*: Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases

**Goal Seven**: Ensure environmental sustainability

*Target 9*: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources

*Target 10*: Halve, by 2015, the proportion of people without sustainable access to safe drinking water and sanitation

*Target 11*: Have achieved by 2020 a significant improvement in the lives of at least 100 million slum dwellers

**Goal Eight**: Develop a Global Partnership for Development

*Target 12*: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system

*Target 13*: Address the special needs of the Least Developed Countries via tariff and quota free access for exports; an enhanced program of debt relief, including the cancellation of official bilateral debt; and more generous official development assistance for countries committed to poverty reduction

*Target 14*: Address the special needs of land-locked countries and small island developing states through the Program of Action for the Sustainable Development of Small Island Developing States

*Target 15*: Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term

*Target 16*: In cooperation with developing countries, develop and implement strategies for decent and productive work for youth

*Target 17*: In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries

*Target 18*: In cooperation with the private sector, make available the benefits of new technologies, especially information and communications technologies

the other hand, the number of rural poor in China was reduced from 250 million in 1978 to about 26.4 million in 2001, mainly due to the high annual growth in the country's GDP, which averaged 9.5 percent between the start of economic reforms in 1979 and 2001. China's per capita GDP increased almost six times over this period. A recent World Bank study confirms that the income of the poor increases with overall economic growth.[3]

and poverty traps. If, for example, a person who did not have access to education or dropped out of school and cannot go back falls into poverty because of a loss of wealth, health, or opportunity, he or she has become a victim of irreversibility. In a poverty trap, regardless of the country's growth rate, the poor are not able to pull themselves out of poverty because they lack basic skills or opportunities to participate in economic activity.

Access to health care can greatly affect per capita GDP growth since healthy workers are more productive (with businesses suffering less absenteeism) than workers who are otherwise comparable except for their health. Moreover, rising longevity opens up new incentives to save—with potentially dramatic effects on national savings rates. Better health care also has a positive spillover effect on the recipients' families. Positive externalities arise in the context of gender-specific poverty alleviation programs as well. Better education for women, for example, is often associated with declines in fertility rates and the improved education, nutrition, and health of children. Thus, a virtuous circle of rapid growth and improving living standards can be created by means of what the Nobel laureate Amartya Sen has referred to as the "enhancement of human capabilities."[4] As Sen has long noted, development cannot be viewed simply in narrow economic terms as the growth of aggregates such as per capita income. Rather, for development to be meaningful it must enhance individuals' abilities to shape their own lives. It must take into account all aspects of an individual's well-

**Number of people living on less than $1 per day (millions)**

| | 1990 | 2000 | 2015 |
|---|---|---|---|
| East Asia and Pacific | 470 | 261 | 44 |
| China | 361 | 204 | 41 |
| Rest of East Asia and Pacific | 110 | 57 | 3 |
| Europe and Central Asia | 6 | 20 | 6 |
| Latin America and the Caribbean | 48 | 56 | 46 |
| Middle East and North Africa | 5 | 8 | 4 |
| South Asia | 466 | 432 | 268 |
| Sub-Saharan Africa | 241 | 323 | 366 |
| Total | 1,237 | 1,100 | 734 |
| Excluding China | 877 | 896 | 692 |

*World Bank (2004a) Global Economic Prospects 2004.*

***Second***, rapid economic growth is not only compatible with, but is likely to be enhanced by, policies that improve the quality of human capital through access to primary and secondary education, health care, and other basic social services. Education and health are examples of what economists call "positive externalities"—where the effects of improving the lives of some people spill over to benefit others. For example, a well-educated labor force can boost productivity, contributing to overall growth and wider distribution of wealth. Education also enables the poor and disadvantaged in society to escape poverty through their own efforts, that is, to counter "irreversibilities"

being—physical and economic security, as well as the exercise of civil rights and the enjoyment of political freedom. Thus, policies and programs that decrease disparities in incomes and assets, build human capital through access to education and health care, and provide safety nets for the most vulnerable are critical to achieving broad-based development.

***Third***, well-functioning market economies are not only superior to centrally planned economies but indispensable to development. As the British economist John Kay writes in his insightful book, *Culture and Prosperity,* "If the strength of the market economy were encapsulated in a single phrase, it would be disciplined pluralism—the process of perpetual experiment in market economies, in which most experiments fail and are terminated, but the few that succeed are quickly imitated." As Kay notes, the importance of markets "is that they are not dependent on the genius of any individual."[5] In contrast, centrally planned or autocratically managed systems, where a single "right answer" to development is articulated, inevitably fail.

***Fourth***, economic theorists have long argued that global trade liberalization promotes economic growth and reduces poverty. Open trade provides economies of scale for countries too small to achieve them domestically and stimulates economic growth through the diffusion of new technology and competitive pressure that reduces the monopoly power of domestic firms that are forced to innovate. Moreover, global trade liberalization increases demand for goods produced by unskilled labor—and as a consequence boosts unskilled wages relative to skilled wages and capital earnings. The tremendous expansion in global prosperity in the second half of the twentieth century occurred in the context of broad-based multilateral trade liberalization within a framework of reciprocity and rules. The evidence is unambiguous: countries that have entered export markets through trade and intensified their links with the global economy have tended to grow faster than those that have not. The findings of numerous studies have been reinforced by a recent World Bank study, *Globalization, Growth and Poverty: Building an Inclusive World Economy*. The study provides strong evidence that globalization (referring to international economic integration) can serve as a positive force in promoting development.[6] The study measures the rate of globalization by changes in the ratio of trade to GDP over the period 1977–97, and distinguishes "newly globalizing" countries (also called "more globalized") from "nonglobalizing" or "less globalized" countries. According to its criteria, two-thirds of developing countries rank among the less globalized countries. The 24 newly globalizing countries that increased their integration into the world economy over the two decades achieved higher income growth, no increase in inequality, longer life expectancy, and a decline in poverty levels. These 24 countries, which include China and India and are home to some 3 billion people, enjoyed an average 5 percent growth rate in per capita income in the 1990s (rich countries experienced an average 2 percent growth rate during this period). On the other hand, countries that have not integrated successfully into the global economy—particularly in sub-Saharan Africa, the Middle East, and the former Soviet Union (together home to some 2 billion people)—have been left behind. These countries have seen their ratio of trade to GDP either remain flat or actually decline. On average, their economies have contracted and poverty levels have risen—in some cases sharply. For many of these countries, especially the LDCs, the problem is not that they are being impoverished by globalization, but that they are being excluded from its benefits.

Yet even the staunchest advocates of globalization point out that it is no magic

bullet.[7] Globalization provides both opportunities and threats. The most salient features of economic globalization—the liberalization of international trade, the expansion of foreign direct investment, and the phenomenal growth of cross-border financial flows—can also make economies vulnerable to shocks and financial collapse. Indeed, the Asian financial crisis of 1997–98 demonstrated that even "model" emerging market economies can succumb to the vagaries of international capital markets. A recent IMF study provides a comprehensive and nuanced understanding of the role played by international capital flows in promoting development, with important implications for developing countries.[8] The authors address the following three questions: Does financial globalization promote economic growth in developing countries? What is its impact on macroeconomic volatility in these countries? What factors can help harness the benefits of financial globalization? The authors note that, according to economic theory, developing countries can accrue huge benefits from financial integration. By opening their economies to capital inflows such as foreign direct investment, portfolio investments, and bank borrowing, the thinking goes, governments not only encourage economic growth, they also help stabilize consumption, which is an important measure of economic well-being.

However, the study found that this theory does not always hold true in practice. Even though per capita income is higher in developing countries that have more open economies, it is difficult to find strong evidence that suggests this is because they have liberalized their capital accounts. In fact, some of these countries have experienced very costly banking or currency crises, when investors suddenly decided to withdraw their money. Nevertheless, the study also found that once financial integration crosses a certain threshold, the positive effects of international capital flows (cheaper access to capital, transfer of new technology, development of the banking system) begin to cancel out the negative effects. Furthermore, countries with good economic policies and low corruption rates stand to gain from financial integration. These countries are successful in attracting foreign direct investment—which is especially conducive to economic growth. In contrast, developing countries perceived by investors as lacking in transparency and/or as having poor economic policies tend to rely more on "hot money," such as short-term bank loans, and less on foreign direct investment. This makes them more prone to crisis. The authors conclude that while that is reason enough for developing countries to proceed with care when it comes to liberalization, it is not reason enough for turning away from it altogether. That is, developing countries can reap significant advantages from opening up to the outside world, but they must create and strengthen existing legal, regulatory, and administrative frameworks to participate more effectively and benefit from the opportunities afforded by the global economy. As the political scientist Robert Gilpin has shown, markets are neither autonomous nor self-regulating, thus an open world economy can be managed most effectively by rules-based regimes.[9]

***Fifth***, there is now virtual scholarly unanimity that strong institutions matter. The economist Robert Barro notes that "differences in institutions across countries have proved empirically to be among the most important determinants of differences in rates of economic growth and investment."[10] Indeed, research is increasingly pointing to institutional factors as being more important than differences in capital/labor ratios and production inputs in explaining cross-country differences in per capita income. For example, the economists William Easterly and Ross Levine point out that the conventional factors of growth (labor, physical, and human capital accumulation) do not fully

explain Africa's experience. More to the point, they argue, many African countries possess very weak public and private institutional frameworks.[11]

Without vibrant institutions, market economies cannot develop and thrive.[12] Institutions that enhance the functioning of markets are those that provide secure property rights protected by the rule of law, impartial enforcement of contracts through an independent judiciary, and regulations to foster competition. Moreover, effective corporate governance and a transparent financial system (in which all market participants have access to reliable information) allow for more prudent saving and investment decisions, and make the economy less vulnerable to domestic and external sources of instability. The economist Mancur Olson once noted that poor countries have failed to realize "many of the largest gains from specialization and trade" because they lack "the institutions that enforce contracts impartially, and so they lose most of the gains from these transactions."[13]

***Sixth***, the building and strengthening of institutions will require good governance. The basis of good governance (that is, representative and responsive government) is a well-functioning democratic political system with an engaged and vibrant civil society. Although the paradigm shift toward neoliberalism in the early 1980s saw a justified effort to reduce the stifling role of the interventionist state and broaden the role of markets, it is now recognized that a minimalist state tends to enervate further the already acute problems of governance. Rather, a democratic state that is market-conforming rather than predisposed toward excessive intervention and regulation can play a positive role in economic development. The received wisdom that alleges an incongruity between the state and the market, including the claim that new democracies are incapable of enacting market reforms, has proven to be misplaced. From the late 1980s onward, democratic regimes—including several fragile and unconsolidated democracies—in both developing and transition countries (including Argentina, Chile, Ghana, India, Peru, Poland, Malaysia, and Thailand) have enacted often far-reaching market reforms, despite the high short-term costs they imposed on powerful domestic groups and large segments of society. While the results in terms of both economic growth and redistribution have been mixed—indeed, pro-market reforms promised more than they have delivered—democratic states pursued these reforms without resorting to the draconian measures of their contemporaneous "illiberal" democracies or their more authoritarian predecessors.[14]

Moreover, in open democracies where societal actors have the opportunity to exert greater pressure for reform through lobbies, the media, networks of nongovernmental organizations, legislative representatives, the courts (to challenge the constitutionality of various laws), as well as to demand greater associational autonomy from the state, are better able to amplify the voices of the poor. Such regimes, despite both domestic and external pressures, tend to have a better track record in providing safety nets to those hurt most by market reforms. Not surprisingly, many now see that the implementation of the more exacting "second-generation reforms"—the creation of flexible labor markets, tax reform, capital account opening, banking and financial sector reforms, anticorruption measures, improved corporate governance, the creation of competent bureaucracies, and targeted poverty programs, among others—requires the political deftness and finesse that only responsive democratic regimes can muster.

***Seventh***, a responsive and accountable state is critical to ensure the provision of classical public goods with positive externalities, such as health care and education, as well as to correct negative externalities, such as

income inequality. Although economic growth reduces poverty, growth alone does not always eliminate entrenched or absolute poverty. As the economists Ravi Kanbur and Lyn Squire note, "in many countries over long periods of time, inequality has been surprisingly persistent, and where inequality has changed rapidly, it has increased."[15] Thus, despite sustained economic growth, income inequality (both among and within nations) can also increase. That is, growth can occur nationally, but poor regions may experience less growth or may benefit less in terms of poverty reduction as a result of a given national rate of growth. For example, China's inland provinces lag far behind its coastal regions—with national poverty rates ranging from 43 percent in Guizhou to negligible levels in the coastal province of Guangdong.[16] Similarly, in India's poorest states, such as Bihar and Orissa, almost half the population lives below the national poverty line, compared to less than 10 percent in the richest state, Punjab. In regions of high inequality, such as Latin America and Africa, one can observe significant growth in real incomes while many still remain in absolute poverty.

The key issue is how to ensure that economic growth has a significant broad-based impact on poverty reduction. Here, specific government programs may be necessary to ensure that a broad cross-section of society benefits from the fruits of economic growth. The public sector, for example, in its expenditure policies, can subsidize the provision of basic social services (such as education and health care), which contribute not only to the general welfare but also to the accumulation of human capital in the more vulnerable sectors so that people have the potential to escape poverty. Moreover, the government, through specific targeted subsidy and transfer policies, can seek to augment, directly or indirectly, consumption among the poorest groups. Public works schemes may also be provided to supplement incomes, particularly for the unemployed—thereby reducing their vulnerability to risk.

***Eighth***, good governance and efficient institutions are only one part of a strategy for promoting development. If the vast majority of people in developing countries are to reap the benefits of market-based growth, they need to participate in markets. However, since most poor people do not have funds or property that can be used as collateral they cannot participate in markets. As a result, many potentially viable projects are not financed, and the poor remain trapped in poverty. There are two basic ways to remedy this problem. First, as Hernando de Soto argues in *The Mystery of Capital*, giving poor entrepreneurs legal title to the assets they already hold will unleash this "dead capital," which can be used as collateral for loans to fund new businesses.[17] Second, since poverty, combined with slow economic growth in the formal sector, has forced a large part of the developing world's people into self-employment and informal activities, providing microcredit to the many potential entrepreneurs who lack collateral (as done so effectively by the Grameen Bank in Bangladesh) will help both business and employment growth. According to the World Bank, more than 500 million poor people around world who run profitable micro-enterprises often cite lack of credit as the primary constraint on business growth. In the poorest countries, these activities constitute a significant part of the private sector—generating jobs and resources for services crucial to poverty reduction, especially for women. But despite the rapid growth of microfinance institutions over the past decade, less than 5 percent of micro-entrepreneurs have access to formal financial services and instead must use less reliable informal sources.

The next step is to link the quasi-formal microfinance institutions with the formal banking system. This would provide more resources and enable the microfinance insti-

tutions to extend their reach beyond the rural and urban poor to other groups who may not be classified as poor, but who are generally excluded from the services of both the formal banking system and microfinance institutions. This is particularly important since the privatization of state banks often results in the closure of rural and semi-urban branches, reducing the net flow of credit to poor farmers and small entrepreneurs. Experience shows that providing opportunities for poor people to generate income themselves will go a long way toward reducing poverty. Well-managed microfinance institutions have proven to be commercially viable. Creating and expanding such services to the entrepreneurial poor will help increase household income, reduce unemployment, and create demand for many other goods and services.

*The North-South Global Partnership*

A determined global partnership between North and South is necessary if there is to be progress in meeting the millennium development goals. The challenges are formidable, however. As the collapse of the ministerial meeting of the World Trade Organization (WTO) in Cancun in September 2003 illustrates, the removal of trade barriers, particularly agricultural subsidies in the industrialized world, remains an agonizingly intractable issue.[18] According to the World Bank, total OECD agricultural subsidies for the years 2000–02 amounted to $315 billion annually. The biggest chunk of these subsidies—$235 billion—was constituted as either direct government payments to farmers ($89 billion) or indirect consumer-financed import barriers and tariffs ($146 billion). The report notes that "of the total farm support estimate of $315 billion, $104 billion was accounted for by the European Union, $94 billion by the United States, and $60 billion by Japan. The annual per farmer subsidy worked out to $23,000 in Japan, $19,000 in the United States, and $16,000 in the European Union, while averaging $11,000 for the OECD countries as a whole."[19] Overall, these agricultural subsidies and high tariffs add up to roughly seven times what rich countries spend on development aid.

In doling out such huge farm subsidies, the OECD countries not only distort world trade in agricultural products but also contribute to income losses for developing country farmers. More than three-quarters of the world's poor live in rural areas, the vast majority depending on agriculture and/or activities related to that sector for their livelihood. The OECD's agricultural protectionist policies lock many low- and middle-income countries out of rich country consumer markets, and agricultural subsidies destabilize and depress world prices. This contributes to worldwide overproduction and dumping, which floods poor markets, undermines incentives for local production, and destroys livelihoods and impoverishes millions of farm communities in many developing countries. By bringing down their trade barriers, the rich nations could contribute significantly to the needs of the developing world. Trade barriers tend to be highest on labor-intensive goods and services in which developing countries have a comparative advantage. Poor-country exports are locked out by high tariffs (not only on agricultural products but also on textiles and clothing) and by tariff escalation—whereby a tariff increases the moment a commodity is processed. This makes it exceedingly difficult for developing countries, especially the least developed nations, to develop and move away from being dependent on the export of raw commodities.

Why has the WTO failed to resolve these issues? After all, the World Bank estimates that lower tariff peaks and averages in both the OECD and developing countries could produce up to $520 billion in income gains for all. Moreover, the multilateral trade negotiation launched by the WTO in late 2001 was termed the Doha Development Agenda to signify the importance of the role

that developing countries and development objectives would play in the multilateral trading system. Finally, the principle of more favorable treatment for developing countries is firmly embedded in the WTO—with the "special and differential treatment" (SDT) provisions calling for preferential access to markets for all developing countries, longer time periods for implementing agreements and commitments, exemptions from certain rules, and promises of technical and financial assistance. Given this fact, why has the organization failed to deliver for the majority of the developing countries who constitute the majority of WTO membership? The answer is fairly straightforward: first, there is considerable dissatisfaction with the existing provisions regarding differential treatment in both the developed and some developing countries; second, although some developing countries benefit from preferential access to OECD markets, few are among the "preferred set"; and third, there is a marked failure by developed countries to move beyond rhetoric and follow through on their commitments. In fact, trade preferences, which have been a mainstay of SDT since the late 1960s, have delivered little. Developing countries have generally not received tariff preferences in products for which they tend to have a comparative advantage. As noted earlier, preferences often exclude important items such as textiles or agricultural products as these are often subject to binding limits on the value of exports that benefit from lower tariffs. Moreover, a whole range of nontransparent administrative requirements, such as the "documentation of origin" and complex rules regarding product standards, further reduce the value of preferences.

This is truly unfortunate because the SDT provisions serve a very important purpose. Many developing countries, particularly the LDCs, lack the capacity to manage the full panoply of WTO rules or, at least, find the returns from creating the institutions to apply them effectively outweighed by the costs. Many also lack the resources to overcome natural obstacles to trade, giving rise to a case for preferential access to markets and development assistance. The Doha Ministerial Declaration called for a review of all SDT provisions with a view to "strengthening them and making them more precise, effective and operational." In the course of 2002, developing countries made 88 specific suggestions regarding improved preferential access to developed country markets and exemptions from specific WTO rules, including making the provision of technical and financial assistance a binding commitment. Despite much dialogue, no agreement was reached on strengthening SDT provisions.

Clearly the successful completion of the Doha round is a shared responsibility. The developed countries have obligations with respect to not only the SDT provisions but also market access and the reduction of trade-distorting subsidies. Put bluntly, the developed countries need to lead by example by delivering in areas in which developing countries have a comparative advantage on a nondiscriminatory basis. In particular, they should aim for the elimination of tariffs on manufactured products, the elimination of export subsidies, the decoupling of agricultural subsidies from production, and the reduction of agricultural tariffs. The liberalization of trade is particularly important in agriculture: in the OECD countries, average agricultural protection rates are more than seven times as high as in manufacturing.

Developing countries must also play their part, as they have the most to gain from a Doha agreement. However, it is important to reiterate that some of these gains will come from trade liberalization by and among the developing countries themselves. While middle-income countries generally have lower and less distorting protection in agriculture, they have high average tariffs in all sectors, and are more restrictive with respect to services. As South-South trade increases in importance, this protection not

only undermines low-income trading partners, but also tends to undercut middle-income countries' productivity. Latin American exporters, for example, face average tariffs in Latin America that are seven times higher than those of industrial countries. In manufactures, 60 percent of total tariff payments by East Asian exporters are paid to other developing countries. Developing countries clearly have much to gain from their own liberalization. Finally, while low-income countries would benefit from nondiscriminatory market access to every market for products where they have a comparative advantage, rather than special preferences in some markets and exemptions from rules, they will also benefit by removing their own trade barriers. While the original timetable, which envisaged the completion of the Doha round by January 2005, is no longer feasible, trade negotiations on these issues must continue. It is essential that WTO members find a way to restart talks to remove key stumbling blocks to increased participation in global trade by developing countries. Indeed, the long-term viability of the global trading system is dependent on an effective mechanism that allows all countries to integrate more fully and benefit from increased international trade, which is vital for economic development and poverty alleviation.

Recent studies show that official development assistance (ODA), or foreign aid, has a strong, positive effect on a country's economic performance if the country has undertaken certain policy and structural reforms. But these studies also show that private investors can be slow to respond when low-income countries improve their investment climate and social services. It is precisely at this stage when aid can have a great impact on growth and poverty reduction. Thus, if the OECD nations were to increase their foreign aid budgets only modestly, it would be a boon to developing nations. Unfortunately, the prognosis on this front is not encouraging. The United Nations suggests that high-income countries should deliver 0.7 percent of GDP in aid. However, only one or two high-income countries meet this target. The fact is that development assistance is on a downward trend. Today, average ODA is at 0.22 percent of GDP, compared to 0.5 percent 30 years ago. But, even if all the G-7 nations (the United States, Canada, the United Kingdom, Germany, France, Italy, and Spain) were to meet the 0.7 percent target, this would generate only $142 billion a year. To put this number in perspective, to give every person living on less than $1 a day a transfer of $1 a day would require $443 billion annually.

Although the current levels of aid are woefully inadequate relative to the task at hand, the problem is further compounded by the fact that the aid available is not always used efficiently. Duplication and waste are pervasive, and the competing donors, recipients, and aid agencies do not always focus on performance and results. As Nancy Birdsall and Brian Deese of the Center for Global Development in Washington, D.C., note, in 2003 "the 50-plus donor nations financed 35,000 different projects in about 150 poor countries, which means 35,000 different sets of reports and evaluations each year. And most donors still employ the practice of 'tying' aid: that is, requiring recipients to procure goods and services from the donor country. All U.S. aid officials and consultants, for instance, must fly on U.S. air carriers, regardless of whether they could find a cheaper flight on an international carrier. A number of aid watchdog groups have estimated that tying aid reduces its value by about 15 to 30 percent. In a world where a highly talented Indian or Brazilian civil engineer could be hired at one-tenth the cost of a Dutch one, this may be a conservative estimate." Furthermore, aid agencies are under constant pressure to demonstrate "results and successes that resonate with their legislatures or other contributors who control the purse strings. And while agencies should be accountable

for how they spend their money, that pressure often expresses itself in a preference for funding 'new' projects over recurring expenses for old ones.... In addition, when every donor insists on funding construction projects—to be completed only by that nation's construction companies under 'tying' rules—the aid business suffers massive inefficiencies."[20]

Yet, this does not mean that more effectively targeted aid cannot lead to more positive outcomes. Indeed, Nicholas Stern, a former chief economist of the World Bank, argues that even very modest transfers—just fractions of 1 percent of GDP from the rich countries to poor countries could enable massive expansions of health services, access to essential medicines, universal primary and secondary education, and other benefits.[21] Thus, the answer is not just more aid, but aid that is used much more effectively than it has been in the past. Clearly, donors are now paying attention. In early 2002, the donors to the World Bank's International Development Association (IDA)—the world's primary source of concessional financing for development—made the replenishment of funds contingent on the establishment of a results-based measurement system for IDA programs. President George W. Bush's Millennium Challenge Account (MCA) initiative, designed to provide assistance to poor countries that are "ruling justly, investing in people, and encouraging economic freedom," reverses a 40-year downward trend in U.S. foreign aid as a percentage of gross domestic product.[22] By targeting limited resources to a select number of countries that use resources effectively, the MCA has the potential to not only limit the financing of costly and inefficient "white elephant" projects but also make real improvements in the lives of the poor. However, as Birdsall and Deese point out, "the administration's well-intentioned focus on performance and results, while innovative, does nothing to address—and may well aggravate—the problem of project proliferation. As currently conceived, both the MCA and Bush's new AIDS initiative will either reinvent, or overlap, with efforts already underway at the international level, many of which are effective and, indeed, already supported by the United States."[23] Also, the MCA budget for 2004 is $1.3 billion, and even with slated increases to $5 billion a year by 2006, U.S. overseas development aid will rise to only 0.15 percent of GDP—placing the United States at the very bottom of the list of donor countries.

Although developing countries are a diverse group, the vast majority of the low-income countries depend heavily on official financing. However, excessive debt in many of these countries poses serious problems for them in meeting their development objectives. Between 1990 and 2001, external debt as a percentage of gross national income rose from 88.1 percent to 100.3 percent in the "severely indebted" countries. In 2001, the LDCs were spending almost 3 percent of GDP on servicing debt. The growing problem of "debt overhang" not only undermines urgently needed progress on policy reform but discourages private investment. Moreover, lenders may be forced to allocate scarce concessional resources to keep high debtor countries afloat—often at the expense of other deserving countries. While the primary responsibility for achieving debt sustainability lies with the debtor countries themselves—in particular, they must keep new borrowing in step with their ability to repay and adopt policies that increase their resilience in the face of external shocks—donors and creditors can greatly help.

First, given the central role of official creditors and donors in providing new resources to these countries, they need to review carefully current financing policies to ensure that they appropriately reflect their risk of debt distress—in particular, that the resources provided to these countries are consistent with their long-term

debt sustainability and with making progress toward the millennium development goals. Second, since an approximate mix of concessional loans and grants may improve a country's ability to absorb large, unforeseen external shocks only to a limited extent, creditors and donors need to consider new or modified instruments to deal with such eventualities. Third, since canceling debt repayments from the world's poorest countries would yield only around $1 billion per year, an increase in the overall concessionality of financing to low income countries, including a larger volume of grants is almost certainly required. Fourth, reducing the debt of the least-developed countries, especially in Africa, will enable them to participate more in globalization and the benefits it can bring. However, providing 100 percent debt relief to these countries would disadvantage other poor countries that have managed their debts carefully. Furthermore, without a massive infusion of funds from international governments to cover the costs of 100 percent debt relief, countries that have managed their finances wisely would have severely reduced access to low-interest loans and grants provided by the World Bank and other institutions. Finally, it is important to reiterate that the reason countries encountered debt problems in the first place was because they experienced prolonged periods of low economic growth. Thus, unsustainable debt levels are a symptom of a much larger problem of low economic growth. Therefore, solving the debt crisis will not, on its own, put these countries on a path to eliminating poverty. Debt relief must be part of a more comprehensive development strategy.

Signaling this new thinking, the World Bank and the IMF launched the Heavily Indebted Poor Countries (HIPC) Initiative in 1996. The initiative is the first comprehensive approach to reducing the external debt of the world's poorest and most indebted countries and helping them break out of the vicious debt cycle. Designed to end repeated debt rescheduling and defensive lending, it reflects the desire of the international community to reduce substantially the external debt burden of heavily indebted poor countries that pursue prudent economic policies and implement agreed-upon social and structural reforms. The initiative was further strengthened in 1999 to provide greater debt relief to a larger group of eligible countries. Currently the initiative provides an opportunity for 38 countries, 34 of them in sub-Saharan Africa, to receive debt relief. When governments decide to participate in the program, they pledge to introduce a series of key economic reforms in return for debt relief. Once a country's program is accepted—or when the country reaches the "decision point"—debt relief is granted. Once the pledged reforms or the "completion point" is achieved, debt relief becomes permanent.

As of May 2004, 27 countries (owing about $110 billion) have qualified for debt relief of more than $53 billion under the initiative. Also, debt service obligations (as a percentage of exports) for the countries under the HIPC Initiative declined from about 17 percent in 1998 to 10 percent in 2003. A key element of the initiative was to redirect the funds that would have been used for debt service into poverty-reduction programs. Among African countries under the initiative, poverty-reduction spending (such as allocations to education and health) has increased from about 39 percent of government revenue in 1999 to 48 percent in 2001. Combined with other forms of debt relief, the initiative will cut the external debt of participating countries by two-thirds, lowering indebtedness to levels well below the average for developing countries overall.

Yet major challenges remain. First, donor countries have not fully delivered on commitments to pay for debt relief. Second, providing debt relief to the 11

remaining countries that have yet to qualify is urgent as the deadline for entry into the program is due to expire at the end of 2004. The World Bank is considering several options designed to help these countries qualify.[24] Third, in all fairness, it should be noted that the HIPC Initiative cannot guarantee debt sustainability. That is, no amount of debt forgiveness can guarantee future financial solvency. Long-term debt sustainability will depend on sustained economic growth. Finally, rich nations can do much more on this front. However, further debt relief should not come out of the shrinking pie of foreign aid because it would simply move aid resources around. Debt relief must come in addition to foreign aid.

*A Critical Juncture*

The world's poor have little hope of emerging from lives of deprivation unless governments in poor and rich countries alike take immediate and concerted action to address the root causes of economic stagnation and poverty. Today, the global community stands at a critical juncture in its fight against global poverty and injustice. It has just 12 years to translate the millennium development goals into reality. Yet, as the World Bank's most recent global monitoring report warns, based on current trends, most developing countries will fail to meet most of these goals.[25] For example, the report reveals uneven progress toward meeting the first goal of halving the number of people who live in extreme poverty by 2015. While this goal is likely to be achieved at the global level—largely through progress in the world's two most populous countries, China and India—Africa will fall well short. The snapshots the report affords of progress toward meeting other millennium development goals—particularly with respect to health, education, and the environment—are bleaker.

Despite recent increases, foreign aid remains at low levels relative to need, and trade barriers continue to discourage developing country exports. The report urges developed countries to lead by example and deliver a "pro-development" outcome to the current Doha round of trade negotiations. The developed countries need to stop dragging their feet over eliminating tariffs on manufactured products, phasing out export subsidies, decoupling agricultural subsidies from production and reducing agricultural tariffs, ensuring free cross-border trade in services delivered over telecommunications links, and removing restrictions on the temporary movement of workers. Aid levels need to rise significantly; although donors have pledged to increase development assistance by $18.5 billion a year by 2006, developing countries could effectively absorb an increase of $30 billion. As the developing countries improve their policies and institutions, the amount of additional aid they could use will rise into the range of $50 billion a year. Moreover, developed countries must deliver more meaningful debt relief and expand access to technology for poor countries. Developing nations, for their part, must keep their pledge to steer their progress by strengthening governance, reforming their economies, and committing to time-bound, specific targets.

Without renewed efforts in these areas, the millennium development goals are unlikely to become a reality, and the Monterrey Compact will be shelved alongside all the other failed development schemes of the past. ●

## Notes

1. See William Easterly, *The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics* (Cambridge: MIT Press, 2001).

2. Elsa Artadi and Xavier Sala-i-Martin, "The Economic Tragedy of the 20th Century: Growth in Africa," National Bureau of Economic Research Working Paper No. 9865, 2003.

3. David Dollar and Aart Kraay, "Growth Is Good for the Poor," *Journal of Economic Growth*, vol. 7, no. 3 (2002), pp. 195–225.

4. Amartya Sen, *Development as Freedom* (New York: Oxford University Press, 1999).

5. John Kay, *Culture and Prosperity: The Truth about Markets—Why Some Nations Are Rich But Most Remain Poor* (New York: HarperCollins, 2004), p. 10.

6. World Bank, *Globalization, Growth and Poverty: Building an Inclusive World Economy* (New York: Oxford University Press, 2002).

7. See, for example, Jagdish Baghwati, *In Defense of Globalization* (New York: Oxford University Press, 2004).

8. Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei, and M. Ayhan Kose, "Effects of Financial Globalization on Developing Countries—Some Empirical Evidence," research paper (Washington, DC : International Monetary Fund, 2003).

9. Robert Gilpin, *The Challenge of Global Capitalism: The World Economy and Its Discontents* (Princeton, NJ: Princeton University Press, 2000).

10. Robert Barro, "Inequality and Growth in a Panel of Countries," *Journal of Economic Growth*, vol. 5 (March 2000), p. 209.

11. William Easterly and Ross Levine, "Africa's Growth Tragedy: Policies and Ethnic Divisions," *Quarterly Journal of Economics*, vol. 112 (November 1997), pp. 1203–50.

12. The advocates of "new institutional economics" recognize that a good market economy requires not only "getting prices right" but also "getting property rights right" and "getting institutions right." This is because property rights and institutions generally set the rules that affect the behavior of economic agents. Institutions can be both formal and informal. Formal institutions include legal regulations and laws, while informal institutions are not legally codified. These include the norms, values, and "social capital" that are often embedded in societies. Institutions that support market transactions perform three functions: smoothing information asymmetries (that is, ensuring that all market participants have access to reliable information) and defining and enforcing property rights and contracts and regulating competition.

13. Mancur Olson, "Big Bills Left on the Sidewalk: Why Some Nations Are Rich, and Others Poor," *Journal of Economic Perspectives*, vol. 10, no. 2 (1996), p. 22.

14. Illiberal democracies deliberately combine the rhetoric of liberal democracy with illiberal rule. Thus, even when competitive multiparty elections are held—thereby qualifying the country as an "electoral" democracy—the day-to-day practices of the state are marked by overt coercion and abuse. For example, political freedoms and civil rights may be formally recognized, but they are imperfectly observed in practice.

15. Ravi Kanbur and Lyn Squire, "The Evolution of Thinking About Poverty: Exploring the Interactions," in Gerald M. Meier and Joseph E. Stiglitz, eds., *Frontiers of Development Economics: The Future in Perspective* (New York: Oxford University Press, 2000), p. 193.

16. Shahua Chen and Yan Wang, "China's Growth and Poverty Reduction: Trends between 1900 and 1999," Policy Research Working Paper No. 2651 (Washington, DC: World Bank, 2001).

17. Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000).

18. In September 2003, trade ministers gathered in Cancun, Mexico, for a WTO ministerial meeting to review progress and negotiate the next stages in the Doha Agenda. The Cancun Ministerial Conference was the Fifth Ministerial Conference to be held since the WTO was created on January 1, 1995. The ministerial conference is the organization's highest level decision-making body. It meets at least once every two years as required by the WTO's charter. However, the WTO member countries were not able to agree on key issues such as agriculture, and the meeting ended without agreement.

19. Kevin Cleaver, "Rural Investment, Key to India's Growth," 2004, at http://web.worldbank.org/wbsite/external/news/o.

20. Nancy Birdsall and Brian Deese, "Hard Currency," *Washington Monthly*, March 2004, pp. 1–2.

21. Nicholas Stern, *A Strategy for Development* (Washington, DC: World Bank, 2002).

22. President Bush's goal to increase U.S. foreign aid to poor nations by $5 billion per year over current assistance levels is by far the largest proposed increase in U.S. foreign aid in several decades. MCA funds would be provided to developing countries as grants, not as traditional U.S. managed projects,

and would be used to help build local governance capacity and project ownership.

23. Birdsall and Deese, "Hard Currency," p. 2.

24. The first option is to extend the "sunset clause" to give countries more time to qualify for the program. The second is to "grandfather" the 11 countries into the program. Under this option no new countries would be eligible for the HIPC Initiative, but when the 11 already identified eventually meet the entry criteria they would be allowed access to debt relief. The final option is to enforce the entry deadline as scheduled and consider alternative approaches to deal with the debt overhang in countries that would not have qualified for relief under the HIPC Initiative by then.

25. *Global Monitoring Report 2004: Policies and Actions for Achieving the Millennium Development Goals (MDGs) and Related Outcomes*, background paper (Washington, DC: World Bank, April 16, 2004).