DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)

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SUPPORTING SOUND POLICIES WITH ADEQUATE AND APPROPRIATE FINANCING

Attached for the September 22, 2003, Development Committee meeting is a paper entitled "Supporting Sound Policies with Adequate and Appropriate Financing" prepared by the staff of the World Bank. This item will be considered under Item I of the Provisional Agenda.

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SUPPORTING SOUND POLICIES WITH ADEQUATE AND APPROPRIATE FINANCING

September 12, 2003

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ABBREVIATIONS AND ACRONYMS

CPIA	Country Policy and Institutional Assessment
DAC	Development Assistance Committee
EFA	Education for All
GDP	Gross Domestic Product
GNI	Gross National Income
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IMF	International Monetary Fund
LICUS	Low-Income Countries Under Stress
MDG	Millennium Development Goal
MTEF	Medium-Term Expenditure Framework
NGO	Non-Governmental Organization
O&M	Operations and Maintenance
ODA	Official Development Assistance
PRSP	Poverty Reduction Strategy Paper
SME	Small and Medium Scale Enterprise
UNDP	United Nations Development Programme

SUPPORTING SOUND POLICIES WITH ADEQUATE AND APPROPRIATE FINANCING
Implementing the Monterrey Consensus at the Country Level

EXECUTIVE SUMMARY AND ISSUES FOR DISCUSSION

This paper responds to the Development Committee's request for the World Bank to report on progress in supporting policy reforms undertaken by developing countries with adequate and appropriate financing. Specifically, it looks at the prospects for accelerating progress towards the Millennium Development Goals (MDGs) at the country level through a combination of better domestic policies and governance, higher aid levels, more effective aid modalities, and improved access to developed country markets.

The essence of the development compact termed the Monterrey Consensus is that concerted and sustained action is required by developing and developed countries in order to meet the MDGs. The country-based analysis of this paper suggests that there is a unique opportunity now to scale up efforts to accelerate progress towards the MDG targets in low- and middle-income countries. Additional aid is part of a broader agenda, including trade and debt relief, on which the international community will have to move vigorously if these efforts are to succeed. Sustained actions on these fronts should go hand in hand with the continued efforts of developing countries to improve their policies and governance so that all available resources — domestic and external — are used productively in spurring growth and improving service delivery to the poor.

Leading up to the Financing for Development conference at Monterrey in Spring 2002 and following it, considerable attention has focused on the cost of attaining all the MDGs in all developing countries and on the implications for aid volumes, assuming that policies in developing and developed countries continue to improve. Using global and sectoral approaches, most estimates — such as those prepared for the Monterrey conference and for the April 2003 Development Committee meeting — point to a figure of at least US$50 billion annually in additional aid (or a doubling of current aid levels).[1]

This paper complements that work by taking a country-based approach to examining the manner in which additional external financing could be used productively in accelerating progress towards the MDGs, in combination with improved domestic policies and governance, more effective aid modalities and greater market access. It, therefore, provides a country-based view of how efforts to meet the MDGs might be scaled up as well as an estimate of the additional financing that could be used effectively as part of these efforts in the initial phase. It focuses mainly, but not exclusively, on a sample of 18 low-income countries with relatively good policies, which account for approximately half of the world's poor and a third of global aid flows (see Table below). While diverse, these countries are broadly representative of low-income countries with relatively good policies. The prospects and the role for aid are also reviewed for

[1] See, for instance, "Recommendations of the High-level Panel on Financing for Development", (United Nations General Assembly, A/55/1000, June 2001); S. Devarajan, E. Swanson and M. Miller, "Goals for Development: History, Prospects and Costs," (World Bank draft, 2002); and "Progress Report and Critical Next Steps in Scaling Up: Education for All, Health, HIV/AIDS, Water and Sanitation", (DC2003-0004, March 27, 2003).

two other groups of countries whose circumstances differ — low-income countries under stress (LICUS) and middle-income countries.

Table : Sample Countries - Key Indicators

	Population (millions)	No. of poor living below US$1/day (millions)[a/]	Income per capita (2001 US$)[b/]	ODA per capita (2001 US$)
India	1,032.4	358.2	460	1.7
Indonesia	209.0	15.0	690	7.2
Pakistan	141.5	18.9	420	13.7
Bangladesh	133.3	48.0	360	7.7
Vietnam	79.5	14.1	410	18.0
Ethiopia	65.8	53.9	100	16.4
Tanzania	34.4	6.9	270	35.8
Uganda	22.8	6.2	260	34.3
Mozambique	18.1	6.8	210	51.7
Madagascar	16.0	7.8	260	22.2
Burkina Faso	11.6	7.1	220	33.7
Mali	11.1	8.1	230	31.5
Benin	6.4	N/a	380	42.4
Kyrgyz Republic	5.0	0.1	280	38.0
Mauritania	2.7	0.8	360	95.2
Bolivia	8.5	1.2	950	85.6
Honduras	6.6	1.6	900	102.9
Albania	3.2	N/a	1,340	85.0
Sample	**1,807.8**	**554.8**	**452**	**8.4**

a/ For each country, this number is based on the share of its population living on less than US$1.08 a day at 1993 international prices (equivalent to US$1 in 1985 prices, adjusted for purchasing power parity).
b/ These figures refer to incomes per capita at current market prices.

This paper demonstrates that, with continued policy and institutional reforms, substantial increases in aid can be effectively used in scaling up progress towards the MDGs. The international community has committed to increase aid volumes by about US$16 billion annually by 2006. Based on extrapolating from the broad typologies of the sample countries, the absorptive capacities of LICUS, and the supportive role of aid in promoting reform in middle-income countries our assessment is that a larger sum will be needed — at least US$30 billion annually in addition to current aid flows. The early commitment of this additional amount will help promote and sustain reform efforts in developing countries and strengthen their capacity to use larger amounts of aid effectively over time. In this way, it will create a virtuous circle that can improve their prospects for meeting the MDGs, particularly by enhancing the pace of policy and governance improvements in LICUS. To the extent this happens, this estimate of additional aid could well be exceeded. For this additional aid to accelerate progress significantly towards the MDGs, it should be provided in the form of cash outlays and with improvements in aid modalities, as discussed below.

This sum of US$30 billion annually in additional aid should be viewed as a conservative estimate of incremental financing needs. The costs of meeting all the MDGs in all countries and the implications for external financing needs, which this paper does not estimate, are likely to be much higher. And, while this paper uses the best available information at the country level, it is incomplete to the extent there are gaps in the analytical base at present. One gap concerns the infrastructure investments that are needed to improve service delivery and to support higher growth, including to take advantage of the export opportunities afforded by trade liberalization.

Another is with regard to the implications for the enhancement of country capacity over time. The country-level estimates also do not consider the costs of meeting global and regional public goods, including HIV/AIDS and some aspects of environmental sustainability. Finally, these financing estimates include neither the future costs of debt relief under internationally-accepted frameworks such as the HIPC initiative nor the implications of assisting low-income countries in dealing with adverse shocks that lead to substantial income losses.

The paper shows that in all 18 of the sample countries additional aid can be used effectively in conjunction with better policies in accelerating progress towards the MDGs. These countries share three characteristics: over the past decade, they have improved their policies significantly; they have used aid productively over this period in making progress towards the MDG targets; and they continue to have substantial unmet development needs. Their experience illustrates how powerful the combination of substantially higher aid and the sustained reform efforts of the countries themselves can be in making faster progress towards the MDGs.

The implications for the amount of additional aid, its phasing and its form vary substantially across the sample. These variations in the amount of additional aid that can be used effectively reflect differences in: (a) existing policies and institutions and the pace at which these might be strengthened over time; (b) poverty incidence and, more generally, the extent of unmet needs vis-à-vis the MDG targets; and (c) current aid levels. A key aspect of reform in all countries will be the mobilization of more domestic revenues. While the scope for such increases will vary across countries, higher domestic revenues will in all cases ensure that larger aid flows do not threaten fiscal sustainability. Large increases in aid (a doubling or more of current flows) could be used effectively in the large Asian low-income countries (Bangladesh, India, Indonesia, Pakistan and Vietnam) and in some Sub-Saharan African countries (such as Ethiopia) in the sample. These countries have a combination of good policies and prospects for further improvement, large unmet needs relative to the MDG targets, and relatively low levels of aid dependence. On the other hand, countries with higher incomes that already receive sizable aid flows, such as Albania, Bolivia and Honduras, could use additional aid effectively but the amounts are likely to be smaller — increases of the order of 20 percent or so. All the Sub-Saharan African countries in the sample (including Burkina Faso, Mozambique, Tanzania and Uganda) as well as the Kyrgyz Republic could also use additional aid productively to supplement the sizable flows they already receive — an increase of about 60 percent on average in the medium-term — but with substantial variance reflecting country circumstances and prospects. The phasing of these incremental aid flows over time will reflect the strengthening of their institutional and human capacities and the expansion of their domestic resource bases. In tandem with better policies and improved governance, these aid flows would contribute substantially to improving MDG outcomes.

Additional aid can also support faster progress towards the MDGs in low-income countries with weaker policies and governance (LICUS-type) than those considered in the sample. In many of these, particularly those in post-conflict situations, there can be significant upfront and transitional costs that are highly productive and can only be met from aid. The challenge will be to provide this aid quickly when needed, and without undermining local efforts to mobilize resources and build capacity. In middle-income countries, including China, aid can play an important role by reinforcing domestic efforts to tackle pockets of poverty and deprivation, and in countering negative shocks. The amount of additional aid these countries could use productively will generally decline as their incomes and the availability of domestic resources rise, while the balance of their reliance on aid and non-concessional flows will depend largely on their access to international capital markets.

The conclusions of this paper concerning aid volumes are predicated on **three** sets of changes in aid modalities.

- As countries build a track record of policy performance, their efforts should be supported with access to timely and predictable aid, one aspect of which is to allow recipient countries greater confidence in the delivery of aid over time for an extended period as their policies and governance improve. Greater assurance that they will receive adequate and timely external support for their reform programs will make it more likely that countries will initiate and sustain such reforms.

- Aid should be provided in ways that are better aligned with the recipient country's own development priorities and processes, as articulated in its poverty reduction or development strategy. This means acceptance of national goals as well as improvements in donor coordination, and greater harmonization of donor policies and procedures around recipient countries' own systems. Experience shows that donors will need to use the PRSP approach to build on the impetus given to such efforts at the Rome Harmonization Forum.

- Aid should be provided in forms that can meet the incremental costs of financing the MDGs. Of the US$52 billion in existing aid commitments, around US$26 billion is available for program and project expenditures in recipient countries. A much higher proportion of additional aid will have to be provided directly to countries in the form of cash so that they can help finance the costs of meeting the MDGs. In some countries, aid should also be provided so that it can meet the need for increased recurrent costs, as for health and education programs — either through budget or sector-wide support in countries with sound budget frameworks, or by targeting assistance to well-designed sectoral programs. And, to ensure debt sustainability in highly-indebted countries with good policies and governance, which are susceptible to shocks, consideration should be given to providing a greater share of the additional aid in the form of grants.

The prospects for achieving the MDGs in many developing countries would be significantly enhanced with greater access to markets in developed countries. Successful completion of the Doha Round is, therefore, a high priority along with continued trade reforms in developing countries, including those aimed at addressing behind the border issues (such as ports and customs administration), which will allow them to benefit from improved market access. Trade and aid are complementary — greater market access will help make aid more productive and aid can help in addressing behind the border issues. So, while improved market access will benefit most developing countries in the longer-term, many will be able to use additional aid effectively in the short and medium term, particularly in upgrading infrastructure facilities that allow them to take advantage of the resulting opportunities to expand their exports.

The country studies also point to information and analytical gaps that should be addressed in the PRSP process. These include: the poor quality of information on the baseline and trends for outcomes reflected in the MDGs (or other national goals); the lack of country-level information concerning the multiple determinants of MDG outcomes; and the limited linkages between these outcomes and the policy and expenditure frameworks articulated in PRSPs, particularly with regard to the role of infrastructure and better service delivery. As information and analysis improve in these areas, the PRSP process will be more useful as a way of operationalizing longer-term MDG targets, and in providing more robust estimates of aid requirements at the country level. This paper should, therefore, be seen as the first step in this regard.

Based on the conclusions of the paper, the following issues are proposed for Ministerial consideration at the Development Committee meeting on September 22:

- Do Ministers agree that the PRSP process would be strengthened if countries' poverty reduction strategies were linked more explicitly to longer-term MDG targets? How, in their view, can this linkage and other steps to strengthen the PRSP process be supported with additional technical and financial assistance?

- In the Ministers' view, what steps should be taken to ensure that the resources that have already been committed are made available in a timely manner? And, how can it be assured that these amounts are provided in a predictable manner and in a form that can readily be used by countries?

- Do Ministers agree that a substantial increase in aid, well beyond existing commitments, can be used productively in support of better policies and institutions to enhance the prospects of meeting the MDGs? And what steps, in their view, should be taken to accelerate the efforts to mobilize this additional financing?

- Given the agreements that have been reached with regard to the need for aligning aid resources more closely with country priorities and processes and on harmonizing donors' requirements and practices, what steps do Ministers consider are required to translate those agreements into action?

- Do Ministers agree that, when warranted by country conditions and linked to improvements in financial and budget management frameworks, more aid will have to be provided to finance recurrent costs and, in some countries, on grant terms?

SUPPORTING SOUND POLICIES WITH ADEQUATE AND APPROPRIATE FINANCING
Implementing the Monterrey Consensus at the Country Level

I. INTRODUCTION

1. At the Development Committee Meeting in April 2003, the Communique (April 13, 2003) "reaffirmed our commitment to the global effort needed to reduce poverty in developing and transition countries and achieve the MDGs" (para. 2). It went on to note (para. 6): "While each service sector will have to find its own approach to accelerating progress, we underlined the importance of anchoring the efforts to achieve MDG goals in country-owned strategies such as PRSPs for low-income countries. We stressed that sound policies and efforts by developing countries should be supported by adequate and appropriate financing and we asked the Bank to report on progress in this regard at our next meeting."

2. This paper is a response to that request. It considers how progress towards the Millenium Development Goals (MDGs) could be accelerated at the country level through a combination of better domestic policies and improved governance, higher aid levels, more effective aid modalities, and improved access to developed country markets. Particular attention is paid to the sequencing of these measures, including the phasing of aid flows over time and ways in which more predictable and timely aid can reinforce improved policies and governance. It also looks at the implications for the alignment of aid flows with country priorities and for the types and terms of aid. The primary focus is on a broadly representative sample of 18 low-income countries with relatively good policies. These country studies are supplemented by more general reviews for low-income countries under stress (LICUS) and middle-income countries — which also have special aid needs. The paper concludes with some broad lessons on how to accelerate progress towards the MDGs, including ways to make aid even more effective in the future.

3. This paper complements earlier work that was presented to the Development Committee Meeting in April 2003. One aspect of that work estimated the costs and external financing needs associated with achieving the service delivery MDGs in all countries if complementary policy and institutional reforms were undertaken. That paper and other work done leading up to the Financing for Development conference in Monterrey in Spring 2002 used sectoral approaches in concluding that at least US$50 billion annually in additional aid (or a doubling of current aid levels) would be required.[2]

[2] See "Progress Report and Critical Next Steps in Scaling Up: Education for All, Health, HIV/AIDS, Water and Sanitation", (DC2003-0004, March 27, 2003), "Recommendations of the High-level Panel on Financing for Development", (United Nations General Assembly, A/55/1000, June 2001); and, S. Devarajan, E. Swanson and M. Miller, "Goals for Development: History, Prospects and Costs," (World Bank draft, 2002). Other complementary work presented to the last Development Committee meeting included the outline of a framework for monitoring policies and actions of developing and developed countries for achieving the MDGs and related outcomes at the global level. See "Achieving the MDGs and Related Outcomes: A Framework for Monitoring Policies and Actions," (DC2003-0003, March 28, 2003) and its update for this meeting, "Global Monitoring of Policies and Actions for Achieving the MDGs and Related Development Outcomes: Implementation Report" (September 2003).

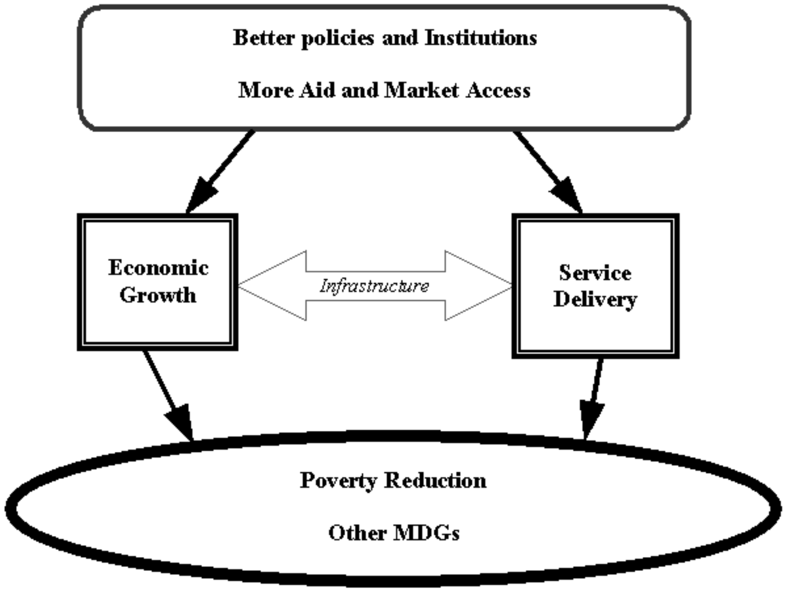
II. IMPLEMENTING THE MONTERREY CONSENSUS

4. There is now a renewed focus on development and a broad consensus on what is needed to reduce poverty and improve living conditions in developing countries. This framework can provide the basis for concerted action. The agreement starts with the set of MDGs agreed by the world's heads of government at the Millenium Summit in 2000. These goals recognize the multidimensionality of poverty, the need to focus on outcomes, and the need to set international benchmarks against which to measure progress. Through Monterrey, Doha and Johannesburg, it has been recognized that there is a need for a new compact between developing and industrial countries if the MDGs are to be achieved. There has been progress beyond the arguments of the past, where some argued that all that was needed is much higher levels of aid, while others asserted that developing countries could succeed simply by their own efforts, by improving policies and governance. There is also consensus on what is needed to accelerate development at the country level — of the centrality of country ownership, the need for a comprehensive and long-term approach, and of the need for partnership. And, there is agreement that putting the global compact into action has to be done country by country in a process in which countries spell out their commitments to policy and institutional reforms, in Poverty Reduction Strategy Papers (PRSPs) or similar country-owned strategy frameworks, and those providing external assistance commit to support these country strategies in a coherent and consistent way.

5. There is also broad agreement on the development framework needed to achieve the MDGs at the country level. There is recognition, first, that progress towards the MDGs will require both faster economic growth and improved service delivery to the poor. No country has made rapid progress on the MDGs without robust growth. Hence the importance of countries improving their investment climates and strengthening the institutional preconditions for growth, which will also allow them to mobilize more domestic resources to use in making progress towards the MDGs And, there is also a recognition that infrastructure development is essential to support both economic growth and service delivery.[3] Second, we know that countries' abilities to translate growth into progress on poverty reduction and other development goals differ considerably with their policy orientation. So countries need to look for ways to improve the extent to which poor people participate in and benefit from growth. For this participation to be effective, there have to be sustained investments in people — educated and healthy people are essential for sustained economic growth. Finally, while growth is critical, there will also be a need for more external resources to be used in tandem with domestic resources, private capital flows, and improved market access in accelerating progress substantially towards the MDGs. The key elements of this framework are summarized below.

[3] See, for example, World Bank, "Infrastructure Action Plan — Overview and Matrix of Management Actions," SecM2003-0302 (July 8, 2003). The links between infrastructure and the MDGs are elaborated in Box 4 in the next section.

Figure 1: A Framework for Accelerating Progress Towards the MDGs



6. Of particular importance is the way in which these elements interact and reinforce each other. As summarized in the forthcoming World Development Report 2004, for instance:[4]

> "To accelerate progress in human development, economic growth is of course necessary. But it is not enough. Scaling up will require both a substantial increase in external resources and more effective use of all resources, internal and external. As resources become more productive, the argument for additional resources is more persuasive. And external resources can provide strong support for changes in practice and policy to bring more effective use. In this sense the two are complementary — that is the essence of the development partnership which was cemented in Monterrey in the Spring of 2002."

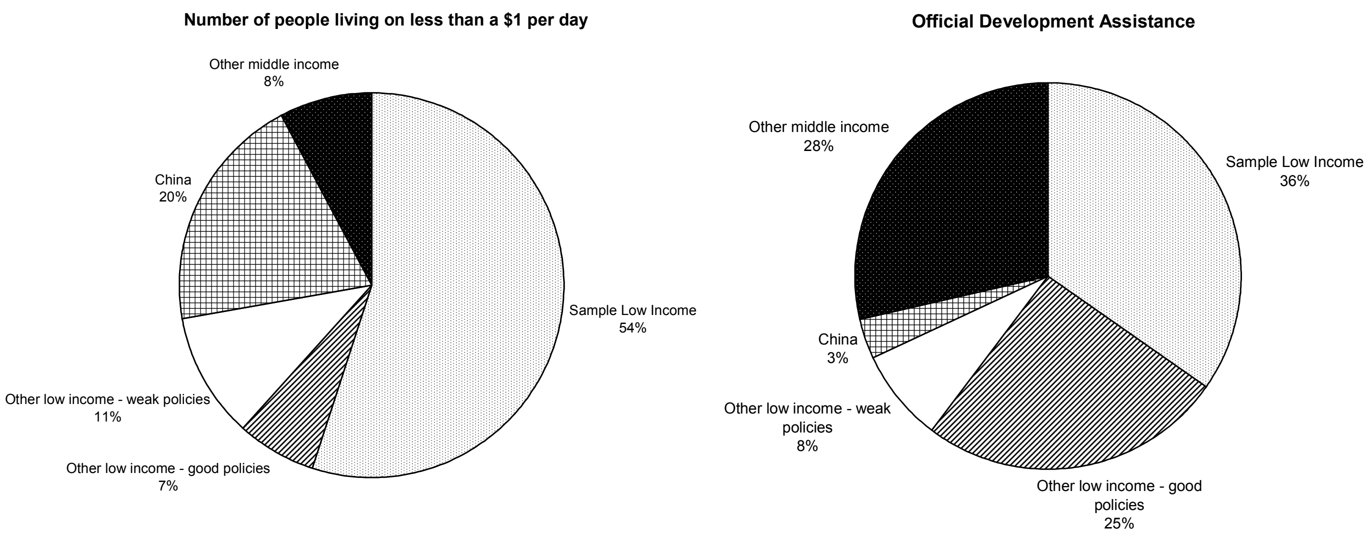
7. Implementation of this development compact at the country level, and in particular, the role for additional external assistance depends on country circumstances. In some countries, the quality of policies, institutions and governance is such that large and immediate infusions of external financing will help accelerate progress towards the MDGs. In others, policies and governance will have to improve substantially before additional aid can be used productively. And in the countries in between, a combination of policy improvements by the countries themselves and the provision of more and better aid, including debt relief where appropriate, and greater market access by their development partners will need to go hand in hand for faster progress towards the MDGs.

8. This paper, therefore, adopts a country focus in examining recent progress and prospects for achieving the MDGs in 18 low-income countries with relatively good policies.[5] In doing so,

[4] See World Bank, "World Development Report 2004: Making Services Work for Poor People" (September 2003).

it takes explicit account of the countries' policy and institutional frameworks and examines how prospects for reform interact with the volume and form of external assistance in determining their pace of progress towards the MDG targets. The 18 sample countries constitute a broad and representative cross-section of all low-income countries with relatively good policies, and account for about 55 percent of the world's poor and 35 percent of global aid flows (Figure 2). The reason for focusing on countries with relatively good policies is that it is for these countries that the case for aid is most robust.[6] The quality of policies refers here to judgments concerning the adequacy of a country's policy, governance and institutional framework in promoting poverty reduction through sustained growth and improved service delivery to the poor.

Figure 2: Poverty and Aid in Developing Countries



Note: ODA calculations are based on allocated amounts of ODA. Low income category includes IDA blend countries.

9. Building on recent PRSPs, wherever available, and the knowledge and judgments of Bank country teams, the following questions are addressed at the country level:

- How much progress has been made towards the MDG targets over the past decade and how have these goals been adapted to country circumstances? What have been the main "success" factors underlying progress?

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[5] For the purposes of this paper, "low-income" is defined as countries with a per capita income of US$745 or less in 2001 plus all other IDA recipients. "Relatively good policies" are defined as an overall score of at least 3.0 on the Bank's Country Policy and Institutional Assessment (CPIA) index in 2002. There are 57 countries in this group of low-income countries with relatively good policies.

[6] There is considerable research within and outside the Bank on this point. See, for example, C. Burnside and D. Dollar, "Aid, Policies and Growth", American Economic Review, September 2000 and P. Collier, and D. Dollar, "Can the World Cut Poverty in Half? How Policy Reform and Effective Aid Can Meet the International Development Goals", World Development, 2001.

- Is the country likely to achieve the MDGs by 2015 — based on current policies, institutions and external resources?
- What changes in domestic policies and institutions, including the increased mobilization of domestic resources, in conjunction with additional external resources could improve the prospects for achieving the MDGs by supporting higher levels of investment and growth and improving the access of poor people to basic services?
- What are the implications for the way aid is allocated and delivered? And, what other aspects of international cooperation (especially market access) will impact upon the chances of success?

III. FINDINGS FROM THE COUNTRY STUDIES

10. This section begins by summarizing the key findings that emerge from the analysis of the sample of 18 low-income countries that have relatively good policies (summaries of the country studies are presented in Annex 1). The role of aid in accelerating progress towards the MDGs is then examined for two other groups of countries: (a) low-income countries under stress (LICUS); and (b) middle-income countries with relatively good policies (Annex 2 contains a review of these countries).[7]

A. Low-Income Countries with Relatively Good Policies

11. <u>A diverse but representative sample</u>. While the 18 countries that have been analyzed in detail as background for this paper share the characteristics of low incomes and good policies and institutions, this sample is diverse in terms of characteristics such as population size, poverty incidence, current aid flows, and institutional and human capacity. It is this diversity that makes this sample representative of the larger group of low-income countries with relatively good policies (see Table 1). At one extreme, the five large Asian countries account for **all** low-income countries in the sample with relatively good policies and populations of over 80 million. The other 13 smaller countries in our sample are as diverse as the group from which they are drawn. They cover different geographical regions, their per capita incomes range from US$100 to US$1,340, and their per capita aid flows vary from US$16 to over US$100.[8]

[7] In analyzing the implications for aid for each of these country groupings, it should be noted that they are a stylized way of categorizing a continuum of countries. So, for instance, countries at the bottom end of the group of countries with relatively good policies (from which our sample of 18 is drawn) may be similar in many respects to countries at the top end of the country grouping with weaker policies (LICUS-type). Similarly, the countries at the bottom end of the middle-income group may have more in common with the low-income countries (including those in the sample) at the top end of the income scale.

[8] The choice of the sample countries is intended only to be illustrative, and in particular does not reflect a judgment concerning their progress or their prospects in terms of the MDGs relative to other countries. Rather, the sample has been chosen primarily to ensure that it is representative of the group of 57 low-income countries with relatively good policies.

Table 1: Low-Income Countries with Relatively Good Policies — Key Indicators

	Income per capita (2001 USD)	Av. GDP growth (percent p.a., 1990-2001)	Population (millions)	No. of poor living below $1/day (millions)	No. of poor living below $2/day (millions)	ODA (2001 USD billions)	ODA/ GDP (percent)	ODA per capita (2001 USD)
India	460	5.4	1,032.4	358.2	825.2	1.7	0.4	1.7
Pakistan	420	3.8	141.5	18.9	92.7	1.9	3.3	13.7
Bangladesh	360	4.8	133.3	48.0	110.4	1.0	2.2	7.7
Indonesia	690	4.1	209.0	15.0	115.7	1.5	1.0	7.2
Vietnam	410	7.5	79.5	14.1	50.6	1.4	4.4	18.0
Asian Sample	***476***	***5.2***	***1,595.7***	***454.3***	***1,194.7***	***7.6***	***1.1***	***4.8***
Albania	1,340	1.5	3.2	n/a	0.3	0.3	6.5	85.0
Benin	380	4.8	6.4	n/a	n/a	0.3	11.5	42.4
Bolivia	950	3.5	8.5	1.2	2.9	0.7	9.1	85.6
Burkina Faso	220	4.7	11.6	7.1	9.9	0.4	15.6	33.7
Ethiopia	100	4.0	65.8	53.9	64.7	1.1	17.3	16.4
Honduras	900	3.1	6.6	1.6	2.9	0.7	10.6	102.9
Kyrgyz Republic	280	-3.2	5.0	0.1	1.7	0.2	12.3	38.0
Madagascar	260	2.1	16.0	7.8	13.3	0.4	7.7	22.2
Mali	230	3.8	11.1	8.1	10.0	0.3	13.2	31.5
Mauritania	360	4.1	2.7	0.8	1.9	0.3	26.0	95.2
Mozambique	210	6.3	18.1	6.8	14.2	0.9	25.9	51.7
Tanzania	270	3.2	34.4	6.9	20.5	1.2	13.2	35.8
Uganda	260	6.4	22.8	6.2	22.0	0.8	13.8	34.3
Other Sample	***273***	***4.0***	***212.2***	***100.5***	***164.1***	***7.5***	***15.1***	***35.5***
All Sample	**452**	**5.0**	**1,807.8**	**554.8**	**1,358.9**	**15.1**	**2.7**	**8.4**
Other Low Income (Relatively Good Policies)	***481***	***1.1***	***329.5***	***68.8***	***157.6***	***11.0***	***8.9***	***33.4***
All Low Income (Relatively Good Policies)	**456**	**4.4**	**2,137.3**	**623.6**	**1,516.5**	**26.1**	**3.7**	**12.3**

Progress and prospects for achieving the MDGs in the sample countries

12. In each of the sample countries, significant progress has been made over the past decade, especially with regard to the income poverty, primary education and water goals. These improvements reflect the policy and governance reforms that these countries have undertaken in a range of areas, and the growth payoff that has resulted in many of them (see Box 1 for this and other themes that emerge from the country studies, including common analytical and information gaps). But, there are also differences in how much progress that has been made, both across goals and across countries. (Figure 3).[9] The least progress has been made on the child and maternal mortality goals, and on sanitation. Across countries, there has been more rapid progress towards specific goals and across a broader range of the MDGs in Indonesia, Vietnam, Bangladesh, and to a lesser extent, Uganda. But, there has been only limited improvement on most outcome indicators in Pakistan, Ethiopia and Madagascar.

[9] Figure 3 summarizes countries' progress towards the MDG targets by showing the value of the relevant MDG indicators in 2000 for each country against its value in 1990. In each panel, the 45 degree line represents no change with points above it or below it signifying progress depending on the manner in which the particular goal is specified.

Box 1: General Themes that Emerge from the Country Studies

The case studies of the 18 countries, which have been prepared by Bank country teams, illustrate several general themes, and point to some common gaps. The themes include the following:

- There is a strong emphasis on **economic growth as the key driver of MDG outcomes**, especially for income poverty, both in explaining past trends as well as in assessing prospects in the two scenarios — with and without substantial reforms and additional aid flows. Thus, all the country studies stress the need for policy and institutional reforms aimed at accelerating growth. This point is emphasized particularly in the countries of Sub-Saharan Africa such as Ethiopia, Burkina Faso and Madagascar as well as in Honduras. A related point highlighted in many country studies, including Burkina Faso and Madagascar, concerns the pattern of growth in terms of its impact on the incomes of the poor. The prospects for reaching the income poverty MDG will depend also on addressing the challenge of making future growth more pro-poor.
- The **interdependence of the MDGs and the multiplicity of determinants** for most goals emerges clearly. One implication is the important part played by income growth in contributing to progress towards the service delivery goals, particularly in Sub-Saharan countries such as Madagascar where the growth record has been disappointing. The other is the strong case for better infrastructure, particularly water and rural roads, and the expansion of girls' education, if progress is to be made on child and maternal mortality.
- Higher growth in the reform scenario in all the country studies contributes to **significantly higher domestic revenue mobilization** in all cases. Consequently, the dependence of most of these countries on aid diminishes over the period and their fiscal situations become more sustainable as a result.
- While there is obviously considerable overlap between the indicators specified in countries' PRSPs and those related to the MDGs, it is difficult to compare directly the targets for each because PRSPs generally set targets over a timeframe of three to five years while the MDGs relate to 2015. Nevertheless, the country studies illustrate that in some areas such as child malnutrition and net primary enrollment, **countries' PRSPs set targets that were at least as ambitious as the corresponding MDG targets**. On the other hand, targets in PRSPs for child and maternal mortality, where indicators improved less during the 1990s, are often less ambitious than the corresponding MDG targets.[10]

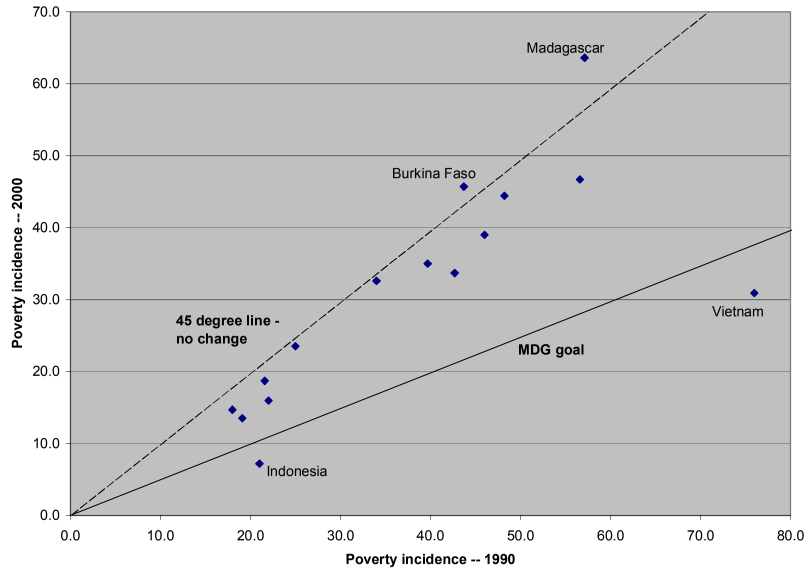
The key gaps that emerge from the country studies include the following:

- While its importance is acknowledged in all cases, the country studies do not account fully for the **role of infrastructure investments in promoting growth and improving service delivery to the poor**. In terms of the implications for additional aid, this gap is particularly significant in relation to the infrastructure needs required to take advantage of the export opportunities provided by a successful Doha trade round.
- Although measures to improve service delivery to the poor are identified as priorities in all countries, the **implications for government expenditures and external financing** are not spelt out clearly. These gaps mirror weaknesses in countries' PRSPs, and reflect several factors: weak capacity with regard to budget formulation and execution, particularly within line agencies; the inherent difficulty of formulating and operationalizing the multi-sectoral approach that is required in addressing the MDGs; and weak links between the spending priorities and policies identified in PRSPs and the countries' annual budgets or medium-term expenditure frameworks (MTEFs).
- **The poor quality of information concerning the baseline and trends on outcomes reflected in the MDGs and their determinants** is a consistent theme across country studies. On several indicators such as maternal mortality there is at best one data point for a number of countries, especially in Sub-Saharan Africa. And even where data are available, as for primary enrollment, there are serious quality and comparability issues that make it difficult to interpret trends or to use in conditioning transfers. Despite the acknowledgement of their importance, country-level information and analysis of the multiple determinants of MDG outcomes are patchy and inadequate.

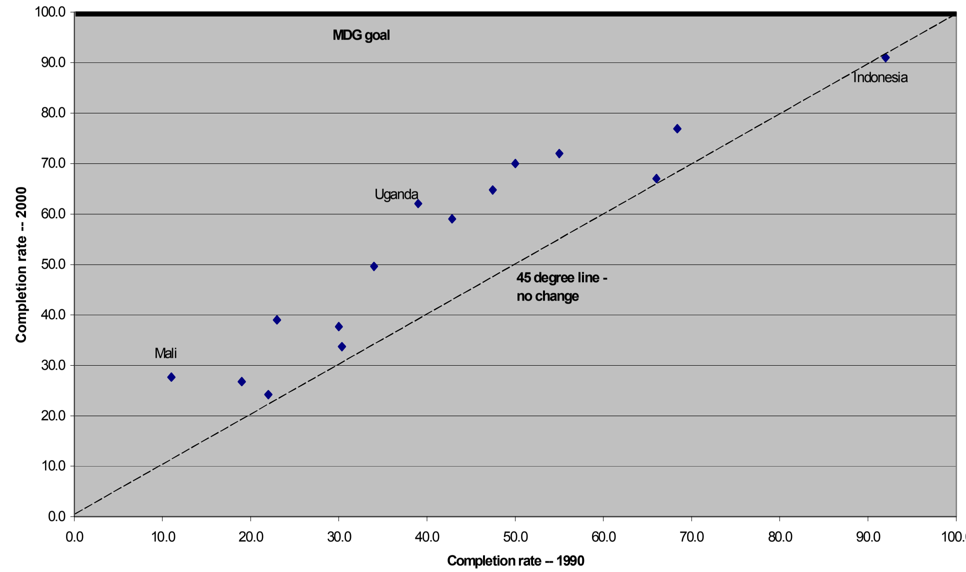
[10] For a fuller discussion of the relationship between MDG and PRSP targets, see "PRSPs – Progress in Implementation", (IDA/SecM2003-0468, August 7, 2003).

Figure 3: Progress on Four MDG Indicators

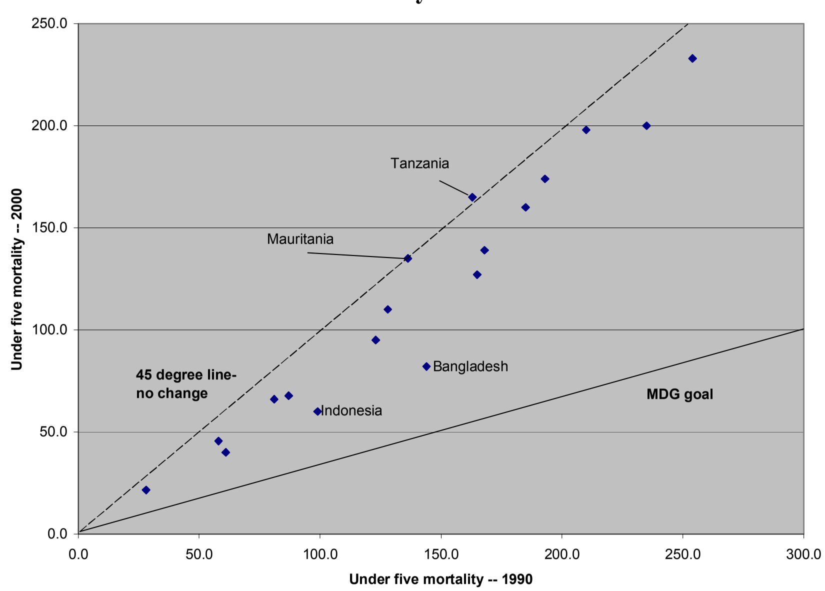
Poverty incidence: 1990 and 2000



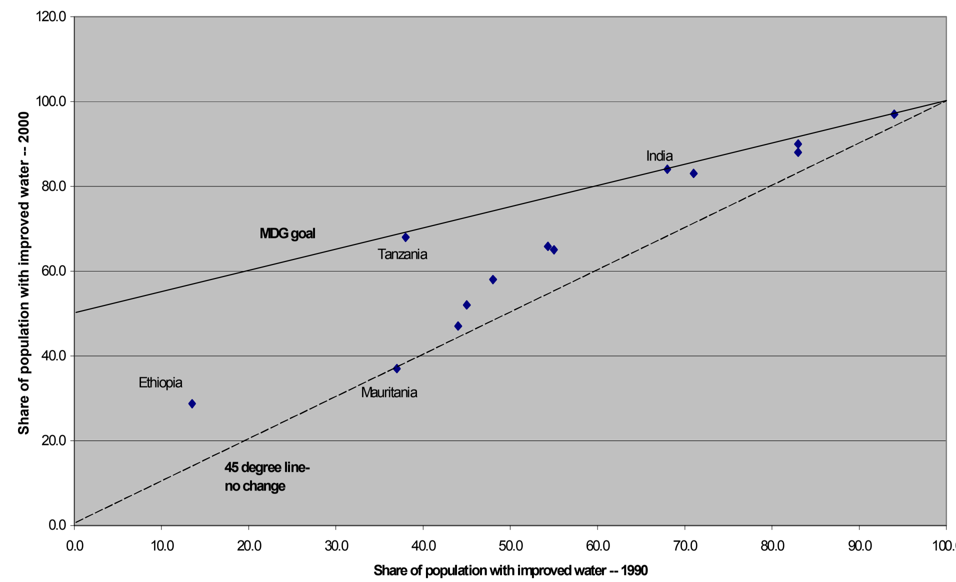
Primary completion rates: 1990 and 2000



Child mortality: 1990 and 2000



Improved water source: 1990 and 2000



Box 2: Meeting the MDG Health Goals — the Challenge of Progress

Achieving improvements in health indicators and meeting these MDG targets is more challenging than in other areas for several reasons. First, the declines in infant and maternal mortality that will be needed to meet the targets are steeper than in other areas (a two-thirds reduction in child mortality rates and a three-quarters reduction in maternal mortality by 2015). Second, improving health outcomes is linked not only to the provision of health services, but also to interventions outside the health sector. Access to clean water and mother's education are both key determinants of infant and child mortality rates. And, achieving sharp declines in maternal mortality requires changes in behavior regarding prenatal care and delivery and an improved road network, in addition to improved hospital care. Third, delivering health care services effectively requires the coordination of policies in a number of areas. These include: public sector management policies so as to provide adequate incentives to health care providers; procurement and distribution policies for pharmaceuticals so that these are available in sufficient quantities in the right places; public health measures to protect the population; and suitable regulation and quality control of private providers who often provide more health services than public providers.

Nevertheless, experience shows that progress towards the health goals is possible. Concerted efforts will be required in a number of areas to ensure sustained improvements in indicators of infant and child mortality and maternal mortality. These areas include: improvements in access to and quality of health services, better infrastructure especially for water and sanitation, and a focus on diseases that: involve large externalities and the provision of public goods, and are highly concentrated among the poor (e.g., tuberculosis and malaria).

13. The progress that has been made since 1990 is obviously a key determinant of countries' prospects for reaching the MDG targets by 2015 if current policies and aid prospects remain unchanged. The left panel of Figure 4 provides a summary of these prospects for each of the 18 countries (Annex 1, Figure 5, shows a more detailed presentation of these projections). As would be expected given the trends over the past decade, it shows a diverse picture by goal and across countries. And as Figure 5 shows, more countries are likely to attain the education and poverty goals than those for health or the environment. In general, this is a reflection of what can be expected if the countries continue to pursue policies aimed at maintaining macroeconomic stability and promoting structural reform. The growth payoff from these policies will yield the biggest gains in reducing income poverty and increasing primary enrollment. However, even among the education goals, while the primary enrollment target is expected to be met in almost two-thirds of the sample countries, those for primary completion and gender pose bigger challenges. Similarly, while almost half the sample countries would meet the income poverty goal, several of them will not be able to meet the goal of reducing hunger. The child and maternal mortality goals are projected to be **not met** almost universally in the sample (see Box 2 for a discussion of why these health goals are particularly challenging). Only Bangladesh, Indonesia and Vietnam will likely meet the child mortality goal. And on maternal mortality, only Vietnam will likely meet the MDG target.[11] Reaching these goals is made even more difficult in many of the Sub-Saharan countries in our sample due to the lack of progress in the 1990s on account of the spread of the HIV/AIDS epidemic. This provides another example of the interdependence between the MDGs (see Box 1 above).

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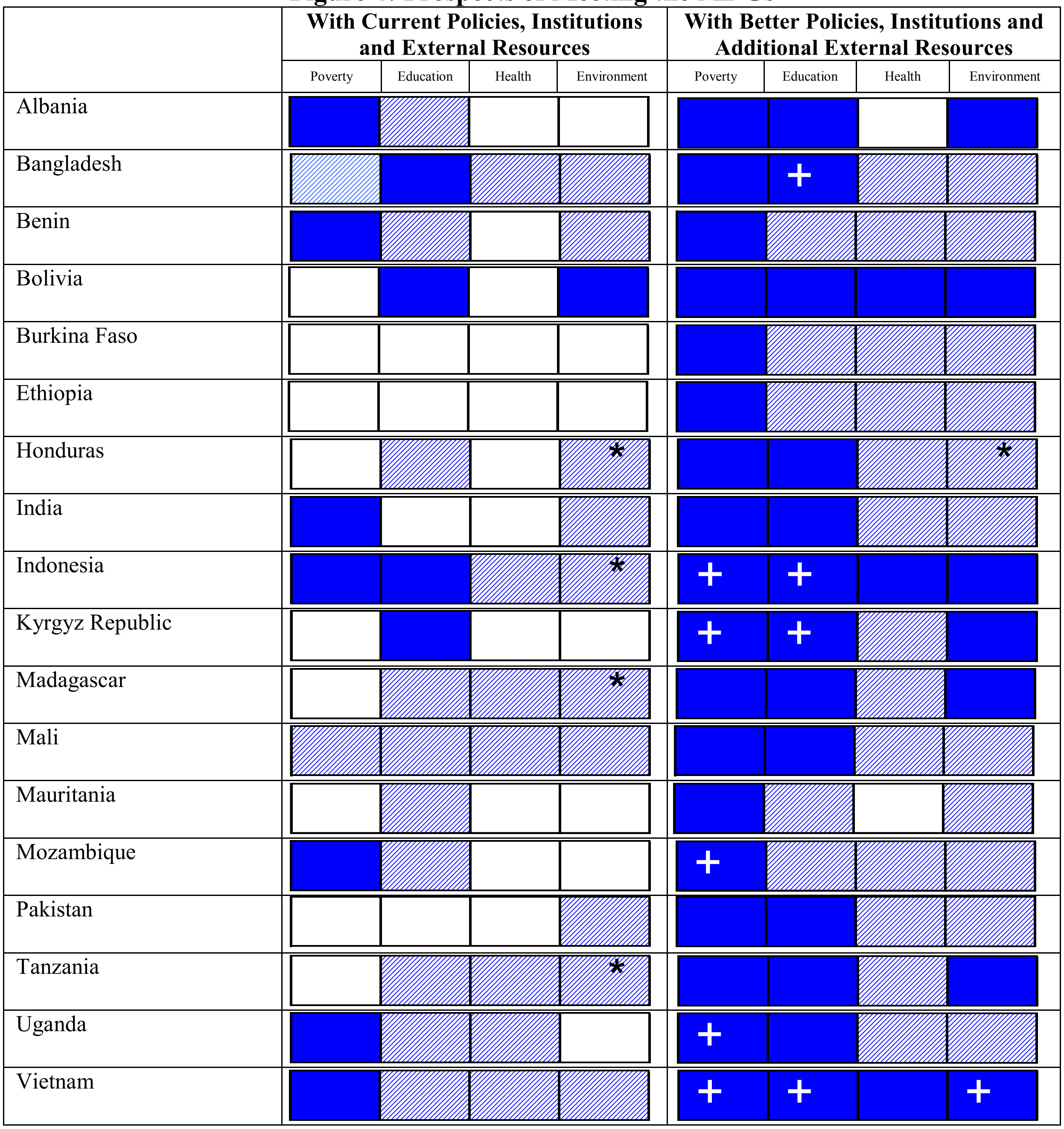
[11] These patterns across goals reflect, in part, the manner in which the targets are set, which in turn affect the likelihood of their being met. The targets for the education goals, for instance, are specified in terms of absolutes (universal enrollment and completion or gender parity) unlike the poverty goals, which are relative. So, for countries with poor initial conditions (e.g., Burkina Faso on primary completion or Ethiopia on gender bias in education), it will be very difficult to reach these targets by 2015 even though they might be making progress towards them. But even for some goals where the targets are set in relative terms (as for child and maternal health), the required rate of decline is so substantial (and more so than the halving required for the poverty goals) as to make them difficult to achieve.

Figure 4: Prospects of Meeting the MDGs



Notes: Each box shows progress in achieving MDG targets combined in four broad areas. This figure summarizes the information for each country in Annex Figure 5. Poverty — income poverty and hunger. Education — primary enrollment, completion and gender equality in education. Health — child (under 5) mortality , maternal mortality, and, where applicable, the prevalence of HIV/AIDS. Environment — improved access to water and sanitation, and where applicable, forestry.

- none of the targets is met | *- at least one target is met* | * *- forestry target is taken into account*

- all targets are met | *- progress beyond the MDG target*

14. Looking across countries, there are striking differences in terms of which goals are met, and three points, in particular, are worth noting. **First**, looking across countries at prospects for achieving the goals illustrates how initial conditions (in 1990) can be transformed for better or for worse by good policies. Bangladesh had among the poorest initial conditions in 1990 but now has a reasonable chance of meeting many of the targets, including that for child mortality reductions. Similarly, Uganda is also now likely to reach a number of goals. On the other hand, Pakistan began the 1990s with somewhat better indicators than its neighbors but its lack of progress means it is likely to fall short in a number of areas, including poverty. Given the close link between economic growth and levels of income and non-income poverty, a key set of policies is with regard to promoting broad-based growth. While Uganda, for instance, was able to reduce poverty incidence (in terms of its national poverty line) from 56 percent to 35 percent between 1990 and 2000 mainly as a result of the 6.4 percent per annum GDP growth rate during the period, much lower growth in Madagascar (about 2 percent per annum and negative in per capita terms) means that its prospects for reaching the income poverty and most other goals is less bright. Beyond reforms to spur growth, a country's commitment to improving non-income aspects of poverty, particularly education and health, is also important. This commitment can be implemented through the government as with primary education in Uganda and Tanzania or through NGOs and community-based groups as in Bangladesh, in Indonesia post-1997, and in some Indian states.

15. **Second**, it is clear that the sample countries in Sub-Saharan Africa face bigger challenges than countries in other regions with regard to several goals, including the primary completion target and access to clean water. In primary education, although Ethiopia, Mauritania and Uganda among others have made rapid progress in expanding enrollment in the recent past, poor initial conditions imply that only Tanzania is likely to achieve universal primary completion by 2015. On water, the initial handicap of most of these countries has been compounded by their lack of progress since 1990. So, whereas all five large Asian countries and almost all the small non-African countries in the sample are likely to meet this goal by 2015, not a single sample country in Sub-Saharan Africa will do so.[12] But, even in other regions, including Asia, the progress that is likely to be made in several areas masks the scale of the substantial needs that will remain to be addressed. For instance, although Bangladesh will likely reach the child mortality target by 2015, its child mortality rate in 2105 will still be higher than Albania's was in 1990.

16. **Third**, aid has helped in improving countries' prospects for making faster progress towards the MDGs, particularly when it has been provided in ways that complement the efforts of the countries themselves, including their efforts to mobilize domestic resources and use these efficiently. Many of the smaller non-Asian countries in the sample have high levels of aid relative to their populations and their economies, and coupled with good policies, this aid has allowed them to finance ambitious development programs aimed at making faster progress towards the MDGs. Donor assistance has allowed Uganda and Tanzania, for instance, to finance their ambitious universal primary education programs. And, external assistance has supported domestic reform efforts in Vietnam and Mozambique, among others. Table 1 also illustrates how

[12] Since the data on access to clean water are unreliable, it is possible that the baseline data for South Asia paint too optimistic a picture of the prospects for these countries under current policies and aid levels.

aid currently flows more to those low-income countries with relatively good policies, including the sample countries — a shift that occurred during the 1990s.[13]

Prospects for accelerating progress with improved policies and additional aid

17. In this scenario, the prospects for accelerating progress towards the MDGs in the sample countries are assessed when the countries undertake significant policy and institutional reforms in the coming decade **and** have access to significant additional external financing in the form of concessional resources. The implications of this combination are examined in terms of: the progress that is likely towards the various development goals (summarized in the right panel of Figure 4); how this varies by country characteristics; and the reforms and additional aid that will be required to sustain this progress. Obviously, there is considerable judgment involved both with regard to reforms and additional aid requirements. The analysis reflected in this paper relies on the judgments of Bank country teams buttressed by existing analysis, including in countries' PRSPs.

18. The reforms in policies and governance that are considered for each country in this scenario focus on enhancing the potential for reducing poverty through sustained growth and improved delivery of services to the poor. Given the cross-sectoral interventions that are needed to make progress towards the MDGs, these reforms fall into three broad areas: improving the environment for private sector activity, particularly in terms of the rule of law and infrastructure; enhancing the quality of governance and capacity in the public sector; and delivering more effective human development and other basic services to poor people. As noted in the summaries of the country studies (Annex 1), there are differences across countries both in terms of the relative importance of each of these areas as well as the precise actions needed in each area and their sequencing over time. Nevertheless, the reforms that are considered in this scenario are intentionally ambitious while attempting to take account of implementation constraints in each country and how these might evolve over the coming decade.

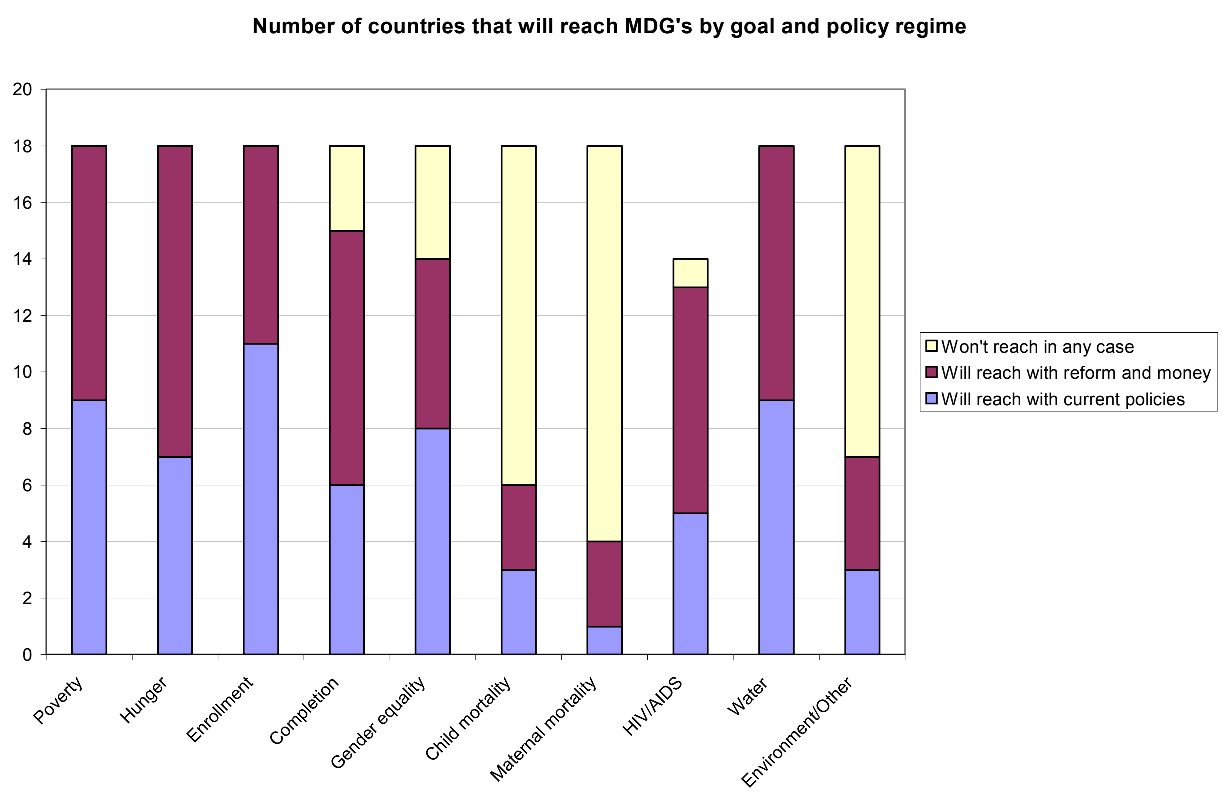
19. The estimates of the additional aid that can be used productively over the coming decade in each country and the phasing of this aid over time take account of the pace at which human, institutional and physical capacity are built up as policy and institutional reforms are implemented and investments are made. The building up and strengthening of capacity will generally lag the reforms being implemented and investments being undertaken. So, countries that have relatively strong capacity to begin with will be able to use larger amounts of aid productively even at the outset. On the other hand, in countries that are already constrained, particularly in terms of human and institutional capacity, such as many of the sample countries, it may take time to build up the capacity to use larger amounts of aid productively, and so their aid requirements will rise over time. Given the time period involved, these estimates of the phasing of aid are uncertain and are likely to be conservative. It is possible that countries might be able to upgrade their capacities more quickly than anticipated, particularly if they are able to invest successfully in capacity enhancement. Such investments can be based, as in Burkina Faso, on an assessment of its capacity weaknesses and needs, as is being undertaken in the context of implementing its PRSP. And, it can take such forms as strengthening the capacity for poverty

[13] One study estimates that whereas in 1990, countries with good policies got about the same aid per capita as those with poor policies, by the late-1990s, the former received twice as much in per capita terms as the latter (see I. Goldin, H. Rogers, and N. Stern, "The Role and Effectiveness of Development Assistance", 2002)

monitoring and program evaluation, as in Bangladesh, and the capacity for policy analysis and formulation, as in Madagascar.

20. Progress towards the MDG targets. The country studies illustrate how powerful the combination of significant reform and additional aid could be in accelerating progress towards the MDGs. Across development goals, the most substantial acceleration is likely to occur with regard to income poverty and hunger (see Figure 5). The combination of policy and institutional reform and additional external resources would likely allow all 18 sample countries to achieve the poverty goals and several of them, including Uganda, Mozambique and Vietnam, are likely to be able to make even sharper reductions in poverty than implied by the MDG target. Significant progress is also likely with regard to the education goals with almost two-thirds of the sample countries attaining the targets even with regard to primary completion and gender (see Box 3 for a summary of how the aid implications of education sector improvements have been derived for the Education for All Initiative — EFA). And, Vietnam and the Kyrgyz Republic could go further in successfully addressing quality issues and expanding the coverage of secondary education. However, progress towards achieving the health and environmental goals will remain a challenge in most countries in the sample. Only a third or less of the countries will achieve all the targets in either area and some will not meet any of the goals in each area.

Figure 5: Progress Towards the MDGs — By Goal and Reform Scenario



Box 3: Costing Education for All

The costs of reaching the primary education goals have been estimated on a country basis as part of the Reaching Education for All (EFA) initiative. Unlike similar efforts to determine existing and likely future costs, this effort has involved working directly with governments and obtaining detailed information on policies and actual costs, as well as examining the implications for the level and use of donor assistance. Based on country-level data and analysis, the performance of the education sector was benchmarked for the best-performing countries in terms of: the share of public resources allocated to primary education; the proportion of non-salary costs in recurrent spending; the level of unit costs per student; and pupil teacher ratios. These benchmarks were then extended to construct reform scenarios and costings for countries whose primary education systems performed less well.

The results suggest that currently both policy and financial constraints limit the number of low-income countries that will reach the MDG targets for primary completion. And, to make faster progress in most countries the financial needs consist largely of higher recurrent costs to run and staff schools adequately. Additional investments in civil works and equipment in the education sector are unlikely to significantly affect education outcomes. Yet, most donor assistance at present consists of resources to meet such investment needs rather than operating costs. The form of aid thus poses a major constraint to progress in expanding and improving primary school performance.

Although the EFA cost estimates do well at integrating policy and financial considerations at the country level, one limitation is that they are specific to the education sector. They do not capture elements such as roads and other basic infrastructure or broader policy and institutional changes such as civil service reform that are necessary to improve sectoral performance and service delivery. These broader investments and policy changes will also be needed to complement the additional resources for the education sector in improving outcomes.

21. Implications for policy reforms. The country studies illustrate that for improvements to occur at this pace, substantial policy and institutional reforms will be necessary to accelerate growth and improve service delivery. As noted in the summary country studies in Annex 1, the priorities in terms of reforms obviously vary across countries. In some, such as Pakistan and Indonesia, strengthening governance in the public sector and improving the investment climate are the policy priorities. In these countries as well as in Ethiopia, ongoing decentralization efforts, if successful, offer potentially better ways to deliver services to the poor. In Madagascar and Burkina Faso, it will be necessary to implement sectoral policies and reorient public expenditure programs to make the pattern of growth more pro-poor. And, in Honduras, more rapid growth will hinge on reforms to deepen the financial sector and to improve governance.

22. One important aspect of reform in all these countries will be greater mobilization of domestic revenues to supplement additional aid and ensure that their fiscal situations remain sustainable in the medium term. Several of the Sub-Saharan African countries in the sample currently receive as much or more aid as they raise in domestic revenues. In order that this is sustainable over the medium term, domestic revenues will need to rise more than proportionately as their incomes grow. In addition, the reforms aimed at improving the investment climate in the sample countries will be important in attracting higher private capital inflows, which will also help reduce their dependence over time on aid flows in sustaining their growth and progress towards the MDGs.

23. Implications for aid volumes and aid effectiveness. The country studies indicate that additional aid can play a catalytic role in all the sample countries in supporting faster progress towards the MDG outcomes. However, the magnitudes of incremental aid requirements are likely to vary across countries. To examine this relationship further, it is helpful to look at the

sample of 18 countries in terms of three groups. One is made up of the five large Asian countries, each of which has large numbers of poor (collectively they account for almost 45 percent of those who live on less than US$1/day), good policies and prospects for further improvement and reasonable institutional capacity, and receive low levels of ODA at present (in per capita terms or as shares of GDP). A second group consists of the 10 countries of Sub-Saharan Africa and Central Asia. These have smaller populations, weaker institutional capacity and typically already receive higher aid flows. In other respects, as for instance in terms of their gaps vis-à-vis many of the MDG targets, this group is diverse. The third group is made up of Albania, Bolivia, and Honduras. All of them have higher per capita incomes than the rest of the sample and are closer to reaching many of the MDG targets.

24. In general terms, the volume of additional aid that can be used productively should be determined by the quality of the country's policies and institutions and prospects for improvement (including its ability to mobilize additional domestic revenues), its level of poverty (or more generally, its distance from the MDG targets) and its existing dependence on aid. On this basis, the country groupings of the sample noted above point to **three** conclusions. **First**, the five large Asian countries — Bangladesh, India, Indonesia, Pakistan and Vietnam — could use a substantial increase in aid in accelerating their progress towards the MDG targets. Since their current aid dependence is low, it should be possible to double (or more) aid to these countries. While increases on this scale will mean that the ratio of aid to GDP will rise in these countries over the medium term, it will remain low in absolute terms and should be sustainable as their incomes and domestic revenues expand with more rapid growth.

25. These increases in aid will allow these countries to make faster progress towards the MDGs (and in the cases of Indonesia and Vietnam go beyond several of the MDG targets). But, this additional aid will need to be sequenced with domestic policy improvements and in particular, should not be used to justify a slowing of the pace of reforms. In some cases, as with Indonesia, the reforms will need to go together with more public investment and higher operation and maintenance expenditures for infrastructure, and additional aid should help in this regard (see Box 4 for the links between infrastructure and the MDGs). Upgrading public sector governance to improve the rule of law, increasing domestic revenues, and strengthening public administration to provide better public services are the key policy challenges in Bangladesh. Restructuring public expenditures to priority areas, including infrastructure investments and basic social service delivery, in the context of fiscal constraints is a priority for India. Vietnam will need to address its policy and institutional weaknesses with regard to property rights and governance (so as to sustain growth) and public expenditure management (so that service delivery can be improved, particularly to the very poor and ethnic minorities). Steps to improve the investment climate will be important in Pakistan.

26. **Second,** the additional aid requirements in the sample countries of Sub-Saharan Africa and Central Asia will average about 60 percent over current aid levels. In these countries, incremental aid requirements depend very much on country circumstances. In particular, in addition to current aid dependence and country policies, the magnitude of additional aid requirements depends also on where countries are today relative to the targets for their development goals and on the pace at which they can reasonably expect to mobilize additional domestic revenues, and upgrade their institutional and human capacities so as to translate good policies and more public spending financed by aid into faster growth and better human development outcomes. Thus, there is considerable judgment involved as to both the volume and

phasing of the additional aid that would be required for countries to accelerate their progress towards the development goals. Nevertheless, the combination of higher growth (about 5 percent per annum, on average) and increased domestic revenue mobilization means that for most of these countries, the ratio of aid to GDP will decline over the coming decade from its current levels, which in most cases is currently high. This ratio will rise only for Ethiopia and Madagascar, and even in those cases, it will likely be lower at the end of the coming decade than what it currently is for Mozambique and Mauritania.

Box 4: What Has Infrastructure Got To Do With The MDGs?

There is growing recognition that infrastructure is crucial to achieving the MDGs. Better outcomes on poverty reduction, education and health all depend upon reliable and affordable provision of infrastructure services. However, physical investments in infrastructure must be paired with an improved environment and increased capacity to make the most effective contribution towards achieving the goals. The underpinnings of this are good policy and governance, which contribute to efficient operation of public and private service delivery alike.

There are four channels through which reliable, affordable and cost-effective provision of infrastructure services can help achieve the MDGs:

- by facilitating poverty reduction through promotion of sustainable economic growth;
- by reducing the fiscal burden of governments to create space for expenditures on health and education;
- by increasing the general welfare of poor households through reductions in the opportunity costs (both time and money) associated with finding imperfect alternatives to meet essential needs; and
- by directing infrastructure investments to ensure better provision of health and education services and a better environment.

The country studies for this paper reflect some of these costs in the investment needs for growth and service delivery. But it is also clear that most PRSPs and the World Bank's own country work that informs them do not yet incorporate infrastructure in a comprehensive and integrated manner. There is a clear need for an improved understanding at the country level of the critical contribution of infrastructure to poverty reduction through growth and service delivery. In the meantime, there is ample country evidence on how infrastructure affects progress on specific goals within the MDG framework:

- **Through growth**. In Uganda, a survey of 243 firms conducted in 1998 showed that inadequate electricity sources were the most important constraint to investment.[14] Firms on average did not receive electricity from the public grid for 89 operating days a year, leading to 77 percent of large firms (in addition to 44 percent of medium and 16 percent of small firms) purchasing generators, representing 25 percent of their total investment in equipment and machinery. Provision of reliable electricity services would likely attract more firms to invest in Uganda — improving the outlook for growth and poverty reduction.
- **Through service delivery**. In rural India, a recent study found that the prevalence and duration of diarrhea among children under five are significantly lower on average for families with piped water than for those without piped water.[15] However, the results also show that the health gains largely by-pass children in poor families, particularly when the mother is poorly educated. This points to the importance of combining infrastructure investments with effective public action to promote health knowledge and income poverty reduction.

27. Some of the Sub-Saharan African countries in the sample illustrate the opportunities and constraints in accelerating progress towards the development goals and how better policies and more aid might interact. Due to a combination of poor initial conditions, its landlocked

[14] R. Reinikka and J. Svensson, "How Infrastructure Provision of Public Infrastructure and Services Affects Private Investment", World Bank, December 1999.

[15] J. Jalan and M. Ravallion, "Does Piped Water Reduce Diarrhea for Children in Rural India?", Indian Statistical Institute and World Bank, August 2001.

geography, and policy and institutional weaknesses, Burkina Faso is unlikely to achieve any of the MDGs if current policies and aid flows remain unchanged (Figure 4). This outcome is likely despite its already significant dependence on aid with over half its budget being financed by donors. However, improved policies and institutions and additional aid would accelerate progress on several fronts, primarily because policy reforms could lead to more rapid and more broad-based growth. Its growth prospects (like those of other commodity-dependent African countries) would be improved if domestic policy reform were complemented with the opening of developed country agricultural markets (see Box 5). However, while there will be faster movement towards the education and health goals, none of these (other than enrollment and HIV/AIDS) will be met by 2015, and the key constraints particularly for the child and maternal mortality goals, which need cross-sectoral action, will be the lags between policy improvements and the upgrading of human, institutional and physical capacity.

Box 5: Trade *and* aid

Significant progress has been accomplished since the end of World War II in reducing the barriers to trade in goods and services, and this has been an important factor in sustaining global growth. However, despite these achievements, many of which have come from past trade rounds, barriers to trade remain stubbornly high in some sectors. The highest tariffs faced by developing county exporters are on agricultural products, processed foods, and textile and apparel. And, these average tariffs mask their actual impacts on the poor since many developing countries, particularly the poorest, rely heavily on the exports of agricultural products and clothing. For instance, cotton accounted for more than 30 percent of merchandise exports in the late 1990s in a range of West and Central African countries, including Burkina Faso, Benin and Mali. It has been estimated that cotton farmers in the region would increase their revenues by over US$250 million annually if industrial country cotton subsidies were removed. Looking across countries, while industrial countries heavily protect their agriculture (to the tune of some US$300 billion annually), middle-income countries, such as those in East Asia, also protect their agricultural sectors, closing these potentially high-growth markets to exporters from low-income countries.

The successful completion of the Doha trade round, which is ongoing, could generate substantial income gains for low- and middle-income countries if it were to address these barriers. As the World Bank's most recent *Global Economic Prospects* report illustrated, if all countries cut tariffs on agricultural and manufactured goods, with developed countries cutting their rates to lower levels, incomes in low-income countries would increase by US$24 billion, or 1.4 percent annually by the year 2015, even if the only impact of these reductions in trade barriers is to reduce distortions. If it is assumed that trade policies also have dynamic effects, as for example through raising productivity, the estimated gains are substantially higher for low-income countries — some US$60 billion in 2015, or an annual increase of 3.6 percent.

But better market access by itself will not be enough to spur growth. Low-income countries with high tariffs and non-tariff barriers will benefit from liberalizing their trade regimes. And, most developing countries will also need to address behind the border — or supply-side — issues that determine how much they benefit from improved market access. Aid directed towards improving infrastructure, such as roads and ports, and improving customs administration, for instance, will have high payoffs. These issues — of complementary policy reforms and investments — will need to be addressed more systematically than in the past by these countries, with support from their development partners, as part of the process of formulating and implementing their poverty reduction strategies. In general, while improved market access will benefit most developing countries in the longer term, many will be able to use additional aid productively in the short- and medium-term, particularly in upgrading infrastructure.

28. In this context, additional aid will help but in order to be productive will need to be matched by a gradual increase in domestic revenue mobilization (from its current level of about 11 percent of GDP). Hence, the proportionate increase in aid flows needed to support and

accompany domestic policy and institutional reforms will likely be of the order of a fifth to about a third of current flows, with the aid phased in over the period 2004-2015 as domestic capacities are upgraded and policies are improved (see Box 1 for general points that emerge from the country studies). Mozambique and Tanzania are similar in many respects to Burkina Faso and will also need relatively modest increases in additional aid requirements for several of the same reasons.

29. Within this group, Madagascar and Ethiopia contrast with Burkina Faso, Mozambique and Tanzania in terms of the potential they offer for increased aid. Both resemble the five Asian economies in that they receive relatively little aid in per capita terms and have large gaps with regard to many of the MDG targets. With current policies and aid levels, neither is likely to make much headway in reaching the development goals (Figure 4). If Madagascar is able to sustain and build on its recent reforms over the medium-term, its prospects in several areas should improve considerably, particularly if accompanied by additional aid. Over time, Madagascar should be able to use significant flows of additional aid in achieving the MDGs, possibly as much as a doubling of current levels of aid. To absorb this additional aid effectively, it will need to improve its policies so that the pattern of growth is more pro-poor, weaknesses in public expenditure management are addressed and service delivery in key sectors is revamped, which may also imply the need for greater contracting of social service delivery to NGOs and faith-based groups. In common with Burkina Faso and Mozambique, Ethiopia had poor initial conditions, which in its case were compounded during the 1990s by political instability. The key difference between the two countries is in Ethiopia's much lower aid dependence — aid per capita is about half that of Burkina Faso and a third that of Mozambique. The quality of its policies and institutions is also not as good as in either of those countries. Thus, as long as it implements substantial policy reform, Ethiopia could make good progress towards the MDGs (although as with Burkina Faso and Mozambique, it is unlikely to meet most of the education and health targets) and absorb substantial amounts of additional aid, to the order of a doubling of aid. These increases will need to be phased in over time as domestic capacity rises and policies improve, particularly with regard to the climate for private investment.

30. **Finally,** the average additional requirement for the third group of countries (those with higher per capita incomes) is much lower — about 20 percent over current aid flows, on average. Consequently, the ratio of aid to GDP in these countries can be expected to fall over the coming decade towards (but not reaching) the levels of those of the large Asian countries in the sample. One reason is that they already receive considerable aid. Aid per capita in all three of these countries is higher than that in most Sub-Saharan African countries. Moreover, their high per capita incomes translate into better MDG indicators than most other low-income countries. Many of their characteristics, therefore, are those of lower-middle income countries rather than low-income countries. Given their income levels, most of the development goals should be within reach for these countries with higher growth and modest increments of aid. While they still have serious challenges with regard to some of the goals, particularly in terms of improving conditions of marginalized regions and groups, and will continue to need aid, many of their gaps with regard to the MDGs will require deeper reforms rather than significantly more concessional aid. And, over time, as they seek to go beyond the MDG targets, they will need to rely more on non-concessional financing.

31. Implications for aid modalities. The country-level analysis of future prospects and the role for additional aid assumes that there will also be changes in aid modalities. There are five

key aspects of the ways in which donors make aid available where the country studies indicate that more progress will need to be made. **First**, as countries build a track record of good policies, the provision of aid needs to be predictable and long-term. As the experience of the sample countries illustrates, the long-term reforms needed to make faster progress towards the MDGs will be facilitated, especially in countries that already receive significant aid flows, only if there is reasonable certainty about the levels of such flows and the conditions under which they are likely to materialize.[16] There has been a movement in this direction in Uganda where the government's Poverty Eradication Action Plan (PEAP) contains well-defined priorities, which have allowed donors to integrate multi-year support through sector-wide approaches and budget support within the government's medium-term expenditure framework. Another important step towards greater predictability, on which less progress has been made even in Uganda, is for donor conditionality to be derived more directly from the government's poverty reduction strategy.

32. **Second**, donors need to provide assistance in ways that are better aligned with the country's own development priorities, as articulated in its poverty reduction or development strategy. This also implies that donors will improve their coordination, and harmonize their policies and procedures associated with the provision of aid around the recipient countries' own systems. An example is the Ethiopian government's emphasis on donor alignment and harmonization as central elements in the implementation of its poverty reduction strategy. Similarly in Mozambique and Benin, bilateral donors are coordinating the disbursement, monitoring and reporting of their budget support under common pooling arrangements. A challenge here will be for donors to harmonize their procedures around those of recipient countries while ensuring that this does not come at the expense of fiduciary and other standards for accountability.

33. **Third**, the mechanisms for providing aid will need to be modified in a way that allows assistance to be phased in and sequenced with improvements in country capacities. In some countries, including Vietnam and Tanzania, such a phased approach is being taken with regard to identifying gaps in systems for managing public expenditures, including procurement and financial management systems, and addressing these, including with support for capacity building.

34. **Fourth**, donors will need to find ways of providing recurrent financing in countries where the binding constraints on improving MDG outcomes are associated with the need to increase costs such as salaries of teachers and health workers, and operating and maintenance expenditures. As countries make progress in improving their public expenditure programs, the provision of recurrent financing can be done through budget support or sector-wide programs, as in Uganda and Burkina Faso. In countries, such as Madagascar, where reforms of public expenditure systems are still in the early stages, investment projects will need to provide for recurrent financing. To address concerns about sustainability, governments must ensure that such expenditures will effectively expand the growth and revenue potential of the economy so that these costs can be financed in the medium-term from domestic revenues. It will be important,

[16] This implication does not presume that there is a link between the volume of aid and countries' willingness to pursue reforms. Rather, it follows from recipient countries being able to plan better if aid inflows are more predictable.

therefore, to provide external financing in the context of a budget framework that takes a long-term perspective on revenues and spending.

35. **Finally**, the country cases point to the importance of tailoring the mix of grants and loans to country circumstances so as not to increase the risk of debt distress in already highly-indebted countries that are exposed to shocks. As Box 6 indicates, debt sustainability considerations suggest that the appropriate mix of grants and loans needs to depend on the quality of a country's policies, its existing debt stock and its vulnerability to shocks.

Box 6: MDGs, Aid Flows, and Debt Sustainability

Meeting the MDG targets will require both an improvement in policies of aid recipient countries and an increase in aid flows from donor countries. However, there is the additional question of whether aid increases should be in the form of grants, in the form of loans, or a combination of both.

Recent analysis in the World Bank has focused on analyzing factors in addition to the debt burden that could be behind episodes of debt distress. This work finds that policies and vulnerability to shocks also matter for debt sustainability. The likelihood of debt distress rises when country policies are poor or when countries experience negative shocks. Countries with good policies and those less vulnerable to shocks are likely to enjoy rapid and stable growth that reduces the likelihood of debt distress in the future. So, debt sustainability considerations imply that low-income countries with good policies that have higher debt burdens or are more prone to shocks may require a higher proportion of grants than others that also have good policies but have less debt or are less susceptible to shocks.

B. Low-Income Countries Under Stress (LICUS) [17]

36. Low-income countries that fall below the performance bar used in identifying the sample countries pose special challenges for the effective use of aid. This group of countries is diverse, including post-conflict countries as well as countries with poor development records. But they share several characteristics: poor and deteriorating economic and social indicators with regard to the MDGs; little data on social conditions and the impact of development programs; and very weak policies, institutions, and governance.[18]

37. In such countries, donors face a dilemma. On the one hand, increasing aid substantially is often ineffective in improving outcomes because of lack of capacity or willingness to use money efficiently in reducing poverty. On the other hand, neglecting these countries perpetuates the poverty and deprivation of their people, and may lead to the collapse of the state, with possible adverse regional consequences. The challenge for donors in these countries is, therefore, to find ways of balancing the countries' limited absorptive capacity and high risk with the need to remain engaged so that the prospects for progress are not compromised.

38. Lack of reliable data in LICUS complicates analysis of the role for aid in achieving improvements against the MDGs. Available data do indicate clearly, however, that these countries are among the most disadvantaged in relation to their prospects for reaching the

[17] This section draws heavily on the findings from the Task Force Report on "World Bank Group Work in Low-Income Countries under Stress", (September 2002); and "Poor Performers: Basic Approaches for Supporting Development in Difficult Partnerships", Development Cooperation Directorate, Development Assistance Committee, DCD/DAC(2001)26Rev1, (November 2001).

[18] LICUS covers a range of countries. Countries at the upper end of the policy performance range can use more aid productively, although even their capacity will be less than in countries with relatively good policies.

MDGs. Current aid volumes vary widely across LICUS. In some countries, concerns over poor governance and repeated cycles of political insecurity have led to low aggregate aid flows, although some measure of humanitarian assistance may still be provided. In other cases, expectations of political change or fear of increased insecurity have led to relatively high aggregate and per capita flows. It also appears that aid to LICUS vary more over time than to better-performing countries. And, while most assistance to LICUS is quite appropriately in the form of grants, the mix of grants and loans also appears to vary across countries.

39. Like better-performing countries, the ability to use aid productively is not static, and can be enhanced by improvements in policies and governance. One area that offers the potential to help use aid more effectively even in the short term is the strengthening of autonomous or non-governmental institutions for service delivery. Investments in better service delivery are critical both to improve social indicators and build support for change. Given the weak capacities of governments, basic service delivery in these countries is often most effective when it works through existing NGOs and community groups with a proven track record of success, or through state-controlled but ring-fenced mechanisms such as social funds. Over the medium-term, such approaches can help build capacity in the form of trained service delivery staff as well as raise demand. It is important that these efforts be evaluated periodically and that they do not undermine an appropriate role for the state in the future. Where possible, they should therefore be twinned with programs to help government monitor and learn from these initiatives and, over time, build successful design and implementation features into core government programs.

40. Donors may also be able to help LICUS societies improve their prospects for using aid effectively by providing more strategic support to domestic reform efforts. There is no template for how the international community can assist these countries in initiating reforms that will help them move towards the MDGs. In all cases, however, better understanding of local social and political dynamics must be the starting point for more effective engagement. This understanding can then help guide selectivity in identifying and reaching consensus on areas of reform where implementation is technically and politically feasible. Timely support to credible early reform efforts is important to help strengthen the hand of domestic reformers, particularly in countries such as Nigeria that have unfavorable initial conditions in terms of debt arrears and negative net transfers of external resources. Again, the challenge is to tackle these issues in ways that reinforce the governments' resolve to push ahead and sustain difficult reforms. In the case of Nigeria, revenues from oil and gas, if well used, should be able to sustain progress towards the MDGs over the medium-term. However, aid may still have a role to play in strengthening the popular base for pro-poor reforms, and working with states that show a commitment to implementing reforms oriented at making progress towards the MDGs.

41. The case for larger financial transfers is stronger in post-conflict countries.[19] Where the political settlement of a conflict is strong and sustainable, the returns to aid for reconstruction are potentially high because it helps rebuild capital stock and responds to urgent humanitarian and social needs. In this situation, the challenge for donors is to finance the large upfront and

[19] Most countries classified as post-conflict by the World Bank are also LICUS, because their policies and institutions are exceedingly weak. These countries are often at risk of a recurrence of conflict, with 50 percent of post-conflict countries falling back into conflict within 10 years. As the experience of Uganda and Mozambique in the early-1990s illustrates, post-conflict countries that do not see conflict recur have the potential to use additional aid productively and grow rapidly. And, if aid can be provided in a timely way once the conflict ends, it can be particularly productive.

transitional costs in these countries in a timely manner and in ways that support rather than undermine local efforts to mobilize resources and build capacity. Several recent post-conflict recovery programs, including Rwanda, Bosnia and East Timor, demonstrate the high potential for aid-supported recovery and progress towards the MDGs in a post-conflict environment. However, recent research on aid and conflict indicates that there may be further room for improving the time profile of aid provision in post-conflict situations.[20] Specifically, the rebuilding of an institutional environment capable of absorbing large aid flows effectively typically occurs after about three to four years following the end of a conflict, while actual aid flows generally peak in the first or second year after the conflict ends and then taper off dramatically. Consideration of mechanisms for more targeted aid in the initial post-conflict period, while stretching the allocation of exceptional aid levels over time offer the potential for improving MDG outcomes in these countries.[21]

42. Exceptionally strong aid coordination is essential in all LICUS situations. The fragility of reform programs in these countries implies that donors must operate so that they do not swamp the limited political and technical capacity that exists, and their technical assistance and financial support should be aligned with a small number of realistic reforms. Virtually, all assistance to LICUS will have to be highly concessional, primarily in the form of grants, given their limited capacity to service external debt in the medium term. And, in post-conflict situations, the shift over time from humanitarian to development assistance will require more reliance on cash assistance rather than commodity aid, greater channeling through the government budget, and the use of competitive contracting rather than relying on single implementing agencies.

43. In shaping a consistent response by the international community to the situations in these countries, several gaps will also need to be filled in order to assess the likely effectiveness of increased aid flows. Information with regard to MDG outcomes in these countries needs to be improved and analyzed along with their prospects for improving policies and governance in order to identify cases where modest increases in aid over time, appropriately phased over time, would be particularly productive in terms of making progress towards the MDG targets. Filling these gaps, perhaps through the use of case studies, as has been done in this paper for better-performing countries, would help illustrate the extent to which changes are needed in the current allocation of aid to LICUS, particularly when the cross-border and regional effects of neglecting these countries are taken into account.

C. Middle-Income Countries

44. Unlike their low-income counterparts, most middle-income countries have already met or are on track to achieve the MDGs well before 2015. Also, most rely on domestic resources and private capital flows to finance the bulk of their investment needs. Yet these countries are still home to 280 million people living on less than US$1 per day and 870 million people living on less than US$2 per day. And, while other social indicators are, on average, better than low-

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[20] See, for instance, P. Collier and A. Hoeffler, "Aid, Policy and Growth in Post-Conflict Countries", World Bank Policy Research Working Paper 2902, October 2002.

[21] A similar model may be appropriate for severe LICUS that achieve successful peaceful governance turnarounds. Current aid patterns tend to provide higher flows to countries that have experienced violent conflict than others that succeed in resolving tensions and improving governance through peaceful means. This pattern may have the unintended effect of discouraging the emergence of responsible domestic leadership.

income countries, there remain important areas of social deprivation, many of which are even more closely linked to inequality in incomes, service provision and influence than in low-income countries.

45. As Figure 2 illustrated, middle-income countries received over a quarter of total aid flows in 2001. The case for aid in these countries in terms of accelerating their progress towards the MDGs varies with their diversity. The per capita income levels of these countries range from US$750 to more than US$9,000, and they differ also in terms of creditworthiness and the adequacy of their policies.[22] It is useful to distinguish between lower middle-income countries, with widespread deprivation and weak creditworthiness, China and upper middle-income countries with relatively good access to private capital markets.

46. The first category is illustrated by countries such as Guatemala, Peru, Morocco and the Philippines. In many respects, these countries are similar to the wealthier low-income countries in the sample. Levels of deprivation are often severe, as in the case of malnutrition in Guatemala or Peru, but not necessarily across all dimensions (primary schooling is almost universal in Peru for instance) or in all regions (the Northeast of Thailand is much poorer than the rest of the country). Many have weak tax efforts, for institutional and socio-political reasons. For countries that are not creditworthy, aid can help in implementing policy and institutional changes aimed at addressing inequality and deprivation. Even for countries that have some access to private capital markets (as with Peru), modest increments of ODA could play a crucial catalytic role in supporting faster progress towards the MDGs. Many of the considerations that apply to low-income countries such as Honduras and Albania apply to these countries as well in terms of the role for and likely volumes of additional aid that can be used effectively.

47. Although China is a lower middle-income country, it is worth considering separately because of its size, its track record in sustaining growth and reducing poverty, and its access to private capital flows. It has already achieved several of the MDGs and is on track to reach all of them by 2015. However, China still has about 200 million people who live on less than US$1 per day and 600 million below US$2 per day. Economic and social indicators also vary considerably between rural and urban areas, and between the poorer central and western provinces and the wealthier eastern and coastal zone. To address these problems will require comprehensive reform of the inter-governmental fiscal system in addition to sectoral reforms to improve service delivery. In tandem, it will require substantial incremental spending, the bulk of which will need to come from domestic sources. Aid can play a role at the margin by helping to advance the necessary policy and institutional reforms needed for China to achieve the MDGs more uniformly.

48. Not surprisingly, the pace of progress towards the MDGs or their achievement is highest among upper middle-income countries. However, even for these countries, there remain major areas of deprivation amongst specific groups or regions, which are associated typically with histories of social exclusion, institutional weakness or relatively weak income growth. In these cases, additional external assistance can be justified if it can complement domestic policy and institutional change in such poorer regions or focused on particular groups. Whether these increments take the form of ODA or non-concessional assistance depends on considerations of

[22] The paper only looks at middle-income countries with relatively good policies because there is no obvious development case for aid in middle-income countries with weak policies.

both national and sub-national creditworthiness. ODA flows could also help soften the impact of unforeseen external shocks on the poor.

49. ODA can play an important role in these cases where its use is part of a national or local compact to tackle policy, institutional constraints to reducing such deprivation, and where, for creditworthiness reasons (at national, local government or non-government levels), non-concessional borrowing is inappropriate. On the other hand, where these countries have at least some access to international capital markets, the form of the compact will be the same, but official non-concessional flows will play the primary role. In either case, official flows can go much further than private flows in supporting the kinds of policy, institutional and structural changes that are typically necessary to tackle the constraints to accelerated efforts to reduce deep-seated inequality and deprivation.

50. The bulk of the resources to accelerate progress towards the MDGs will have to come from domestic sources, at least in upper middle-income countries. Aid can help at the margin by reinforcing domestic efforts. Official flows can also provide support for counter-cyclical action to reduce vulnerability, along with short-term domestic action to strengthen social safety nets and long-run domestic action on financial strengthening, reducing debt burdens and building stronger fiscal systems. Over time, as income levels rise, official flows to middle-income countries should become increasingly non-concessional. And, in many cases, trade reform that provides greater access to developed country markets for goods and services from these countries can do more to support their domestic efforts to raise growth in poorer regions than will incremental aid flows.

IV. IMPLICATIONS FOR THE INTERNATIONAL COMMUNITY

51. The country studies on which this paper is based suggest that this is an opportune time for the international community to scale up its efforts to accelerate progress towards the MDGs in low- and middle-income countries. Scaling up to meet the MDGs will need action by the international community on four fronts. First, the country-level frameworks, provided by the PRSP approach in low-income countries, and national development strategies more generally, will need to be linked more explicitly with longer-term MDG targets and specify what countries and their development partners will do to meet these goals. Second, substantial additional aid will be necessary to support countries' efforts in improving their policies and governance. Third, the manner in which existing and new aid is provided will need to change. Finally, developed countries will need to provide greater market access to products from developing countries.

52. **Country-level frameworks**. In low-income countries, PRSPs are the vehicle by which policies, programs and resource requirements should be linked to the MDG outcomes. This will require that countries use their PRSPs in formulating medium-term goals and translating these into annual budgets and programs that also incorporate expectations concerning aid flows. The country studies illustrate that in order to do this effectively, a number of information and analytical gaps will need to be addressed in country-level work that informs PRSPs. In particular, the poor quality of information on MDG outcomes (or other national goals) will require a concerted effort to build statistical and analytical capacity in many countries. This will require

additional investments at the national and international level.[23] And, although it is clear that MDG outcomes have multiple determinants, there is limited country-level analysis or information concerning these links. The most progress has been made in terms of integrating the links between growth and poverty reduction. But, there are still large gaps for service delivery, where more progress has been made for education than health, and in bringing out the indirect role of infrastructure. With better information and analysis in these areas, which will need to be done with countries taking ownership in the context of the PRSP process, it will also be possible to get more robust estimates of aid requirements at the country level.

53. **Aid volumes**. The country studies confirm that in all 18 sample countries, additional aid in support of better policies and governance would greatly accelerate progress towards the MDGs over the coming decade. The basis for this conclusion is provided by three characteristics that these countries have in common: they have improved their policies over the past decade; they continue to use aid productively; and all of them have significant unmet development needs. The implications for additional aid that can be used effectively and its phasing over time vary widely across the sample countries. These variations reflect differences in: (a) existing policies and institutions and the pace at which these might be strengthened over time; (b) poverty incidence and, more generally, the extent of unmet needs vis-à-vis the MDG targets; and (c) current aid levels.

54. The case for large and immediate increases in aid (a doubling or more) is strongest for the five large low-income countries within Asia (Bangladesh, India, Indonesia, Pakistan and Vietnam). These countries have a combination of good policies and prospects for further improvement, large gaps with regard to key MDG targets and low levels of aid dependence. Among the Sub-Saharan African countries, Ethiopia and Madagascar have similar characteristics and could also absorb substantial increases in aid (a doubling or more) although these increases will need to be phased in more gradually as institutional capacity is built up.

55. The Sub-Saharan African countries in the sample as well as the Kyrgyz Republic could all use additional aid productively beyond the sizable flows most already receive — an increase of about 60 percent of current flows on average in the medium-term. Their incremental needs vary primarily with the amount of aid they currently receive, and will rise over time in absolute terms as their institutional and human capacities improve in tandem with policies and governance.

56. The countries with higher per capita incomes, such as Albania, Bolivia and Honduras, are similar in many respects to lower middle-income countries. They will continue to need aid but have smaller incremental needs — around 20 percent of current flows, on average. And, their aid requirements will fall over time as they tap non-concessional official resources and, eventually, international capital markets.

57. Although this paper does not attempt to extrapolate from these estimates for the sample countries to a new global estimate of aid requirements to meet the MDGs in all countries, it shows that substantial increases in aid can be effectively used in support of continued policy and

[23] Improving data is an important element of monitoring progress towards the MDGs and PRSP goals. To do this, many organizations are scaling up their statistical support activities. One example is the World Bank's new and simplified lending program focused on statistical capacity building (STATCAP).

institutional reforms in accelerating progress towards the MDGs. The donor community has committed to increase aid volumes by about US$16 billion annually by 2006. Based on extrapolating from the broad typologies of the sample countries, the absorptive capacities of LICUS and the supportive role of aid in middle-income countries, our assessment is that a larger sum will be needed — at least US$30 billion annually in addition to current aid flows. If this additional amount can be committed early, it can help create a virtuous circle in terms of the prospects for meeting the MDGs by encouraging countries, including some LICUS, to deepen and sustain their reform efforts. This is one reason that this estimate should be viewed as an initial and conservative one. Another reason that the amount of aid that could be used effectively in the medium term may be considerably larger is that, although this analysis has used the best available information at the country level, there are gaps in this analytical base. Of particular importance are those with regard to infrastructure needs, including those associated with export opportunities afforded by a successful Doha round; the costs of global public goods such as HIV/AIDS and the environment; the likely pace of capacity enhancement, which is difficult to predict over a decade; and the future costs of debt relief under HIPC and the implications of helping low-income countries deal with adverse shocks that lead to large income losses.

58. **Aid modalities**. It is clear that there is no one answer on what makes for good aid. A lot will depend on the circumstances in both the providing and recipient countries. What matters is that these two sides of the aid equation need to mesh at the country level. The main implications for aid modalities are therefore as follows:

- Support good policies with timely and predictable aid. The recent shift in aid allocations towards low-income countries with relatively good policies is a positive trend which should be continued. These countries are able to use aid well — thereby generating high returns in terms of progress towards the MDGs. Furthermore, as countries build a track record of policy performance, they should be rewarded by access to timely, predictable and long-term aid commitments. Progress towards the MDGs is necessarily a long-term process and requires sustained reforms of policies and institutions by countries. Such reforms are possible, especially in countries that already receive large aid flows, only if there is a reasonable degree of certainty about the levels of such flows and the circumstances under which they are likely to materialize.

  This does not mean that LICUS-type countries should be cut off from aid. In some cases, especially post-conflict countries, there can be very significant upfront and transitional costs for humanitarian assistance, as well as to rebuild infrastructure and provide basic social services. Other countries embarking on reform programs can also face unfavorable initial conditions in terms of arrears on external debt and negative net transfers of external resources. The challenge is to provide this aid quickly — without undermining local efforts to mobilize resources and build capacity. More generally, LICUS require very careful aid coordination and management, so as not to swamp the limited political and technical capacity that exists.

  As countries develop, and move into the category of middle-income countries, aid can still play an important role at the margin by reinforcing national or sub-national efforts to tackle pockets of poverty and deprivation, and in supporting counter-cyclical actions to reduce vulnerability to adverse shocks. The amount of additional aid these countries could use productively will start to decline as their incomes rise and the availability of domestic resources increases. And, for these countries, the balance of their reliance between concessional and non-concessional official flows will very much depend on their access to international capital markets.

- Align aid with country priorities and constraints. Aid should be provided in ways that are better aligned with the priorities as articulated in countries' poverty reduction or development strategies. This also implies that aid providers will improve their coordination, and harmonize their policies and procedures around the recipient country's own systems. A challenge here is to find ways to improve these systems, so that harmonization is not achieved at the expense of fiduciary standards.

  The mechanisms for providing aid will need to be modified in a way that allows assistance to be phased in and sequenced with improvements in country capacities. Such sequencing will ensure that aid will be used productively to allow faster progress towards the MDGs. It will also avoid potential problems associated with aid dependence in recipient countries. Aid volumes (as a share of GDP and government spending) should eventually decline, as countries develop stronger private sectors and improve domestic resource mobilization.

- Provide appropriate forms of aid on sustainable terms. Aid will need to be provided in a form that can finance the incremental costs of achieving the MDGs. Of the US$52 billion of official development assistance in 2001, around US$26 billion was available for program and project expenditures in recipient countries. The remainder of aid is allocated for special purposes including technical cooperation (consultant services and scholarships), expenditures on emergency and disaster relief, funding for debt relief and administrative expenditures associated with aid.[24] A much higher proportion of aid will need to be provided for financing of costs to meet the MDGs. Alternatively, proportionately higher volumes of aid will be needed than estimated in this paper.

  In many countries, the increased costs of achieving the MDGs are recurrent costs such as teachers' salaries, school textbooks, medicines and vaccines, and the O&M of basic infrastructure. Aid should be provided in ways that can meet this need — either through budget or sector-wide support in countries with sound budget frameworks, or by targeting assistance to well-designed sectoral programs (with clear links to the MDGs or national goals) and linked to improvements in financial and budget management frameworks. To address concerns about the long-term sustainability of such spending, it will need to be consistent with the growth and revenue potential of the economy, which is more likely if

[24] According to the Development Assistance Committee (DAC/OECD) data, of the US$52 billion of official development assistance (ODA) in 2001, US$33.4 billion is accounted for by bilateral grants, US$1.6 billion by bilateral loans, and US$17.3 billion in contributions to multilateral institutions. Special purpose grants as described above constitute US$22.1 billion, so that bilateral grants net of special purposes amounted to about US$11 billion. Of this, more than 80 percent are in the form of project grants in infrastructure and social sectors. Most bilateral donors provide aid in the form of grants rather than loans, but interest payments on past loans amounted to US$2.9 billion in 2001, offsetting the net loan commitments of US$1.6 billion. For multilateral institutions, net concessional flows to developing countries in 2001 amounted to US$15.5 billion compared to the gross contributions of US$17.3 billion.

financing is provided in the context of a budget framework with clear policy priorities and a long-term perspective on revenues and expenditures.

For a number of highly-indebted countries, especially in Africa, much of the additional aid will need to be provided in the form of grants rather than loans so as not to increase the risk of debt distress, while ensuring that the overall amount of assistance is still determined by the quality of policies. In general, more attention should be given to country policies and vulnerability to shocks in determining debt sustainability, and therefore the appropriate mix between loans and grants.

59. **Trade policy.** For many low- and middle-income countries, trade and aid complement each other. These countries' prospects for achieving the MDGs would be significantly enhanced with greater access to markets in developed countries. The highest tariffs faced by developing country exporters are on agricultural products, processed foods, and textiles and apparel — products that dominate their exports, especially for the poorest countries. Successful completion of the Doha Round of negotiations is therefore a high priority. At the same time, there is still ample scope for further trade reforms in developing countries, generating benefits from expanded north-south and south-south trade. And, the ability, particularly of low-income countries, to benefit from improved market access will depend on addressing behind the border issues such as upgrading physical infrastructure and improving customs and port administration. It is important, therefore, that trade policies and trade-related investments receive adequate attention in the formulation and implementation of countries' poverty reduction and development strategies. Aid for trade, particularly in the short run, will also be an important factor in realizing the gains from trade, especially in improving infrastructure (such as roads and ports). With progress in these areas, and enhanced market access in developed countries, the requirements for aid will be contained and eventually reduced over the medium-term.

60. This paper illustrates that there are opportunities as well as major challenges in scaling up efforts to meet the MDGs. It is clear that the way forward will require actions now on the part of both developing and developed countries. But, unless there is a sense of urgency, there is a serious risk that the MDGs will not be met across a broad range of countries. Many developing countries, including those studied for this paper, have put in place better policies and have used development assistance productively over the past decade as they have made progress towards the MDGs. This provides a strong foundation on which future efforts of the international community can build and represents a significant opportunity. This opportunity should be grasped with concerted action now to provide more and better aid and improved market access in support of developing countries' own efforts. At the same time, the challenge is for developing countries to sustain their progress in such areas as public expenditure management, governance and service delivery.

Annex 1: Summary of Country Studies

1. This Annex summarizes the key findings of the case studies for the 18 low-income countries that were prepared by Bank country teams as background for this paper.

2. The country case studies summarize trends since 1990 in the indicators of the MDGs and relate these to economic developments and policy changes. Each country study then considers the prospects for achieving the MDG (or PRSP) targets or significantly accelerating progress towards them by 2015 in two scenarios. These scenarios reflect the best judgments of Bank country teams, and are based on recent analytical work that has been done or is ongoing by the Bank, the countries (e.g., in the context of preparing or implementing their PRSPs), or their other development partners. (See Annex Table 2 for a list of Millennium Development Goals and Targets.)

3. The first scenario looks at prospects for progress towards the development goals if domestic policies and institutions remain roughly unchanged and aid levels continue as currently projected. The second scenario considers the prospects for achieving these targets or accelerating progress towards them if countries undertake significant policy and institutional reforms over the decade and receive additional external financing in the form of concessional resources. Hence, this case is ambitious in terms of both the extent to which countries undertake reforms as well as the scope for aid flows to rise above their historical levels. The focus in both scenarios in the country studies is not merely to look at whether or not the various MDG targets are met but rather to look at the implications for the pace of progress towards the targets and, where these can be met, to also consider the extent to which the target(s) can be exceeded, or in cases such as primary education, where the target is universal coverage, whether additional reform and aid would allow progress to be made on other dimensions such as quality. This approach is consistent with the view that the MDGs represent not absolute goals but rather a continuum along which progress is desirable.

4. The general approach to the second (ambitious) scenario in the country case studies is to look first at the implications of the proposed reforms for overall growth, both through improved efficiency of existing investment as well as higher levels of investment. Particular attention is focused on the institutional constraints to achieving higher growth, which imply that it will take time for growth to respond to policy reforms. The additional requirements for aid are then derived as the residual after taking account of how much of these higher investment needs can be financed by increases in private capital inflows and private domestic savings. The higher growth rates in this scenario will lead to an improvement of the pace of progress towards several MDG targets, particularly for income poverty and hunger and less so for education and health.[1] Also, some of the capital costs needed for progress towards the income and service delivery goals will be included in these incremental investment estimates. Other recurrent costs that will be associated with improving service delivery (such as teachers' and health workers' salaries and operating and maintenance costs) are estimated separately and added in to estimate total aid requirements at the country level.

[1] See World Bank, "World Development Report 2004: Making Services Work for the Poor," Overview, (September 2003).

5. While this conceptual approach is clear and is the basis for the country-level estimates, it is not straightforward to implement because of gaps in knowledge concerning the country-specific empirical relationships. One difficulty in estimating these relationships is the interdependence among the MDGs, which implies that progress along one front, such as clean water, has positive feedback effects on others, such as child mortality. A second problem is that the outcomes embodied in each MDG have multiple determinants. Little is known about the relative importance of each determinant, such as mother's education or clean water in reducing child mortality, about their interaction effects, and about how these impacts vary according to country characteristics.[2] For these reasons, there is a significant role for judgment in arriving at the country-level estimates that are used in this paper, and the country studies rely on those of World Bank country teams.

Albania

6. ***Retrospective.*** The Albanian economy underwent different phases of development following its transition to a market economy in 1991. In the early 1990s, Albania experienced a sharp contraction of real GDP (almost 15 percent p.a. in 1990-1992) and high inflation. This was followed by a period of significant economic recovery (average growth of more than 9 percent over 1993-1996) until the pyramid crisis of 1997 when growth declined by 7 percent. Albania, however, recovered very quickly from that crisis and growth averaged over 7 percent in the period from 1998-2001. Progress towards the non-income MDGs however, has not followed this generally strong growth performance, e.g., in education, where enrollments in basic education actually decreased during the 1990s.

7. ***Prospective.*** The outlook for Albania to meet MDG targets is generally favorable. With economic growth projected to remain strong at about 5 percent p.a., meeting the income poverty MDGs is well within Albania's reach. Prospects for growth, however, critically hinge on: continued implementation of structural reforms, particularly those directed at improving governance, removing obstacles for businesses, and fostering greater private sector activities. With additional funds for education, Albania can progress beyond the education MDGs. In health, the position is complicated by the fact that levels of child and maternal mortality are low by the standards of other countries at similar levels of income. So although Albania will be able to make progress on the health targets with additional resources and other complementary reforms, it is unlikely that it will be able to reduce child and maternal mortality by two-thirds by 2015 (which would bring mortality to the level of Western European countries). However, with low levels of external indebtedness by international standards, Albania is in a good position to absorb new assistance in the form of credits, although its absorptive capacity will depend on the extent of institutional reforms. With complementary reforms, it is estimated that Albania could absorb US$70 million per year in additional aid, which would likely allow the country to either achieve or make substantial progress towards all the MDGs (data for environmental targets unavailable).

Bangladesh

8. ***Retrospective.*** Progress towards the MDGs has been significant and for most indicators, Bangladesh is on target or better with respect to achieving the goals. The exceptions are maternal

[2] For a discussion of this and other reasons as to why the MDGs are difficult to cost, see Box 2.4, WDR 2004, op. cit.

mortality which is measured neither accurately nor frequently enough to judge with certainty, and child malnutrition where trend income growth alone will not be enough, and more emphasis on behavioral change communication will be crucial to achieving the goal. This remarkable progress can be attributed to three factors. First, economic growth has risen from 3.7 percent p.a. in the 1980s to 4.8 percent in the 1990s and over 5 percent in two of the last three years. Second, the government has given priority to public spending on education, health, the social safety net, and disaster management. Third, the involvement of committed NGOs and community-based groups, many of whom are world leaders in innovative ideas and operational methods, has helped.

9. ***Prospective.*** Despite the progress noted above, the challenges ahead for Bangladesh to continue economic growth and sustain progress on MDG goals are formidable. Child malnutrition is still among the highest in the world, and maternal mortality rates are among the highest outside Sub-Saharan Africa. Education quality is very poor in government schools at all levels. And, while most of the population now has access to clean water, arsenic levels in groundwater pose much different, and harder, problems than have needed to be solved to date. Since much of the improvement in social indicators is attributable to NGOs and community based groups, scaling-up to national levels will require active cooperation between government and these organizations. Meeting the MDGs will require much faster growth, which in turn depends on reforming the state sector (including the nationalized commercial banks), substantially improving the investment climate and tackling issues of governance.

10. Increased aid can help overcome some of the impediments to an improved investment climate in several ways. It can absorb some of the huge and necessary adjustment costs to convert state-owned enterprises and state-owned banks into commercial ventures. It can improve basic infrastructure that has not been a focus of NGOs and will be required to address needs for large projects such as port facilities. ODA can also help institute more efficient tax policies and administration by overcoming short run adjustment costs. Within the realm of social services, competent and accountable administration is needed to build on the successful track record of NGOs and communities. Absorptive capacity is high because overall levels of aid flows to Bangladesh are relatively low. Furthermore, the government has maintained macroeconomic stability such that more aid would not present problems; and has made a substantial contribution to social sector spending.

Benin

11. ***Retrospective.*** Compared to most African countries, and to its starting point of economic collapse and political crisis in 1989, Benin has achieved remarkable progress in sustaining robust growth over the past decade. Growth generally exceeded that of other economies in the region and productivity gains have allowed per capita income growth to rise from 1.1 percent per year over 1990-1995 to 2.3 percent over 1996-2000 and 2.8 percent in 2000-2002. The Government's structural adjustment program has been successful in establishing fiscal discipline, opening up the economy, privatizing most public enterprises, and strengthening private sector incentives. An assessment of Benin's performance in the 1990s however reveals a basic paradox: that of the successful implementation of a broad development strategy, with the perception of unrealized potential and unmet expectations, due in part to insufficient reform. Social indicators improved significantly throughout the 1990s, particularly in education and health. However, these achievements did not translate into significant progress in income poverty reduction.

12. ***Prospective.*** In the "base case" scenario, in which Benin's positive growth trend continues, but no significant reforms are undertaken nor additional resources provided, the outlook for achieving the MDGs is mixed. Although Benin could reach MDG targets in income poverty, hunger, primary enrollment and access to safe water, the prospects are such that it would fall short of other MDGs, especially in health. At present, the utilization rate of health services is approximately 34 percent. The "high case" scenario, in which growth accelerates, government revenue increases along with external financing, and debt sustainability is assured by increasing the proportion of aid in the form of grants, presents a more positive outlook for achieving the MDGs. In this scenario, the completion and HIV/AIDS targets are attainable, with added assurance of reaching the poverty and water goals. However, the gender, health (both under 5 and maternal mortality) and sanitation goals will remain difficult to attain by 2015. Gender disparity for primary and secondary school enrollment will be eliminated, but not at all levels of education. Benin's absorptive capacity is limited by deficiencies in public expenditure and financial management capabilities, the quality of public administration and policies, and the efficiency of service delivery. If these are progressively addressed over time, Benin could absorb between US$100 and US$150 million per year in additional aid over the coming decade.

Bolivia

13. ***Retrospective.*** As one of the first Latin American countries to implement structural adjustment policies and wide-ranging reforms, Bolivia achieved relatively strong economic growth performance over the last decade. Real GDP grew at an average of 4.2 percent per year over 1990-1998, or 1.8 percent per year in per capita terms. Growth during those years was catalyzed by a surge in public and private external financing in the context of a favorable external environment. But negative growth in 1999 and again in 2001 primarily due to external shocks, reduced the average annual per capita growth over the period 1990-2001 to 1.1 percent. The country progressed rapidly towards several MDGs, and has almost achieved MDG targets in education, gender equality and water and sanitation. Poverty reduction is also largely on track, but much remains to be done on health, despite declines in infant and maternal mortality rates.

14. ***Prospective.*** If Bolivia can average 1.7 percent per capita GDP growth p.a. over the period 2002-2015 — roughly the same growth experienced during 1990-1998 — the income poverty MDGs will be achieved. Assuring a sufficient rate of growth will require (i) governance reforms to streamline budget and regulatory processes, and reduce corruption; (ii) sustained macro-financial stability to enhance investor credibility; (iii) exploitation of new gas reserves; and (iv) implementation of mechanisms to buffer the impact of external shocks, and thus reduce the vulnerability of the poor to shocks. Additionally, a recent study suggests potential gains to growth could result from increases in infrastructure and human capital investment. Achievement of the health MDGs, however, will require sustained increases in the share of public expenditures to the health sector in order to reverse the declining trend experienced in the 1990s. In this context, incremental financing required is of the order of US$160 million per year, an amount that is within Bolivia's absorptive capacity. Under the above assumptions about reforms and the availability of resources, Bolivia could achieve all the MDGs by 2015.

Burkina Faso

15. ***Retrospective.*** Since the early 1990s, Burkina Faso's GDP has grown at annual real rates close to 5 percent, or almost 2.5 percent per capita. However, while 80 percent of employment is concentrated in the primary sector, much of the economic growth occurred in the manufacturing and services sectors, leading to stagnation in poverty reduction despite this aggregate growth performance. Progress towards non-income MDGs has been slow as well, with only minor improvements in school enrollments and in infant and maternal mortality rates.

16. ***Prospective.*** To meet the income poverty MDGs, Burkina Faso would need real GDP growth of between 6.5 and 7 percent p.a., or per capita growth of above 4 percent. Given the low share of the labor force in the faster-growing modern sectors, these estimates may fall short of the growth rates that are necessary. Trying to meet the other MDG targets will require massive additional resource inflows but the effectiveness of these is doubtful given the country's limited absorptive capacity. The enrollment target is achievable given increased growth, tax revenues, and a substantial increase in the number of teachers. Gender targets, however, will not be met due to the sizable disparities in primary levels. In health, most of the key indicators appear to have stagnated or worsened during the 1990s, despite various efforts to initiate sector reforms.

17. The disappointing progress in the 1990s can be in part attributed to weak policy implementation and declining spending in the health sector, developments which were reversed in 2000. In moving toward the MDGs, the effectiveness of health spending remains a concern, especially with respect to expenditure on health infrastructure. In most sectors, the major constraint is not aid, but deficiencies in attracting private investment, weak capacity, inefficient use of resources, and difficulties in delivering basic services on the local level. Given the country's dependence on aid flows, additional public investment will likely be of limited productivity, and strategies for accelerating growth would need to rely mostly on stimulating private investment. While some additional resources could undoubtedly be absorbed in carefully targeted areas in the short and medium term, the useful additional aid Burkina Faso could absorb would rise over time to about US$140 million if accompanied by policy reforms.

18. Beyond increasing aid flows, accelerating economic growth and progress towards the MDGs in Burkina Faso will depend on (a) attracting larger private investment flows; (b) diversifying the economy in order to accelerate growth, and substantially increasing the share of exports in GDP; and (c) reducing the stop-go nature of public spending and cushioning the impact of exogenous shocks. This will require reforms to improve the investment climate, greater access to developed country markets (especially for cotton and textiles), and targeted social protection measures with steady funding levels to reduce the impact of shocks on the most vulnerable.

Ethiopia

19. ***Retrospective.*** Following a decade marked by conflict and famine, Ethiopia's economic performance was encouraging in the 1990s, and estimates of poverty reduction range from 1 to 5 percent per year between 1995 and 2000. Market reforms and institutional strengthening in the period put Ethiopia on the right path, but the high volatility of growth demonstrated the country's continued vulnerability to exogenous shocks. Progress on the non-income MDGs accelerated in the second half of the decade, especially in education and water.

20. ***Prospective.*** In order to achieve the MDG targets, Ethiopia must make progress in three interrelated areas: (i) in the coverage of current programs and the quality of service delivery; (ii) in the extent and pro-poor nature of economic growth; and (iii) in a reduction in vulnerability to weather, sickness, and trade-related shocks. Under current trends, Ethiopia will not reach the education targets despite rising gross enrollments, and will fall short in all others. The health targets remain elusive with expected outcomes falling short of the target by approximately 70 percent. Growth acceleration is therefore crucial to improving outcomes. An acceleration of growth *and* additional ODA would allow Ethiopia to reach the targets on poverty and hunger. However, the health and water goals are much harder to reach. Moreover, the pace of structural reforms needs to be increased if Ethiopia is to achieve sustainable and higher real GDP growth.

21. Ethiopia receives relatively low levels of ODA compared to its counterparts in Sub-Saharan Africa. A doubling of aid would allow the country to reach the poverty, hunger, enrollment, water and sanitation and HIV/AIDS targets, and make much faster progress on the health, gender, and environment targets (but not reach them). Such a development is dependent on successful decentralization and capacity building efforts, which would increase the absorptive capacity. In order to reach the other MDG targets, Ethiopia would need to accelerate its policy efforts aimed at gender parity, health outcomes and environmental sustainability.

Honduras

22. ***Retrospective.*** Honduras experienced highly uneven growth over the last decade, with average GDP per capita growth of approximately 0.3 percent over the 1990s. This allowed for only marginal poverty reduction over the period in a country where about a quarter of the population lives in extreme poverty. Health and education indicators have shown improvement over the past decades, with particularly strong gains in health. However, inability to achieve sustainable economic growth jeopardizes progress towards the MDGs.

23. ***Prospective.*** The education sector provides an example of efforts to achieve the MDGs. EFA is expected to provide both the resources and the policy framework that will allow Honduras to achieve the enrollment and completion targets. In the health sector, recent improvements in implementation capacity should also help accelerate movement towards the MDG targets on maternal mortality and child health. On HIV/AIDS, improved implementation capacity, together with enhanced donor resources and increased donor coordination should have an impact in reducing the HIV prevalence rates, especially if supported by more effective policies on prevention. Still, the overall challenge for Honduras is achieving faster sustained economic growth that will compensate for the poor performance of the 1990s.

24. Weak institutional capacity presents a major obstacle to accelerating growth, aid absorption and effective service delivery. Reforms to improve governance are needed to restore private sector dynamism, which will be essential for sustained growth. Of particular importance are reforms to the public expenditure management system, in order to encourage fiscal discipline and efficient resource allocation in line with policy priorities. Developing a strategy for private sector participation and public spending on infrastructure is crucial to enhance the investment climate. With policy and institutional reforms, it is estimated that Honduras could effectively absorb an additional US$120 million in aid per year.

India

25. ***Retrospective.*** India has made good progress on growth and poverty reduction over the past decade. GDP growth has averaged 5.4 percent p.a. since 1990, and has been a major factor in reducing the poverty rate by 5 to 10 percentage points. Substantial progress has also been made in improving literacy, enrollment, completion and gender balance in primary education. However, much less progress has been made on health outcomes, especially maternal mortality and reducing malnutrition. Progress has been uneven regionally, leaving the greatest challenges in the four populous states of Uttar Pradesh, Bihar, Madhya Pradesh and Orissa, where more than half of India's poor live.

26. ***Prospective.*** Under current trends, India will likely achieve MDG targets in only income and food poverty, and access to safe drinking water. With better policies and institutions, India will likely reach MDG targets in all areas, except maternal mortality, HIV/AIDS and sanitation. Policy changes, such as reform of the electricity sector could "free up" funds for goals such as education. However, some of the required policy and institutional changes, such as greater openness on HIV/AIDS, are so demanding that the targets are unlikely to be attained even under a best-case scenario. Many of the needed reforms to achieve the MDG targets are at the state level. The challenge is to find ways in which to support states in order to attain the MDGs at a national level. This will call for progressively increasing state interventions that relate to meeting the MDGs. Furthermore, this entails channeling funds to states in ways that reward good performance on resource mobilization, expenditure management, service delivery and social outcomes. Ensuring that such performance-based funding reaches the "lagging" states will be a special challenge. The government will need to pursue more aggressive fiscal consolidation in order to help reform-minded states to meet their MDG challenges. Moreover, the poorest states tend to be the ones that have undertaken the least reforms, and even with progress in this regard, they will continue to be dependent on shared taxes and direct transfers from the central government for some time.

27. India receives negligible amounts of ODA by any measure: relative to its population of poor people, budget, policies, GDP and above all to the country's importance for achieving the MDGs globally. Given the small size of ODA relative to the economy, the role of ODA is not so much to meet a financing gap as to promote reforms and best practices, especially at the state level. The Government of India recently decided to accept bilateral aid inflows from only six countries. It has also argued that official development assistance is most efficiently delivered by multilateral agencies, and would welcome increased multilateral aid commitments. If provided in a responsive manner, linked to progress on reforms and social outcomes and with external financiers working in close partnership with the government to support state level reform, substantially increased aid flows to India could have a major impact on poverty – both in India and globally.

Indonesia

28. ***Retrospective.*** Indonesia's economic growth prior to the political and economic crisis of 1997-1998 was substantial. Real GDP per capita grew between 1990 and 1997 at an annual average rate of almost 5.5 percent. Despite the major economic contraction during the crisis, income per capita had rebounded by 2000 and was again increasing. Poverty reduction was also robust during the decade, with extreme poverty falling from 21 to 6.7 percent

between 1990 and 2000, implying that the MDG target for halving extreme poverty had already been achieved. The gender target has been met, and progress has resulted in a high probability of achieving the under 5 mortality target by 2015. Progress on education has stalled, but this is partly due to the already high enrollment and completion rates (both above 90 percent) with which Indonesia began the 1990s. Despite progress on access, quality issues remain in both health and education, and better accountability must complement increased financing. The prospect of reaching the environmental targets is highly unlikely given organizational and institutional constraints. Moreover, maternal mortality, and HIV/AIDS are at risk under current policies.

29. ***Prospective.*** Despite this impressive progress, the crisis made apparent the need for major governance reforms to underpin future economic growth in Indonesia. Consolidation of post-crisis reforms, infrastructure improvements, enhanced revenue mobilization and continued decentralization to improve service delivery are necessary to enhance the investment climate and make aid more effective. The international community has increasingly used community-based delivery mechanisms to control corruption and improve responsiveness to local demands. In the future, additional funding and assistance could also be directed to provincial or district local governments that demonstrate a commitment to pro-poor policies, stronger governance, resource mobilization, and a more competitive investment climate. Aggregation masks the disparity between regions on achieving the MDG targets, and decentralization offers the opportunity to direct funds to the regions most in need. Donors have also pushed for improvements in government procurement and financial management, backed by more fundamental legal reforms that would allow for a much-needed expansion of public investment in infrastructure. Additional aid may increasingly need to be in the form of concessional resources, to avoid loading the government with unmanageable levels of external debt.

30. With these ingredients in place, Indonesia has the potential to achieve all of the MDGs (with the possible exception of environmental resource loss) by 2015, and push well beyond them in poverty reduction and education. However, an improved investment climate is important for growth and revenue generation. Progress on deforestation will require a major change in government commitment and policies. Broader progress on non-income aspects of poverty, including vulnerability and security, will only come with sustained institutional reforms. There is also scope for more effective and efficient use of public resources, especially given the short-term fiscal constraints. Good governance is imperative, in particular improved accountability between client and service providers.

Kyrgyz Republic

31. ***Retrospective.*** After a period of severe economic contraction in the first half of the 1990s, the Kyrgyz Republic recovered with strong growth performance. Since 1996, annual GDP growth has averaged around 5 percent. While very few people live under $1 a day, there are still over 13 percent (2001) living under the national extreme poverty line -- the indicator for the localized poverty target. The 1999 Census data suggests that enrollment in basic education (grades 1 - 8) is of the order of 90 percent.

32. ***Prospective.*** Other than the poverty targets, the Kyrgyz Republic is unlikely to meet the MDGs without continued growth, substantial reforms and additional external resources. Despite positive education statistics, attendance is low and there is a definite risk of reversals on the high

enrollment and completion numbers. The Kyrgyz Republic is making progress in reducing infant and maternal mortality through its health reform program, supported by IDA and other donors. The incidence of HIV/AIDS is still quite low but action is needed to prevent its growth. However, under current trends, the under 5 and maternal mortality goals will not be achieved without significant improvement, in part due to the large inequities by income. Water and sanitation coverage are both low, and systems are in dire need of rehabilitation. Sustaining growth will be a priority -- in its absence, it would be difficult to reduce poverty and maintain spending. With growth of over 4.5 percent annually from 2003-2015, an additional US$75 million annually in aid, and a comprehensive package of economic and institutional reforms, the country will attain the income poverty, education, and the environment MDGs; and make faster progress, although not attain the child and maternal mortality targets.

33. A reform scenario would need to build on the following three blocks: (i) continued strong macroeconomic management; (ii) good performance in governance and banking sector reforms; and (iii) tangible improvements in the enabling environment for private business. Barring external shocks and adverse regional environment, strong progress should be translated into: strong economic growth; further fiscal adjustment; a well-designed debt sustainability strategy; public expenditure management reform; export diversification, and a continued shifting from public to private sector-led growth. Decentralization of service provision, enhanced revenue mobilization, continued capacity building, and privatization would be needed as elements of a necessary reform package. It is important to note, however, that this is an ambitious agenda and sustaining reforms will not be easy over a long period.

Madagascar

34. ***Retrospective.*** Historically, Madagascar's economic performance has been poor, with real per capita income being halved between 1960 (independence) and the beginning of the new millennium. Recent years have been no exception to this trend; per capita GDP growth was negative from 1991-1996, and again in 2002 (a year of political and economic crisis). Poverty reduction has also been dismal; both the poverty headcount rate and extreme poverty increased between 1993 and 2002. However, progress over this period has been impressive with respect to the MDG targets for gender equality, primary school enrollments, and deforestation. There has been slow progress towards health-related MDGs.

35. ***Prospective***. Under current trends, Madagascar should achieve a number of the MDG targets (complete enrollment in primary school; gender equality at all levels of education; halting spread of HIV/AIDS and malaria and halting deforestation) if current development policies and aid levels continue. However, the likelihood of reaching a key number of other MDGs (extreme poverty and hunger, child and maternal mortality, and primary school completion) is low, and their achievement would require (unprecedented) growth, private investment, external aid and deep public sector reforms. Specifically, growth per capita would have to accelerate to 3 percent p.a. until 2015, and the pro-poor orientation of this growth would have to improve significantly as well.

36. With better policies, institutions and additional aid together stimulating pro-poor growth, Madagascar could achieve all the MDGs except the child and maternal mortality goals. Additional foreign assistance (grant and credit) requirements are estimated to be initially around US$180 million per year (2004) and rising in line with increasing GDP to be about

US$370 million in 2015 (2003 prices). This would imply an increase of foreign assistance (grants and credits) from around 6 percent of GDP to 9.3 percent of GDP (from 2004 onwards), and several sectors would need to increase absorptive capacity. Short-run additional absorptive capacity is likely to limit investment to that in infrastructure sectors (and current spending in education and health). In the short run, additional investment lending would need to be absorbed through traditional project lending. In the medium term, a move towards programmatic lending through pooled donor assistance is possible if key institutional reforms in public expenditure management and procurement are completed.

37. Reactivation of economic growth will be aided by reforms both within the public sector (to increase effective aid utilization) and with respect to creating a secure environment for private investment (which would be complementary to any increased aid inflow).

Mali

38. ***Retrospective.*** Mali's economic performance has been strong in recent years, with average annual growth of 5 percent since 1994 (2.5 percent p.a. in per capita terms). This favorable macroeconomic performance can be attributed to the effective implementation of macroeconomic stabilization and economic liberalization policies, which created the foundations of a market-led economy and encouraged private sector development. Despite the strong growth experienced since 1994, Mali's economic performance remains fragile in view of the economy's vulnerability to climatic conditions, fluctuating terms of trade, dependence on ports in neighboring countries and the concentration of its exports in three primary sector products. The growth experienced since the 1994 devaluation also masks significant annual volatility. Progress on poverty reduction is uncertain due to lack of reliable data, but progress has been made towards MDG targets in education, water and sanitation, and HIV/AIDS, although less so in health.

39. ***Prospective.*** The challenge for Mali is to formulate a policy and capacity building package, which will increase growth beyond the real average annual rate of 5 percent to an ambitious average of 8 percent, in order to significantly reduce poverty. New sources of growth will need to be promoted, as cotton and gold production alone will be insufficient to ensure high sustainable growth. Mali is well positioned to meet MDG targets on poverty, enrollment, HIV/AIDS and access to safe water. Although net primary enrollment rates should be met on current trends, issues of access and quality constraints will need to be addressed. However, the outlook for achieving the MDGs on health, gender, and sanitation is not as favorable. The prospects for gender parity at the primary and secondary levels may be better than indicated due to measures now being taken to improve the enrollment and retention of girls in school. For water, sustainability of the existing and new infrastructure would need to be assured through strengthened operations and maintenance. It should be noted also that while the national averages of the indicators may reach the MDGs, regional disparities will remain, as will those between urban and rural areas. The environmental and sanitation programs will need considerable attention to realize progress and meet the increased pressures stemming from population growth and intensified urbanization.

40. Institutional reform will be necessary to place Mali on a more stable path of progress. Constraints to progress in the current environment include weak capacity at the local levels, poor resource mobilization (including poor transfers from the central entities), inconsistency between

national sector programs and local development plans, poor governance and a weak institutional framework. The country would be well positioned to achieve the MDGs once various ongoing reforms become entrenched, and the constraints that hinder the effective and efficient provision of public services and rapid private sector growth are removed.

41. At this stage, the binding constraints are of an institutional and managerial capacity rather than of financial capacity, although it must be noted that some additional financing would facilitate progress on the institutional and managerial reforms needed to be able to make significant progress on sector programs. Once the institutional reforms are advanced, Mali should be able to absorb significant additional resources. In health and sanitation, although additional resources would accelerate second-generation policy measures to stimulate growth and productivity improvements, the MDG targets would still not be met. Estimates for additional annual financing necessary to achieve the MDGs are of the order of about US$165 million. Additional financing for the social sectors would need to be phased in view of the absorptive capacity constraints.

Mauritania

42. ***Retrospective.*** Mauritania's per capita GDP growth has averaged about 2 percent since 1995, but the economy remains vulnerable to exogenous shocks. Poverty reduction has been positive during the 1990s; those living below the poverty line declined from 56 to 47 percent over the period 1990-2000. However, poverty reduction was slower in the latter half of this period, due principally to lackluster growth in the primary and secondary sectors, where most of the populace earns its income. Progress was painfully slow in reducing child and maternal mortality, and the education sector was plagued by high repetition and attrition rates, despite rising gross enrollments.

43. ***Prospective.*** Under current trends, Mauritania will meet only one of the MDG targets, gender parity. The prospects for eliminating gender disparity are good as gender equality at both the primary and secondary level has almost been attained. At the same time though, completion rates declined between 1999 and 2001. Proper management of aid flows from donors and EFA, as well as the transfer of these funds to decentralized levels, such as communities and schools will be needed to accelerate progress to the education targets. For Mauritania to reach the income poverty MDGs, real GDP growth must accelerate. This is highly dependent on development of the private sector, which will require substantial reforms to enhance the business climate, among them: developing adequate infrastructure; removing remaining barriers to competition and factor mobility; improving the legal and regulatory environment; further streamlining tax regulations; improving savings mobilization; developing financial intermediation to facilitate access to services and credit; and lowering production and transaction costs. Achieving the health goals requires reforms to increase the availability of human resources and of essential supplies; strengthen the management and administrative capacity at all levels of the health system; and improve the participation of beneficiaries.

44. With accelerated growth, policy and institutional reform and additional aid the situation is more promising, with the goals for poverty, hunger, enrollment, gender and water achieved. However, to reach the income poverty MDGs will require better ability to absorb the existing flows of funds (only 50 percent of HIPC resources have been spent so far). In this respect, public expenditure management reform is vital.

Mozambique

45. ***Retrospective.*** Mozambique has experienced rapid economic growth since the signing of the peace accords in 1992, with annual real GDP growth falling below 7 percent in only two years during the period 1993-2002. Mozambique's recovery from the devastating floods of 2000 is almost complete, as the economy grew by 8.3 percent in 2002. However, progress towards the MDGs has been less dramatic, with only marginal improvement in under-five mortality during the 1990s and low primary completion rates despite rising enrollments. Mozambique also lags its neighbors in water and sanitation access.

46. ***Prospective.*** With current policies and aid flows, the MDG targets for income poverty, hunger and primary enrollment are likely to be met. However, making faster progress towards the other MDG targets will require significant reforms and substantial additional resources. However, given the country's high aid dependence (approximately 12 percent of GDP in grants and concessional loans), sustainability and absorptive capacity are significant limiting factors at present. There are serious problems with absorptive capacity in most sectors due to limited managerial capacity in government ministries, and in some sectors, policy and organizational difficulties that would result in ineffective use of increased concessional finance. As a result, effective use of concessional finance cannot rise swiftly in education, health, water supply, sanitation or agriculture. However, financing could increase substantially and effectively in road rehabilitation, and sewage and drainage in the medium-term (3-5 years) provided certain key policy conditions are met. In aggregate, the estimated additional aid requirements would rise from about US$85 million to US$225 million over the period 2004-2015 as absorptive capacity increases and policy constraints are relaxed.

47. Lack of reliable data for many MDG indicators makes it difficult to assess the likelihood that Mozambique will achieve several MDG targets. However, in the scenario with policy and institutional reforms and additional aid (as envisaged under EFA for education), it is possible that by 2015, progress could be made beyond the income poverty goal. The targets could also be met with regard to primary completion, HIV/AIDS and access to water. However, the gender equality target as well as the child and maternal mortality goals likely will not be met even in this scenario.

Pakistan

48. ***Retrospective.*** Economic growth in Pakistan slowed significantly from 6.5 percent in the 1980's to just over half of that level in the last half of the 1990s, and poverty reduction stalled. Growing debt problems and defense expenditures increasingly crowded out spending on social sectors. Further, implementation problems -- of the Social Action Program for example -- have hampered effective use of whatever spending that occurred. As a result, progress towards the education and health MDGs has been painfully slow, and current levels of primary enrollments, gender balance, infant and maternal mortality are poor compared to other countries in the region.

49. ***Prospective.*** However, Pakistan appears to be at an important turning point and there are hopes of reversing the weak economic and social performance witnessed for more than a decade. The government has recently made progress on reducing the debt burden and creating "fiscal space" for human development expenditure to address the social gap. However, the priorities for

the medium-term should include further reduction of public debt through further fiscal adjustment. The key now is to strengthen governance in the public sector and implement reforms to improve the climate for private investment. Such measures could raise growth to 6 percent p.a., and have a major impact on poverty reduction. Progress has been made in terms of decentralization, with significant devolution of power to local governments (including with regards to health and education expenditures). Over the longer term, further progress may well provide some of the delivery vehicles needed to respond to local demand and improve the quality of services. In this more favorable environment, additional aid could help kickstart the poverty strategy and accelerate progress towards the MDGs, especially in the education and health sectors where there are sizeable challenges. There appears to be enormous demand for education as witnessed by the rapid expansion of private education in the past decade, even at the primary level. Concerted efforts are underway to improve monitoring of outcomes, especially in the health and education sectors, which is essential to track progress and ensure that progress is being made.

50. Although Pakistan would be on track to reach the MDG target only in access to safe drinking water under current funding, policies and institutions, improvements in each of these areas could allow the country to achieve the MDGs in all areas except maternal mortality and environment (data on HIV/AIDS are not available). This would, however, require major reorientation of institutional arrangements such that services become more outcome oriented.

Tanzania

51. ***Retrospective.*** Following a period of mediocre growth performance in the first half of the 1990s, economic reform led to a recovery of growth in Tanzania during the second half of the 1990s and into the current decade, with average GDP per capita growth of around 3 percent over the past four years. The reforms are credited with placing the country on a sustainable growth path, with less vulnerability to external shocks. Tanzania made progress in poverty reduction, primary school enrollment and access to safe drinking water over the period, but experienced some setbacks in under 5 mortality rates and in halting the spread of HIV/AIDS.

52. ***Prospective.*** Economic growth per capita in Tanzania is projected to be around 2.5 percent annually, rising to 3.4 percent if the country can reform its institutional and policy environment to the level of India, Brazil or Namibia. If growth is extended sufficiently to rural areas, the outlook for attaining the MDGs is favorable, with the exception of health. However, economic growth in the projected range by itself is unlikely to lead to the achievement of the MDG goals. Specific efforts to reach the service delivery targets will be required, in terms of both increased aid and enhanced absorptive capacity. Additional public sector investment required to reach the MDG targets is estimated at US$350 million annually, though the proportion required in aid depends in large measure on the success of efforts to improve domestic revenue mobilization. With almost half of the FY04 fiscal budget financed by foreign credits and grants, debt sustainability will require enhanced grant financing. Institutional quality needs improvement to raise absorptive capacity, particularly at the local level, where education and pay levels of civil servants are low.

53. If current funding, policies and institutions are continued, Tanzania will likely achieve MDG targets in primary school completion, halting the spread of HIV/AIDS and forests/environment. However, if additional required funding is made available and policy and

institutional reforms are undertaken, Tanzania will likely meet MDG goals with regard to poverty, hunger, gender, and the environment, in addition to primary education but will fall short with respect to maternal and child mortality where the impact of HIV/AIDS on mothers and medical personnel will make the targets difficult to reach.

Uganda

54. ***Retrospective.*** Economic growth performance was quite strong in Uganda in the early 1990s, averaging 6.9 percent annually. Over the last decade, Uganda made substantial progress on the goals of income poverty reduction, education enrollment, gender parity in primary education, HIV/AIDS, and increasing access to safe water. On the other hand, substantial challenges remain in ensuring gender parity in secondary education, reducing infant, under 5 and maternal mortality, and improving environmental sanitation. But, economic growth has slowed in recent years to levels below 5 percent per year, jeopardizing the strong progress made in poverty reduction and other sectors.

55. ***Prospective.*** To reach the MDG target for poverty reduction, Uganda must maintain a real GDP growth rate of 6 percent -- a feasible goal, given past performance, but not a foregone conclusion. Enhancing investor confidence, improving service delivery in education and health, financial deepening and upgrading infrastructure have been identified as key determinants of the future progress towards attaining the MDGs and national poverty goals. Any substantial growth payoff in the future will require a deepening of institutional reforms. More importantly, future growth will require deeper structural change combined with sustained human and physical capital accumulation.

56. Additional resources will almost certainly be necessary if Uganda is to go significantly beyond reaching the poverty, enrollment and HIV/AIDS targets by 2015. However, the absorptive capacity of the country already appears to be stretched. With over half of the government budget financed by external sources, sustainability is a concern. The government's priority is to restrain the growth of public expenditure to a rate that is lower than the growth of domestic revenues, in order to reduce the fiscal deficit. The government appears not to want more aid in the aggregate, unless there is a shift in the composition of aid away from project aid and towards general budget support. Given these constraints, progress towards the MDGs will depend upon sustained economic growth, increased efficiency of service delivery, and inter-sectoral reallocations, along with additional aid phased in over time. Additional aid requirements will increase to about US$310 million annually by 2015. In this scenario, Uganda will likely be able to go beyond the income poverty, hunger and HIV/AIDS targets by 2015, while also reaching the primary enrollment, gender and water goals. The child and maternal mortality goals, however, will still be difficult to reach.

Vietnam

57. ***Retrospective.*** Vietnam has experienced rapid and equitable growth in the last decade as it transitioned from central planning to a market economy. Average annual GDP per capita growth between 1990 and 2000 was an impressive 5.9 percent. Per capita growth deceleration during the Asian crisis years was mild, never falling below 3.4 percent. Vietnam's growth has also been strongly pro-poor: aggregate inequality indicators such as the Gini index remained basically unchanged over the 1990s. More disaggregated analyses show that the poor did better

than the rich, in relative terms. The combination of fast growth and stable inequality explains the remarkable accomplishments of Vietnam in terms of poverty reduction, as the poverty MDGs have already been met. Progress in other sectors has been robust as well, with the enrollment and completion goals attainable.

58. ***Prospective.*** The outlook for growth in Vietnam is for continued strong performance, although there is concern that the substantial positive effects of land redistribution on growth and equity have run their course. To consolidate growth and progress sufficiently towards the health, water and sanitation MDGs, Vietnam must carry out significant institutional reforms in the coming years. Equity considerations are highly relevant to reach both the MDGs and VDGs (the Vietnam Development Goals or localized MDGs), in particular the affordability of education and health care for poor households. The recently completed Comprehensive Poverty Reduction and Growth Strategy (CPRGS) commits Vietnam to full openness to the global economy over the coming decade, and the creation of a level playing field between the public and the private sectors. It emphasizes that the transition should be pro-poor, and notes that this will require heavier investment in rural and lagging regions, and a gradual reform implementation. Policy changes will increase absorptive capacity and the effectiveness of aid, but sustaining progress will require improved public expenditure planning to better align with the stated goals, especially linking nationally-defined targets to sub-national planning and budget processes.

59. Building administrative capacity, especially at the provincial and local levels, will be crucial to the effectiveness of policy implementation. Modernizing the legal and institutional framework that was inherited from the era of central planning into one more adapted to current needs will be a daunting challenge. Creating a vibrant private sector that can compete internationally and provides employment opportunities will also be key, especially as state-owned enterprises privatize and contract. Given Vietnam's substantial progress thus far and its improving investment climate, these reforms along with additional aid will place the country on track to achieve all the MDGs by 2015.

Annex Table 1: Low Income Performing Countries — Key Indicators

	Income per capita (2001 US$)	Av. GDP growth (percent p.a., 1990-2001)	Population (millions)	No. of poor living below $1/day (millions)	No. of poor living below $2/day (millions)	ODA (2001 US$ billions)	ODA/ GDP (percent)	ODA per capita (2001 US$)	Number of countries in the group
India	460	5.4	1,032.4	358.2	825.2	1.7	0.4	1.7	
Pakistan	420	3.8	141.5	18.9	92.7	1.9	3.3	13.7	
Bangladesh	360	4.8	133.3	48.0	110.4	1.0	2.2	7.7	
Indonesia	690	4.1	209.0	15.0	115.7	1.5	1.0	7.2	
Vietnam	410	7.5	79.5	14.1	50.6	1.4	4.4	18.0	
Asian Sample	***476***	***5.2***	***1,595.7***	***454.3***	***1,194.7***	***7.6***	***1.1***	***4.8***	***5***
Albania	1,340	1.5	3.2	n/a	0.3	0.3	6.5	85.0	
Benin	380	4.8	6.4	n/a	n/a	0.3	11.5	42.4	
Bolivia	950	3.5	8.5	1.2	2.9	0.7	9.1	85.6	
Burkina Faso	220	4.7	11.6	7.1	9.9	0.4	15.6	33.7	
Ethiopia	100	4.0	65.8	53.9	64.7	1.1	17.3	16.4	
Honduras	900	3.1	6.6	1.6	2.9	0.7	10.6	102.9	
Kyrgyz Republic	280	-3.2	5.0	0.1	1.7	0.2	12.3	38.0	
Madagascar	260	2.1	16.0	7.8	13.3	0.4	7.7	22.2	
Mali	230	3.8	11.1	8.1	10.0	0.3	13.2	31.5	
Mauritania	360	4.1	2.7	0.8	1.9	0.3	26.0	95.2	
Mozambique	210	6.3	18.1	6.8	14.2	0.9	25.9	51.7	
Tanzania	270	3.2	34.4	6.9	20.5	1.2	13.2	35.8	
Uganda	260	6.4	22.8	6.2	22.0	0.8	13.8	34.3	
Other Sample	***273***	***4.0***	***212.2***	***100.5***	***164.1***	***7.5***	***15.1***	***35.5***	***13***
All Sample	**452**	**5.0**	**1,807.8**	**554.8**	**1,358.9**	**15.1**	**2.7**	**8.4**	**18**
Other Low Income (Relatively Good Policies)	***481***	***1.1***	***329.5***	***68.8***	***157.6***	***11.0***	***8.9***	***33.4***	***39***
All Low Income (Relatively Good Policies)	**456**	**4.4**	**2,137.3**	**623.6**	**1,516.5**	**26.1**	**3.7**	**12.3**	**57**

Annex Table 2: Millennium Development Goals and Targets

Goals	*Targets*
1. Eradicate extreme poverty and hunger	• Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. • Halve, between 1990 and 2015, the proportion of people who suffer from hunger.
2. Achieve universal primary education	• Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.
3. Promote gender equality and empower women	• Eliminate gender disparity in primary and secondary education, preferably by 2005 and in all levels of education no later than 2015.
4. Reduce child mortality	• Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.
5. Improve maternal health	• Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.
6. Combat HIV/AIDS, malaria and other diseases	• Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. • Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.
7. Ensure environmental sustainability	• Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. • Halve, by 2015, the proportion of people without sustainable access to safe drinking water. • Have achieved, by 2020, a significant improvement in the lives of at least 100 million slum dwellers.
8. Develop a global partnership for development	• Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system. • Address the special needs of the least developed countries. • Address the special needs of landlocked countries and small island developing states. • Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. • In cooperation with developing countries, develop and implement strategies for decent and productive work for youth; • In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries; • In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Annex Table 3: Sample Countries - Trends in Selected Economic Indicators

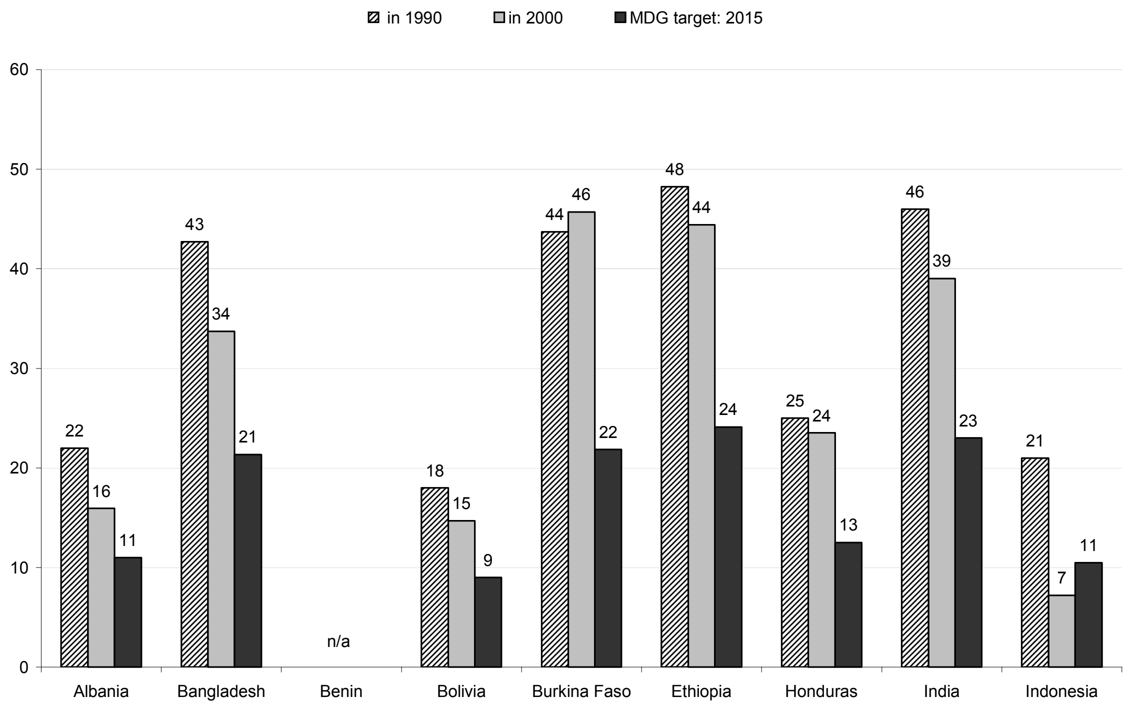
	GDP growth (percent, per annum)			*Revenue/GDP (percent)*			*ODA/GDP (percent)*			*Investment Rate (percent of GDP)*			*Agricultural Exports (US$ millions)*		
	1990	**2001**	**Av. 1990-2001**	**1990**	**2001**	**Av. 1990-2001**	**1990**	**2001**	**Av. 1990-2001**	**1990**	**2001**	**Av. 1990-2001**	**1990**	**2001**	**Av. 1990-2001**
Albania	*-9.6*	*6.5*	1.5	..	..	18	*0.5*	*6.5*	14.9	*29*	*19*	16.1	..	*18.3*	17.0
Bangladesh	*5.9*	*5.3*	4.8	..	..	9	*7.0*	*2.2*	3.9	*17*	*23*	19.8	*117.0*	..	97.9
Benin	*3.2*	*5.0*	4.8	..	..	..	*14.5*	*11.5*	12.8	*14*	*19*	16.8	..	*245.0*	297.6
Bolivia	*4.6*	*1.2*	3.5	*14*	*17*	16	*11.2*	*9.1*	9.3	*13*	*13*	16.8	*74.1*	*38.5*	73.6
Burkina Faso	*-1.5*	*5.6*	4.7	*11*	..	14	*12.0*	*15.6*	17.7	*21*	*25*	24.4	..	..	142.6
Ethiopia	*2.5*	*7.7*	4.0	*17*	..	17	*11.8*	*17.3*	13.2	*12*	*18*	14.7	..	..	67.7
Honduras	*0.1*	*3.3*	3.1	..	..	..	*14.7*	*10.6*	9.9	*23*	*31*	30.8	*33.2*	*52.7*	38.6
India	*5.8*	*5.5*	5.4	*13*	*13*	12	*0.4*	*0.4*	0.5	*24*	*22*	23.0	*718.8*	..	508.8
Indonesia	*9.0*	*3.4*	4.1	*19*	*21*	18	*1.5*	*1.1*	1.1	*31*	*22*	26.2	*1,283.7*	*2,084.6*	2,142.8
Kyrgyz Republic	*5.7*	*5.3*	-3.2	..	*16*	16	*n/a*	*12.3*	12.9	*24*	*18*	18.0	..	..	48.2
Madagascar	*3.1*	*6.0*	2.1	*12*	..	10	*12.9*	*7.7*	11.9	*17*	*16*	12.9	*12.8*	..	24.0
Mali	*-1.9*	*1.5*	3.8	..	..	..	*19.9*	*13.2*	17.0	*23*	*21*	22.2	*222.6*	..	358.2
Mauritania	*-1.8*	*4.6*	4.1	..	..	..	*23.3*	*26.0*	23.0	*20*	*27*	20.9	..	..	0.0
Mozambique	*1.0*	*13.8*	6.3	..	..	..	*40.7*	*26.2*	40.0	*16*	*37*	23.3	..	*28.1*	25.0
Pakistan	*4.5*	*2.7*	3.8	*19*	*16*	17	*2.8*	*3.3*	2.0	*19*	*16*	18.4	*561.5*	*184.8*	346.7
Tanzania	*7.0*	*5.7*	3.2	..	..	..	*27.5*	*13.2*	17.7	*26*	*17*	20.5	..	..	102.9
Uganda	*6.5*	*4.6*	6.4	..	*11*	11	*15.5*	*13.8*	15.4	*13*	*20*	16.5	..	*68.4*	47.9
Vietnam	*5.1*	*6.8*	7.5	..	*20*	21	*2.9*	*4.4*	4.1	*13*	*31*	24.7	..	..	..

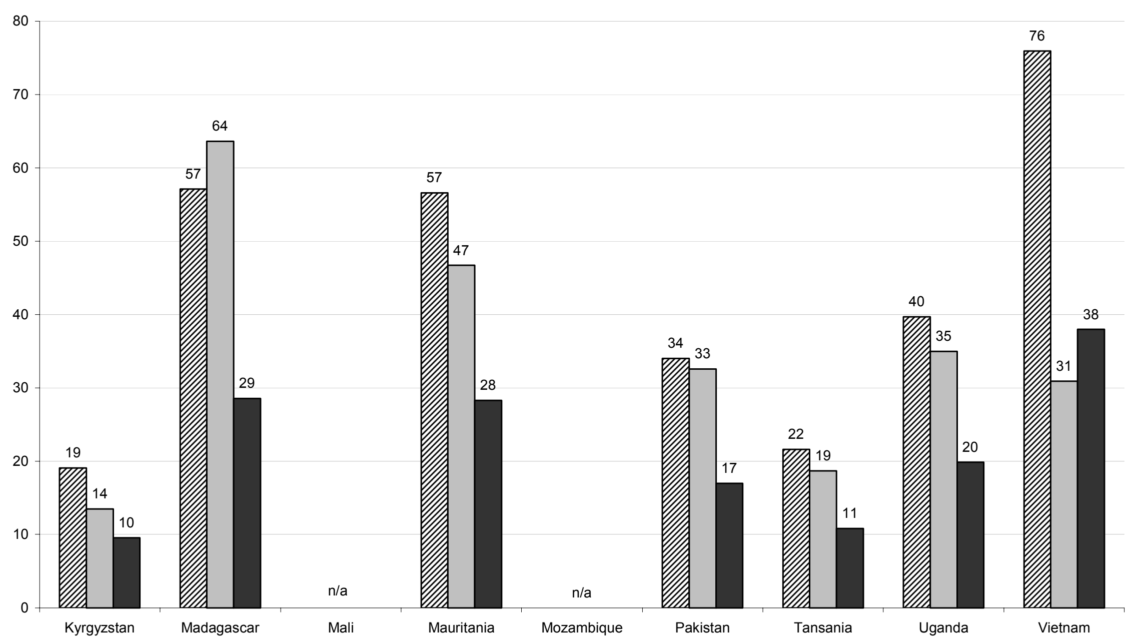
Annex Table 4: OECD countries: Trends in selected indicators

OECD Countries	**1990**	**2001**	**Av. 1990-2001**
GDP growth (percent, per annum)	*2.9*	*0.7*	2.3
ODA (US$ billions) [1]	*56.7*	*57.9*	62.1
Agricultural Imports (US$ billions)	*79.6*	*87.2*	90.5

1/ ODA to countries and territories in parts I and II of the DAC list of aid recipients

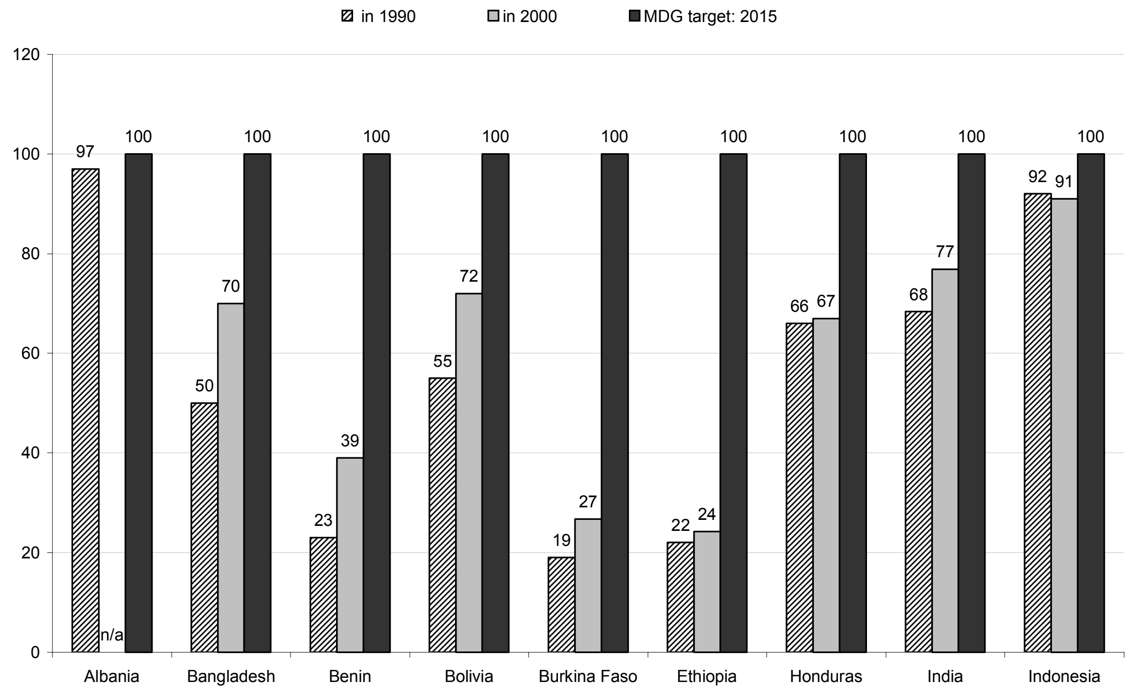
Annex Figure 1: POVERTY: population living on less than US$1 per day (percent)[3]

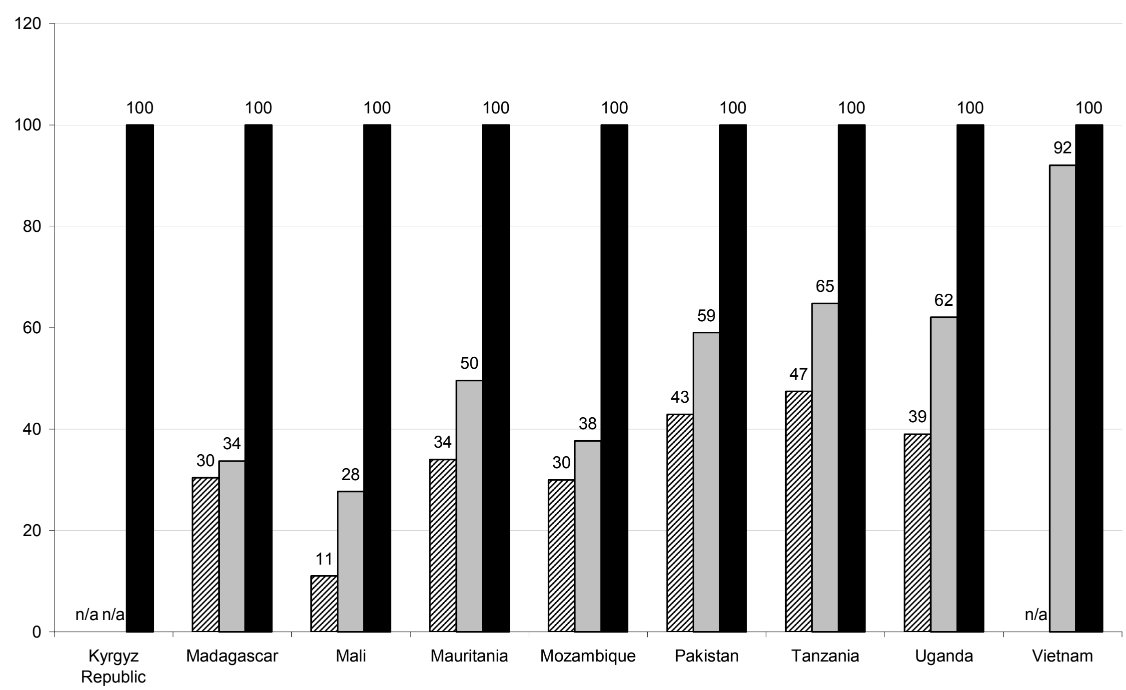




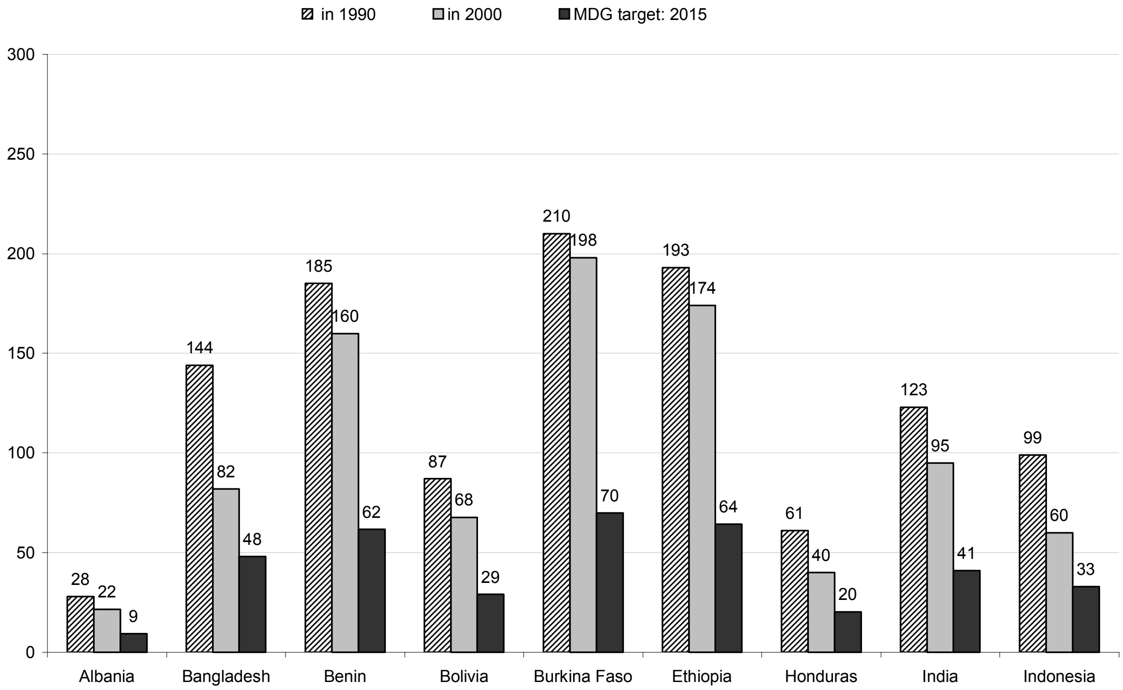
[3] Information on number of people living below national poverty line is used, when US$1 per day figures are not available.

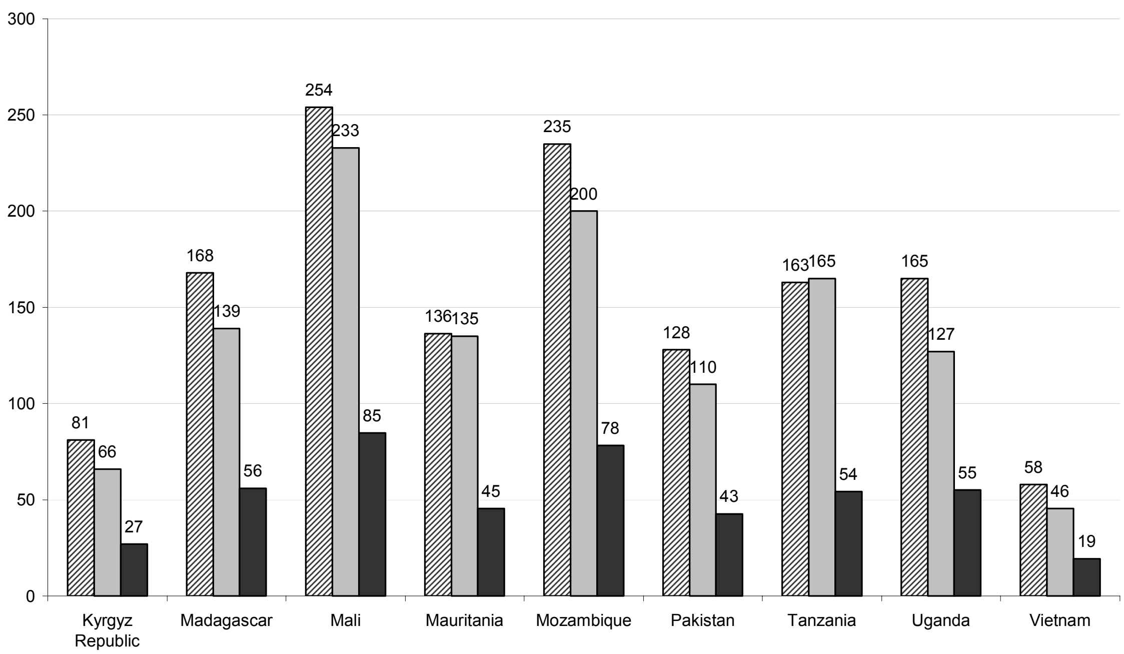
Annex Figure 2: EDUCATION: primary completion rate (percent)



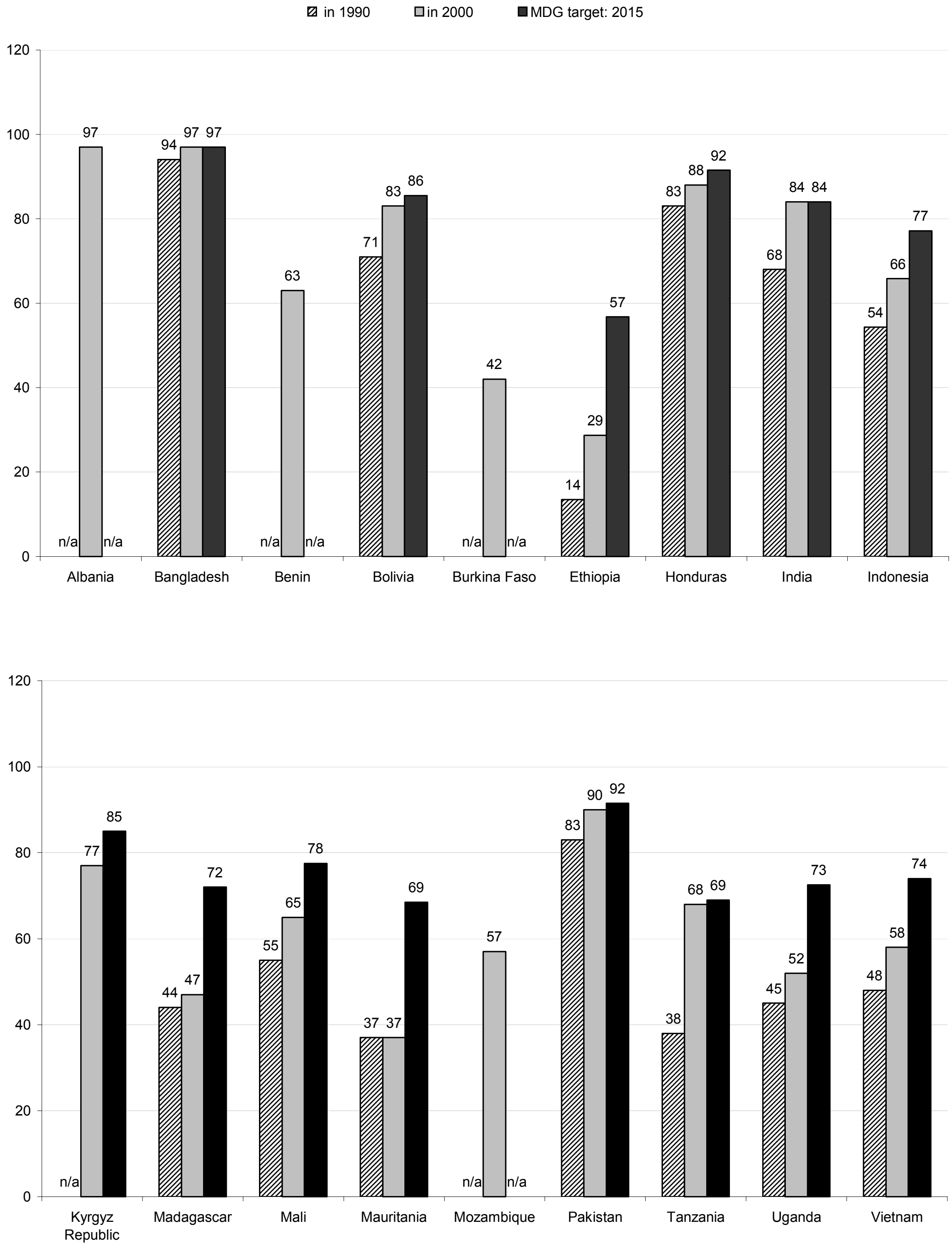


Annex Figure 3: HEALTH : Mortality rate, under-5 (per 1,000 live births)





Annex Figure 4: ENVIRONMENT: access to water (percent of population)

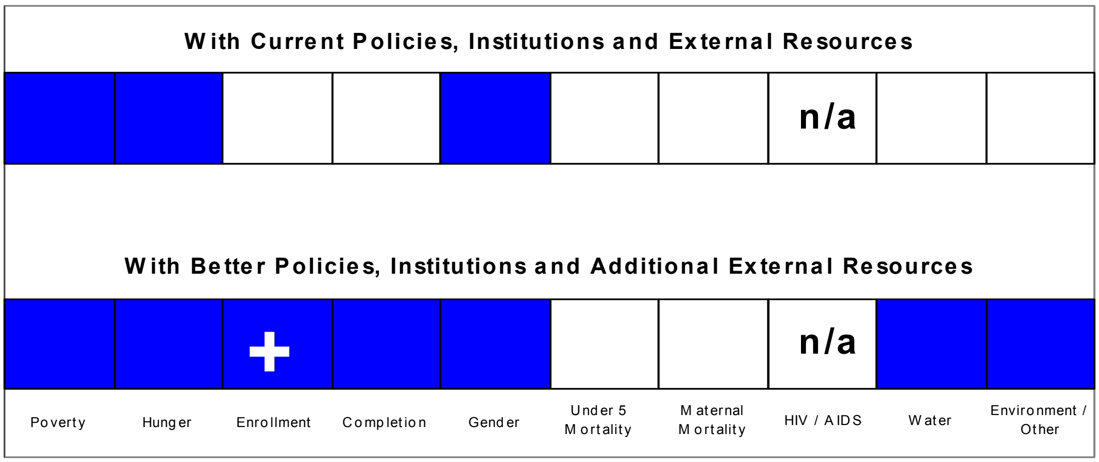


Annex Figure 5: Prospects of Meeting the MDGs — Two Scenarios

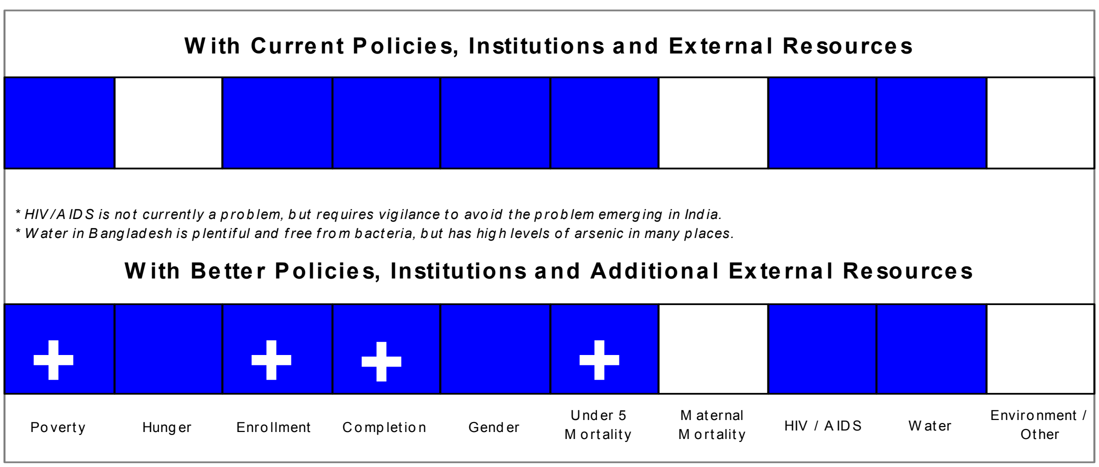
This figure is a detailed version of the information for each country presented in Figure 4 in the report.
Note: Each box shows progress in achieving the corresponding MDG target in each scenario.

- the target is not met *- the target is met* + *- progress beyond the MDG target* **n/a** *- not applicable*

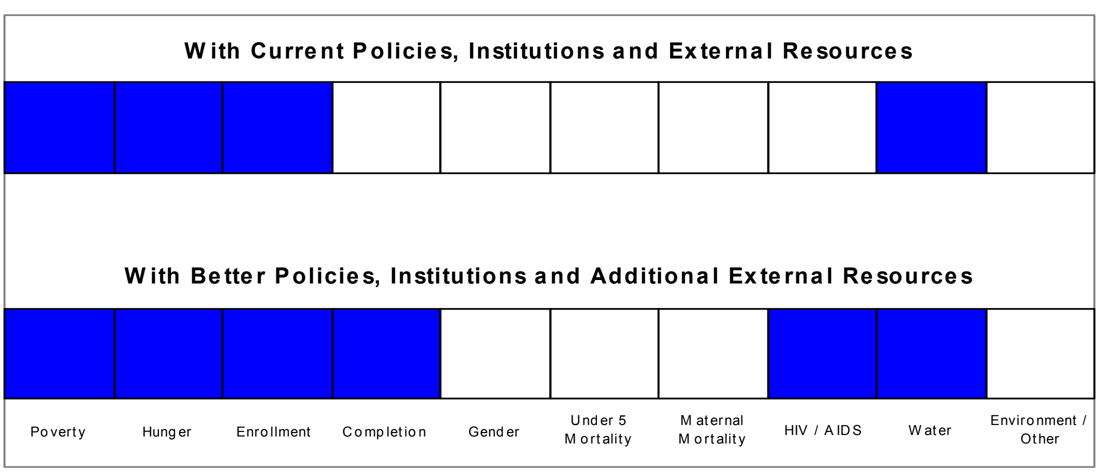
Albania



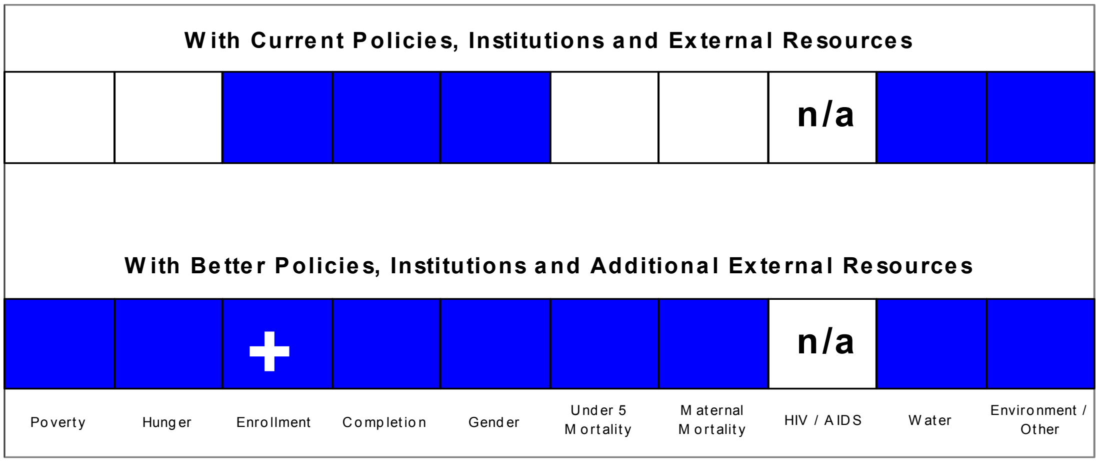
Bangladesh



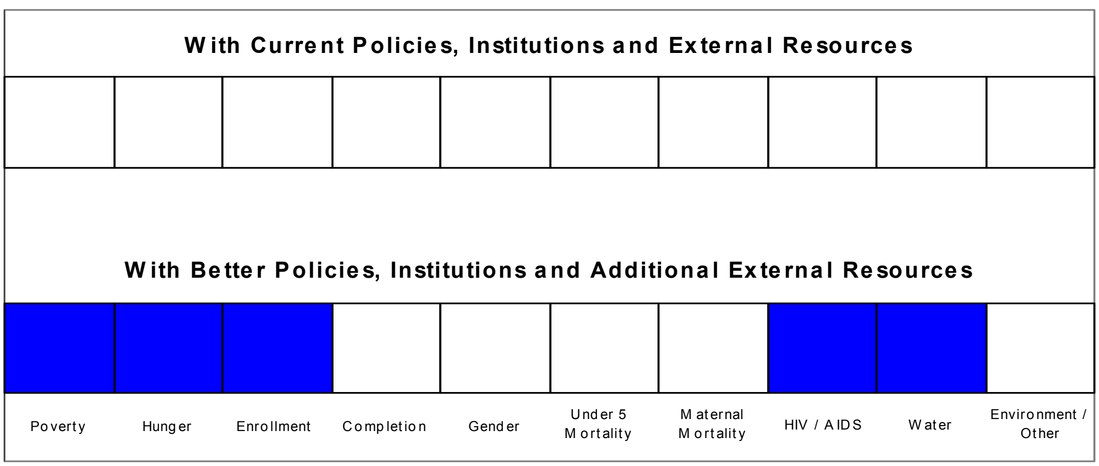
Benin



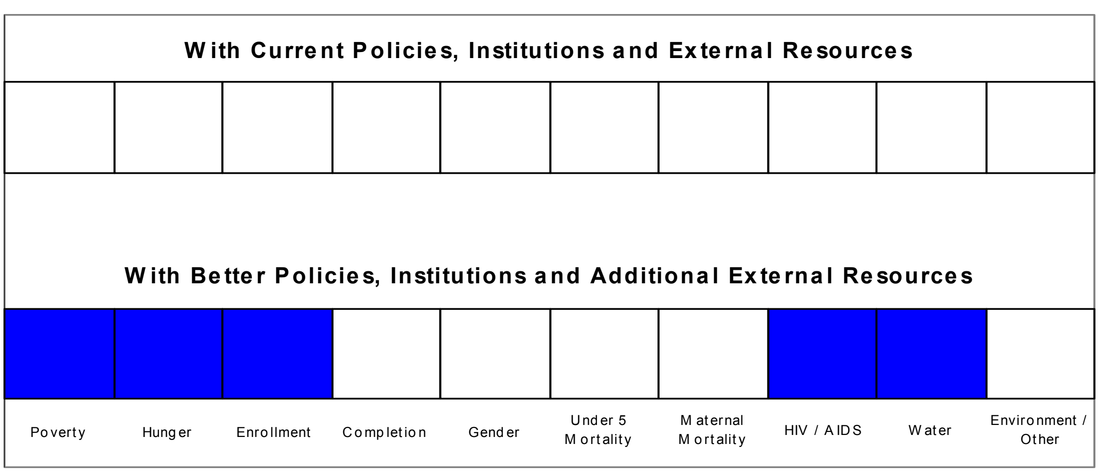
Bolivia



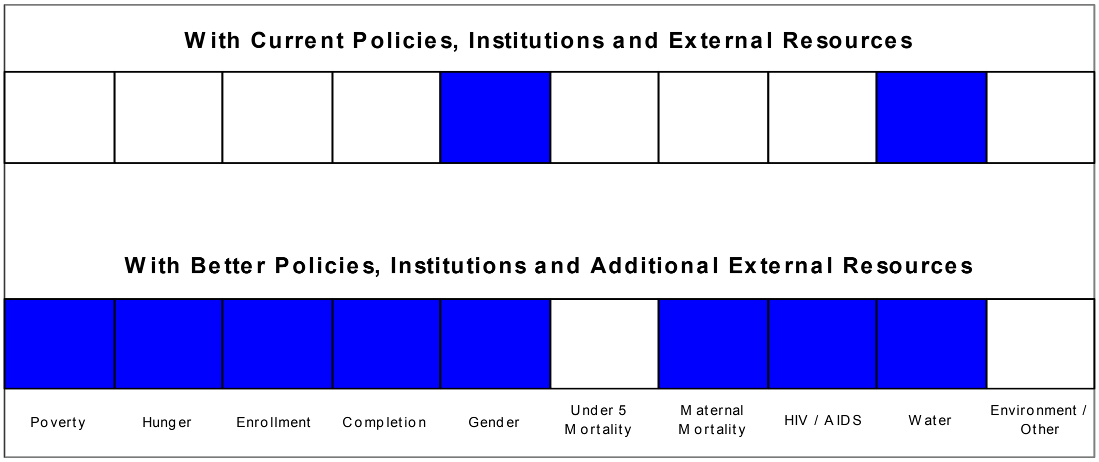
Burkina Faso



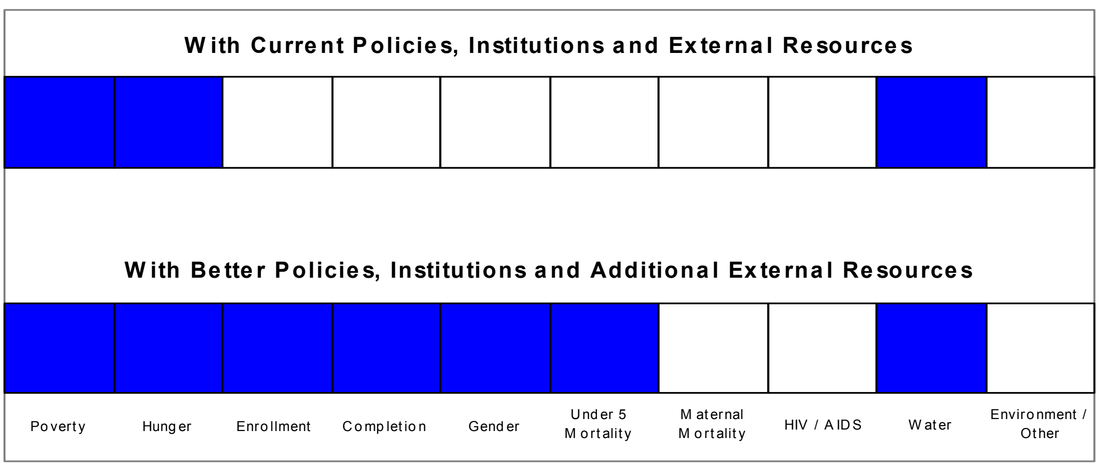
Ethiopia



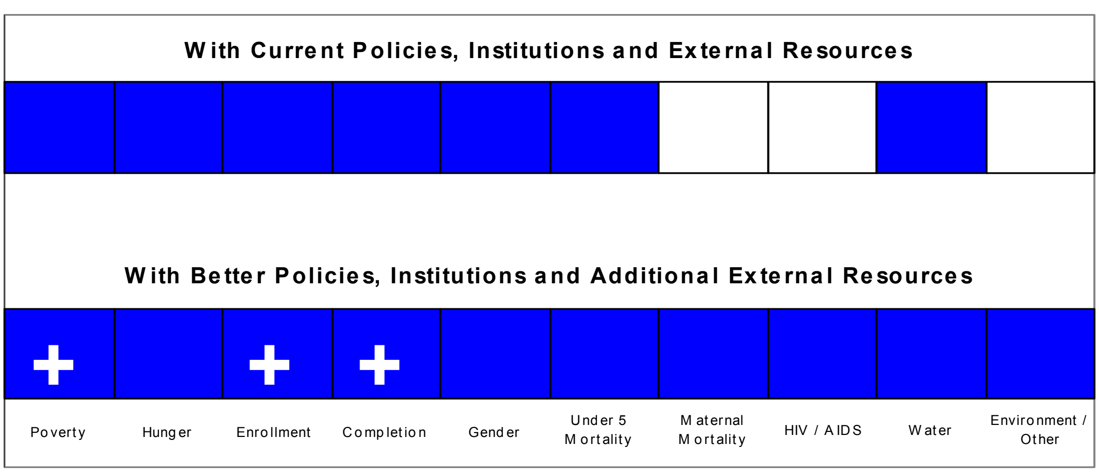
Honduras



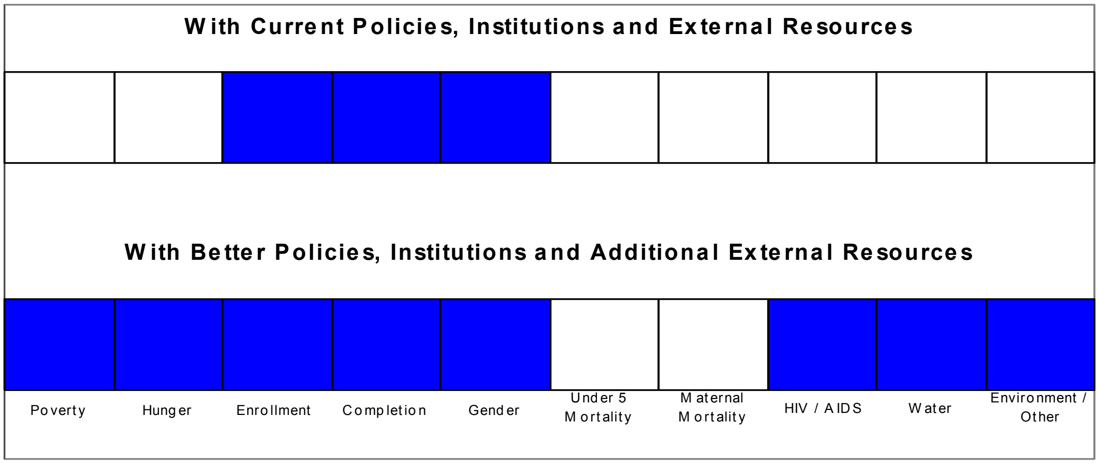
India



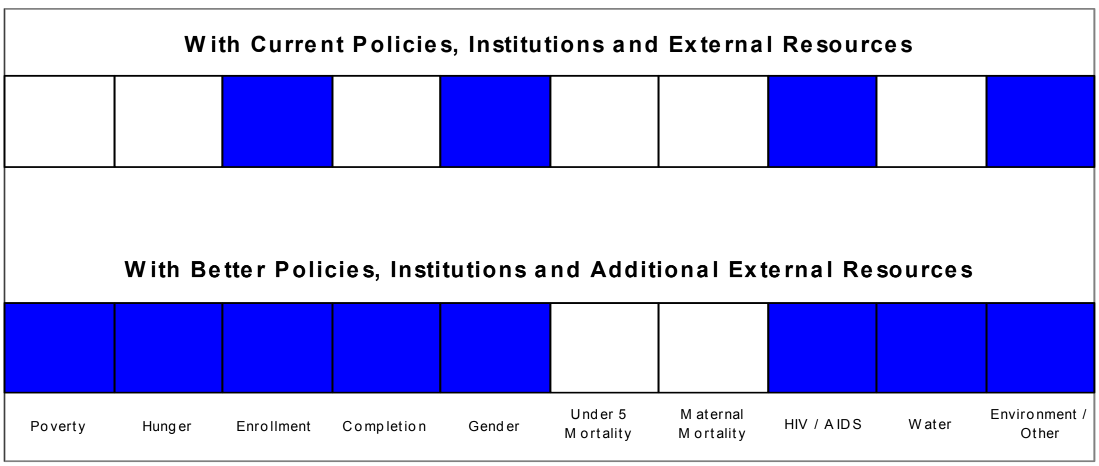
Indonesia



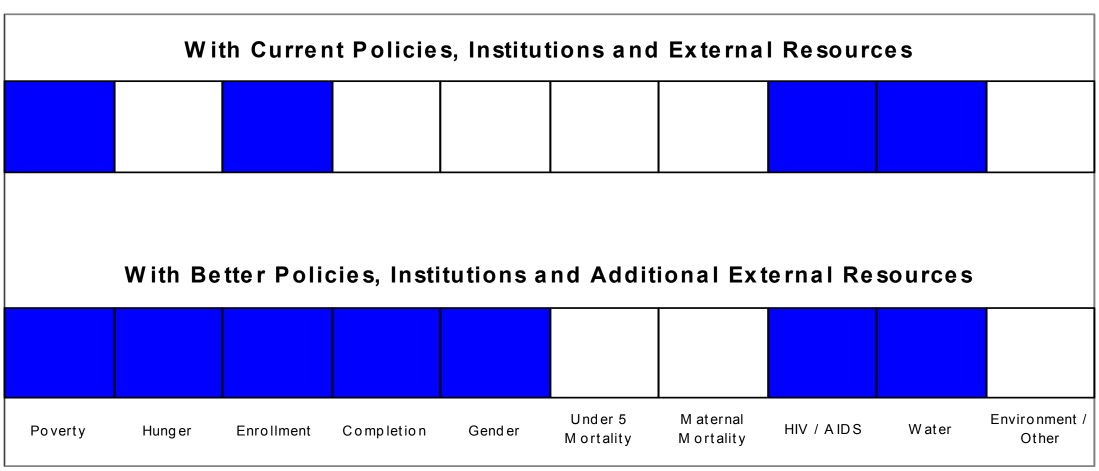
Kyrgyz Republic



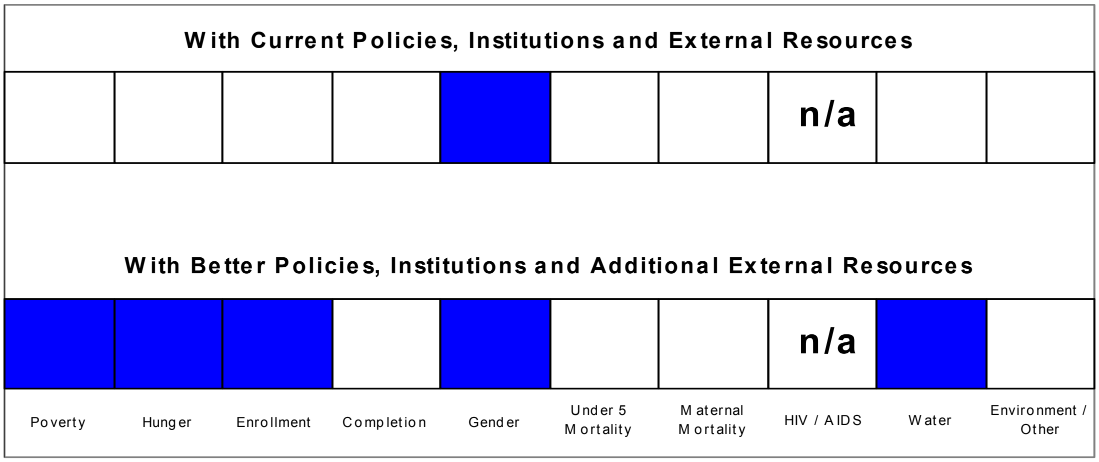
Madagascar



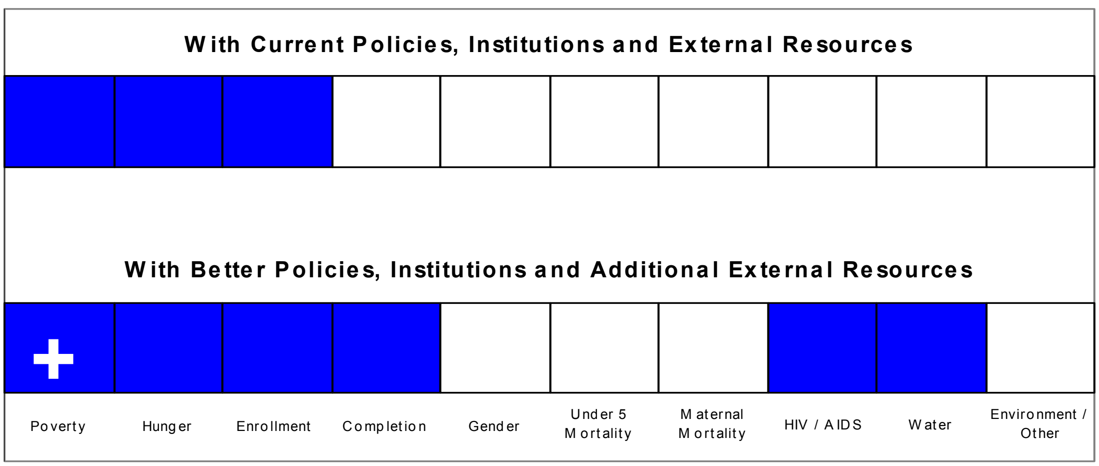
Mali



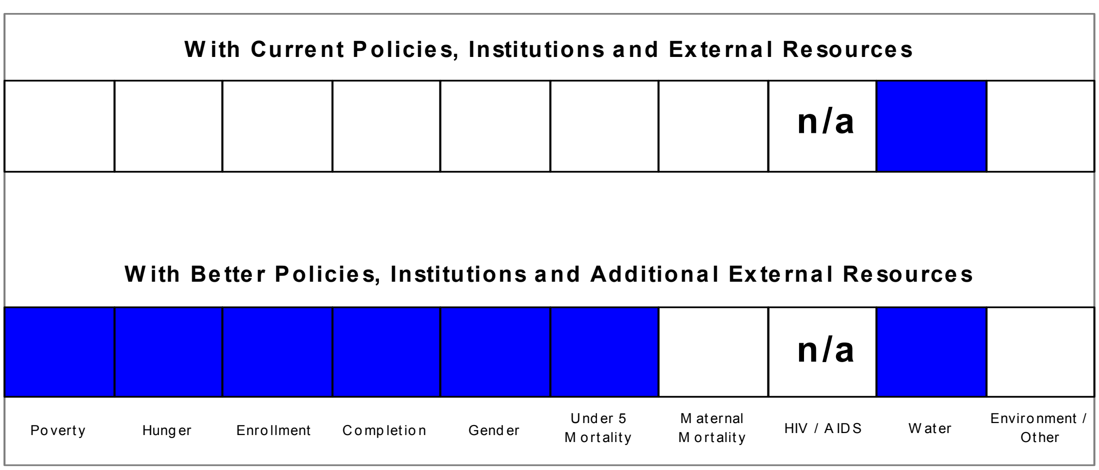
Mauritania



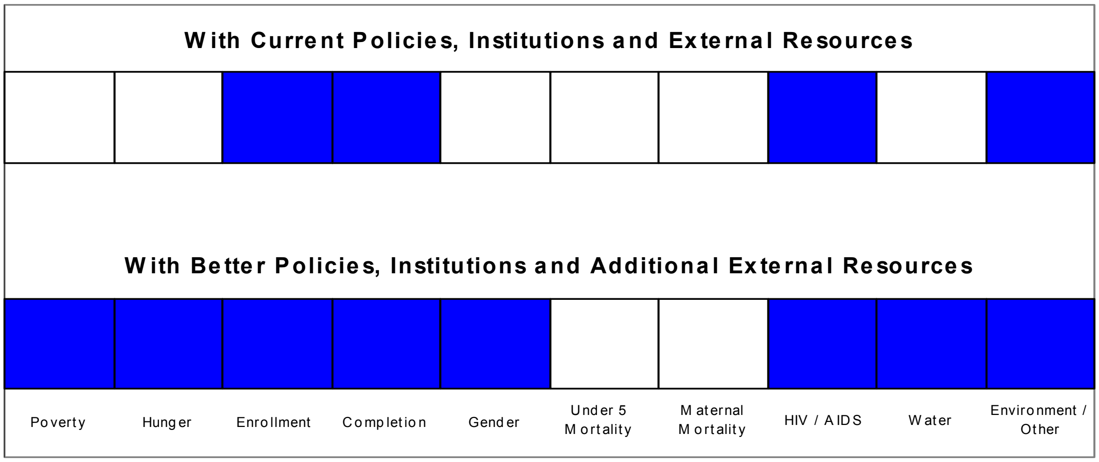
Mozambique



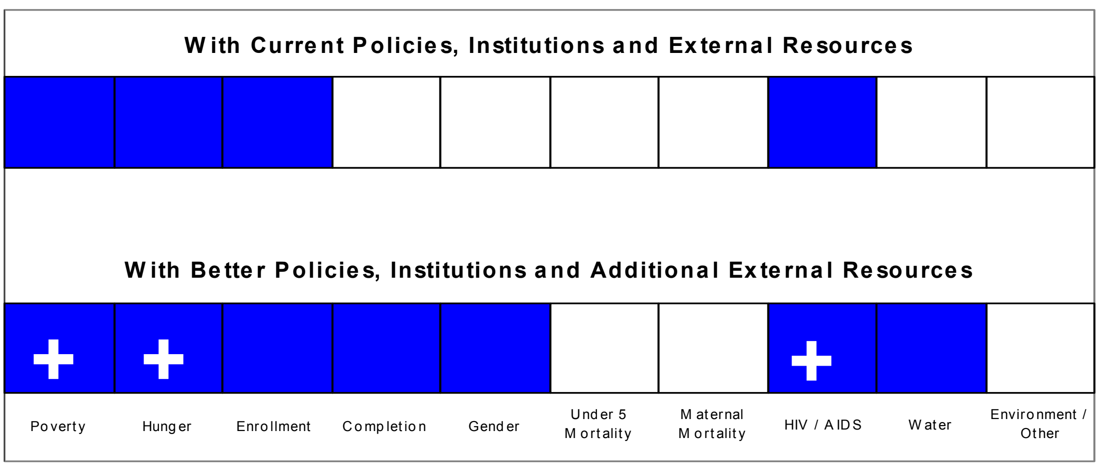
Pakistan



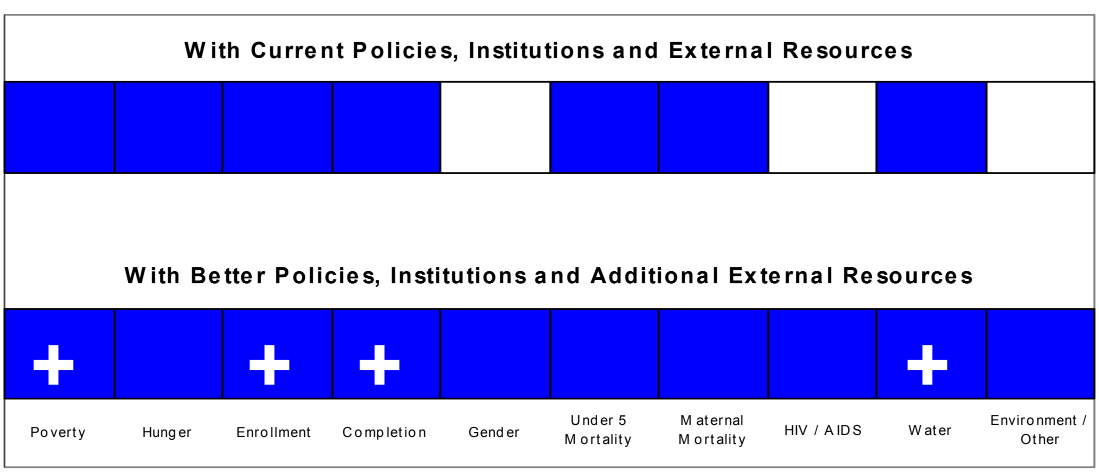
Tanzania



Uganda



Vietnam



Annex 2: Review of LICUS and Middle-Income Countries

1. This paper has focused on low-income countries with relatively good policy performance. This is where the case for aid is strongest. But we also have to recognize that there are other low-income and middle-income countries that have special aid needs. To what extent can additional aid accelerate progress towards the MDGs in these countries?

Low-Income Countries Under Stress (LICUS)

2. Low-income countries at the bottom of the performance spectrum are classified as LICUS by the World Bank.[1] They are a very diverse group, ranging from post-conflict countries to countries which have struggled with poor development records over many years. What they share in common is: (a) a desperate need to accelerate progress towards the MDGs; (b) a paucity of information on social conditions and the impact of development programs; and (c) very weak policies, institutions, and governance. Unfortunately, high aid volumes do not work well in these environments because governments lack the capacity or inclination to use finance efficiently for poverty reduction.[2] Yet neglect of such countries perpetuates poverty and may contribute to the collapse of the state, with adverse regional and even global consequences.

3. The challenge of aid effectiveness in LICUS is thus to balance limited absorptive capacity and high risk with the need to maintain engagement. Lack of reliable data in LICUS complicates the analysis of the role of aid in achieving improvements towards the MDGs. While quantitative statistics are available for only a few LICUS, it is clear that these countries are among the most disadvantaged in relation to the MDGs. Aid patterns, however, appear to vary considerably across LICUS. In some LICUS, concerns over poor governance and repeated cycles of political insecurity have led to very low aggregate flows of developmental aid, although some measure of humanitarian assistance may still be provided. In other cases, expectations of political change or fears of increased insecurity appear to have led to relatively high per capita flows. Anecdotal reports from donor meetings also indicate that aid to LICUS may vary much more dramatically over time than in the better performers. Most assistance to LICUS takes the form of grants, which is appropriate given the limited capacity in most LICUS to service debt, but there again appears to be high variability in the mixture of grant and credit-based assistance.

4. Like the better performers, the abilities of LICUS to use aid productively are not static, and can be enhanced by improvements in policies and governance. In this regard, donors may be able to help LICUS improve their prospects for using aid effectively by providing more strategic support to domestic reform efforts. Better understanding of local social and political dynamics must be the starting point for more effective engagement. Past experience suggests that conditionality is unlikely to be effective in countries with little ownership of reform. Traditional technical assistance also has a poor track record – often replacing or overwhelming rather than building local capacity. Instead, the key is to focus on a few critical areas of reform which are

[1] This section draws heavily on the findings from the Task Force Report on "World Bank Group Work in Low-Income Countries under Stress" (September 2002); and "Poor Performers: Basic Approaches for Supporting Development in Difficult Partnerships", Development Cooperation Directorate, Development Assistance Committee, DCD/DAC(2001)26Rev1, (November 2001).

[2] LICUS vary across a spectrum: those at the higher end of the performance spectrum can absorb higher volumes of aid, although in all cases capacity to use aid effectively will be lower than in countries with stronger policies, institutions and governance

politically and technically feasible for national actors to implement, and work to strengthen champions for these reforms both within the government and more broadly in civil society. There is no boiler plate reform path which will help these countries achieve the MDGs, although more work is needed on the lessons learnt in countries that were once in the LICUS category on the role of aid in supporting successful turnarounds. In some countries, entry points for reform may occur in economic policy management or core governance areas such as public finance or civil administration. In others, the main opportunity to move forward may lie in improving basic service delivery, building momentum for wider governance reforms by demonstrating successful relationships of service provision and accountability in one or two sectors.

5. Investments in social service delivery in LICUS are critical both because social indicators are desperately low, and because improved education, in particular, can help support broader domestic demands for change. Innovative approaches to social service delivery also offer the potential to use more aid productively even in the relatively short run. In the weakest LICUS, basic service delivery is often most effective when it works through existing NGOs and community groups with a proven track record of success, or through ring-fenced mechanisms such as social funds. They can help build long-term capacity in the form of trained service delivery staff and – by showing households what provision they should expect – they build demand. It is important that these efforts do not undermine an appropriate role for the state; where possible they should therefore be twinned with programs to help government monitor and learn from these initiatives and, over time, build successful design and implementation features into core government programs. In many LICUS there are also reformers within the public administration struggling to improve government health and education services. In these cases, donors can support their efforts directly through targeted technical assistance for government service provision.

6. While the path to making progress on the MDGs will be different in each country, consensus between domestic stakeholders and donors on a limited number of reform objectives, together with close donor coordination, are important in all LICUS. This is because political and technical capacity to implement reforms is weak and aid flows typically meager. Reforms are therefore more likely to work where donors avoid overwhelming domestic reformers with conflicting demands for change, and where technical assistance and financial support is coordinated behind a limited number of reform efforts.

7. While financial allocations in most LICUS should be modest, the case for higher financial transfers can be strong in post-conflict countries.[3] Many of these countries have very large initial financing needs to meet immediate humanitarian needs, rebuild infrastructure destroyed during the conflict, and provide basic social services to their people. Domestic resources are scarce – and the international community can't afford to wait until all the prerequisites for effective aid are in place. So how can the international community help ensure that urgent needs in post-conflict countries are met – while also building local government capacity to take responsibility for development in the future?

[3] Most countries classified as post-conflict by the World Bank are also LICUS, because their policies and institutions are exceedingly weak. These countries are often at risk of a reoccurrence of conflict, with 50 percent of post-conflict countries falling back into conflict within 10 years. Using elements of the LICUS approach in these countries is important – in particular better political analysis, sequencing governance reforms and capacity building – to minimize this risk and build a more sustainable recovery.

8. Take the example of **Afghanistan**. After more than 20 years of conflict, and three years of drought, Afghanistan is one of the poorest and longest-suffering countries in the world. When the Afghanistan Interim Administration took office in January 2002, an estimated 7 million people were vulnerable to hunger and very large numbers were dependent on massive inflows of food aid. A preliminary needs assessment prepared by the World Bank, UNDP and Asian Development Bank estimated reconstruction needs to be US$8-12 billion over five years.[4] At a donors meeting in Tokyo in January 2002, US$5.2 billion was pledged for the reconstruction of Afghanistan. By June 2003, all of this amount had been committed, and US$1.8 billion was disbursed (mostly through the UN and NGOs). However, much of that assistance (45 percent) went to meet humanitarian and relief needs, leaving large gaps in financing available for critical reconstruction activities.

9. The Transitional Islamic State of Afghanistan (TISA) has prepared a National Development Framework (NDF), which was presented to the international community in April 2002. While it falls short of a full PRSP, it is an impressive accomplishment under the circumstances. More specific objectives and programs have been set out in the National Development Budget (NDB) for FY04. Many of the goals of the NDB are aligned with the MDGs: to raise rural and urban livelihoods, and eliminate poverty; to get all children back to school; to reduce mortality and morbidity, especially among women and children; and to address the threat of HIV/AIDS. The government has also stressed the importance of addressing the causes of Afghanistan's serious humanitarian problems, not just the symptoms. The related shift from humanitarian to development assistance has three major implications for aid modalities: (1) from in-kind commodity aid to cash assistance; (2) from assistance directly to implementing agencies to aid that passes through government budget channels; and (3) from assistance that is "sole sourced" to specific implementing agencies to transparent, competitive contracting.

10. Afghanistan is (and will likely be for the foreseeable future) highly aid dependent. Domestic revenues are projected to reach only about 5 percent of GDP and 9 percent of the total ordinary and development budget in FY04. The balance (around US$2 billion) will have to be funded by aid. This puts a major strain on the limited capacity of the government -- and reinforces the importance of effective aid coordination. Efforts to improve domestic revenue mobilization, public expenditure monitoring and management, and civil service capacity to implement development programs are clear priorities for technical assistance. Aid coordination has started to improve with the recent decision to fold the functions of the donor-led Afghanistan Support Group into the government-led Consultative Group process. The multi-donor Afghanistan Reconstruction Trust Fund, set up in May 2002, has also been reasonably successful in coordinating financing for the recurrent budget, investment programs and technical assistance.

11. Like Rwanda, Bosnia, and East Timor before it, Afghanistan demonstrates the potential for aid-supported recovery and progress towards the MDGs in a post-conflict environment. However, recent research on aid and conflict indicates that there is still room for improving aid allocation patterns in post-conflict countries.[5] Specifically, the rebuilding of an institutional environment capable of absorbing large aid flows effectively typically occurs after about three to

[4] See "Afghanistan: Preliminary Needs Assessment for Recovery and Reconstruction," Asian Development Bank, United Nations Development Programme, and World Bank (January 2002).
[5] See, for instance, P. Collier and A. Hoeffler, "Aid, Policy and Growth in Post-Conflict Countries", World Bank Policy Research Working Paper 2902, October 2002.

four years following the end of a conflict, while actual aid flows generally peak in the first or second year after the conflict ends and then taper off dramatically. Consideration of mechanisms that allow more targeted aid in the initial post-conflict period while stretching the allocation of exceptional aid levels over time offer the potential for improving MDG outcomes in these countries.

12. Of course, many of the challenges faced by post-conflict countries are also present in other LICUS countries going through major political transitions. Take the example of **Nigeria**. With some simplification, but not exaggeration, Nigeria can be thought of as two distinct economies: the oil economy and the non-oil economy. The oil economy touches perhaps 5-10 percent of the population and provides per capita income of around US$2,000. The other 120 million Nigerians depend for their livelihoods on the non-oil economy, where per capita income averages perhaps US$200. This is one of the largest groups of extreme poor in the world. Despite generally favorable oil prices, per capita incomes have fallen in recent years and poverty (already 70 percent) is probably still on the rise.

13. The elections held in April 2003 marked a watershed in Nigeria's road to democracy. In more than 40 years of independence, Nigeria had never before enjoyed more than four years of civilian democratic rule or a smooth transition from one civilian administration to the next. There is now a real opportunity (and desperate need) to shift the focus of politicians and officials away from seeking private gain towards addressing the pressing development challenges of the country. The MDGs potentially provide a powerful instrument for motivating good policies and strengthening public accountability. But the challenge in Nigeria is multiplied many times by the country's federal character, where largely independent states bear constitutional responsibility for most basic service delivery. In this democratic and decentralized environment, it is essential to build the "voice" of civil society for pro-poor reforms.

14. Aid can play a role in strengthening the information and capacity base of pro-poor and pro-reform groups in civil society. Over the longer term, with improvements in governance, Nigeria should be able to finance the bulk of its development efforts from growing oil and gas revenues. But, if the government is committed to implementing reforms, there will be large upfront and transitional costs to be met. These include clearing arrears to the Paris Club (US$2.1 billion at end-2002) and reversing the large negative net transfers (US$2.1 billion in 2001) from official sources. There will also be potential opportunities to work with states that show a commitment to achieving the MDGs. The challenge will be to tackle these issues in ways that reinforce rather than undermine the government's resolve to push ahead with difficult reforms.

15. In conclusion, LICUS countries are very diverse – with very different aid requirements. Aid will generally be more knowledge-intensive than financing-intensive. But there is also a need in some of these countries for well-timed and well-targeted financial assistance. Given their limited capacity to service debt, almost all of this aid should be in the form of grants. And given their limited administrative capacity, it often makes sense to use NGO and community channels for service delivery. The upfront and transitional costs for post-conflict countries and countries embarking on serious reforms can be large. The challenge is to finance these costs in ways that support rather than undermine local efforts to mobilize resources and build capacity.

16. In shaping a consistent response by the international community to the situations in these countries, several gaps will also need to be filled in order to assess the likely effectiveness of

increased aid flows. Information with regard to MDG outcomes in these countries needs to be improved and analyzed along with their prospects for improving policies and governance in order to identify cases where modest increases in aid over time, appropriately phased over time, would be particularly productive in terms of making progress towards the MDG targets. Filling these gaps, perhaps through the use of case studies, as has been done in this paper for better-performing countries, would help illustrate the extent to which changes are needed in the current allocation of aid to LICUS, particularly when the cross-border and regional effects of neglecting these countries are taken into account. The new DAC initiative on difficult partnerships offers an opportunity for collaborative work to fill these gaps.

Middle-Income Countries

17. Middle-income countries are also very diverse – with per capita income levels ranging from less than US$750 up to more than US$9,000.[6] Many of them have already met or are on track to achieve the MDGs well before 2015, and most rely on domestic resources and private capital flows to finance the bulk of their investment needs. Yet these countries are still home to 280 million people living on less than US$1 per day and 870 million people living on less than US$2 per day. While other social indicators are on average better than low-income countries, there remain important areas of social deprivation. Issues of inequality in various dimensions – in incomes, service provision and influence – are of even greater importance than in low-income countries in explaining and tackling continuing deprivation.[7]

18. Middle-income countries received more than US$13 billion in ODA in 2001, or about one quarter of total aid flows. So what is the case for aid in these countries? And what more needs to be done to reduce poverty and accelerate progress towards the MDGs?

19. It is important to frame an answer in terms of the diversity of country conditions. While there is a continuum of characteristics, it is useful to distinguish lower middle-income countries, with widespread deprivation and weak creditworthiness, China and upper middle-income countries with relatively good access to private capital markets. The first category is illustrated by countries such as the Philippines, Morocco, Guatemala and Peru. These are in many respects similar to the better off low-income countries. Levels of deprivation are often severe, as in the case of malnutrition in Guatemala or Peru, but not necessarily across all dimensions (primary schooling is almost universal in Peru for instance). Many have weak tax efforts, for deep institutional and socio-political reasons. Where they are not creditworthy, ODA is crucial for the implementation of a compact for change. Even where they have some access to private capital markets (as in the case of Peru), modest levels of ODA can play a crucial catalytic role in supporting change to reach MDGs both in government and non-government activities. The general considerations are therefore similar to low-income countries.

20. **China** requires separate consideration because of its sheer size, its excellent track record at relatively low income levels, and its high levels of creditworthiness. China is a lower middle-

[6] The paper only looks at middle-income countries with relatively good policies. There is no obvious development case for aid in "non-performing" middle-income countries or high-income countries.

[7] Deprivation is used to describe living standards below those necessary for a minimally decent quality of life. It is equivalent to poverty when it is understood in a broad, multi-dimensional sense (not limited to income poverty). It should also be noted that the meaning of deprivation depends on conditions specific to a society. In national level debate and diagnosis it is always important to supplement the international standards emphasized in the MDGs with country-specific measures.

income country, with a per capita income of around US$950. But China's social indicators compare favorably with those of other middle-income countries and many are on par with those in the upper middle-income group. Since 1978, when the reform period began, average real GDP growth of above 9 percent per annum has helped to lift nearly 250 million people out of poverty. Current information suggests that China has already achieved several of the MDGs, and will probably achieve the remainder well before 2015.

21. But China is also a very large and diverse country. Despite the impressive gains of the past two decades, there are still 200 million people living on less than US$1 per day – and 600 million living on less than US$2 per day. There are also large variations in income levels, poverty incidence and social indicators across the country. These are driven mainly by rural-urban differences, and by disparities between the poorer central and western provinces and those in the rich eastern/coastal zone. Although many social indicators show that the disparities are narrowing, income inequality continues to widen, and there remain disparities in access to public services between poor and other groups. Current aid flows, at around US$1.5 billion per annum, are justified by the need to address these concerns.

22. Of the 600 million people who live on less than US$2 per day, a large number fall into poverty at least once in their lifetimes, usually as a result of uninsured income risks or catastrophic events such as illness. China's transition to a market economy has been marked by a sharp deterioration in some social services and a social security system that leaves the majority of the population unprotected. These problems result mainly from a malfunctioning system of inter-governmental finance. Expenditure assignments also contribute to the problem, as a substantial share of social and infrastructure spending is devolved to local governments, some of which may need to be reassigned to higher levels of government. The resulting horizontal and vertical disparities in per capita public expenditure, gross under-funding of public systems of health, education and the environment, combined with high co-payment burdens on individuals undermine the uniform achievement of the MDGs across China's regions.

23. Reaching the MDGs requires comprehensive reform of the inter-government fiscal system. Key considerations should include giving more control over tax rates to local governments, while centralizing some spending responsibilities such as pensions. Transfers should be more rule-based and aimed at ensuring that each province would have sufficient resources to deliver minimum standards of public services. It also requires sectoral reforms to improve the efficiency and effectiveness of service delivery. For example, expansion of rural water is part of the much larger challenge of improving water management through both policy and institutional changes, including more participatory approaches and community ownership. However, even with reform, the cost of meeting the MDGs in the lagging regions is very high (reflecting the vast numbers living in poverty). For example, the EFA Global Monitoring Report estimates that the additional resources required to ensure all students complete primary education is around US$1.2 billion per year. Achieving the MDG for under-five mortality would cost anywhere from US$500 million to US$850 million, depending on assumptions about the numbers of children currently not receiving immunization or treatment for common illnesses. Providing safe water to the whole population would cost an estimated US$10 billion to connect 400 million people with piped water. Improved sanitation could cost as much as US$100 billion, plus another US$20 billion for operating costs between now and 2015.

24. In total, it is estimated that for China to achieve the MDGs will cost around 2.5 percent of GDP (or US$30 billion per annum) in incremental resources. While these are very large numbers, the bulk of funding will inevitably have to come from domestic sources. It is fundamentally a matter of government spending priorities and fiscal incentives at the center, state and local levels. However, to the extent that aid can help advance the reforms needed to achieve these goals, it can play a valuable role at the margin.

25. The situation in upper middle-income countries has similarities and contrasts to China. **Mexico** illustrates. While several times richer, Mexico faces a situation with respect to the MDGs that is comparable or, if anything, somewhat worse than in China. Mexico is likely to achieve the MDGs for universal primary education, gender balance and reversing the spread of HIV/AIDS. But progress on income poverty reduction was set back by the financial crisis of the mid-1990s.[8] In addition, despite steady progress, Mexico may well not reach the MDGs for infant and maternal mortality.

26. Mexico also illustrates a common feature of many upper middle-income countries (as well as China and large low-income countries): the concentration of deprivation in geographic regions and particular groups. In Mexico's case, there are large regional differences, with states in the southern part of the country, such as Chiapas, Oaxaca, Guerrero and Veracruz, showing markedly lower levels of incomes and higher levels of deprivation. This is partly associated with high levels of deprivation amongst specific socio-cultural groups – in this case, indigenous populations. Prospects for achieving the MDGs within these states, or amongst indigenous groups, is much weaker than elsewhere in the society. Accelerating progress on the MDGs will require tackling complex problems of institutional weakness, histories of social exclusion, high proportions of rural, remote locations, and weak dynamics of economic change.

27. Veracruz provides an illustration of recent initiatives in policy and institutional change to tackle health and education deficits (that are actually somewhat higher than in other southern states, after controlling for incomes). This is reflected in its increased commitment of own resources, equaling almost one third of total spending in both education and health (compared to only about 10 percent in the other three southern states). In addition, Veracruz has implemented institutional reforms to improve service coverage and quality in these two sectors and remains committed to their implementation. In such circumstances, when poorer regions help themselves, there can be a case to reinforce and scale up their efforts with additional support, so that the MDGs can be achieved more rapidly.

28. Other upper middle-income countries have geographic areas or socio-cultural groups that have a similar structure. This is the case, for example, in the north east of Brazil and for the Afro-descendent population throughout Brazil, as well as for the Roma in Eastern and Central Europe. In cases such as these, external assistance can be justified if it can complement domestic policy and institutional change in such poorer regions or focused on particular groups. Whether this takes the form of ODA or non-concessional assistance depends on considerations of both national and sub-national creditworthiness.

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[8] Preliminary results from the 2002 household income and spending survey find significant declines in income poverty relative to 2000 that would put Mexico back on track to reach the MDG for this measure. However, it is unclear if this represents a new trend or once-off effects.

29. In conclusion, many middle-income countries have already met or are well on the way to achieving the MDGs before 2015. With some notable exceptions, such as China, this often reflects more favorable initial conditions than exceptional progress over the past decade. Not surprisingly, achievement of the MDGs is highest in the upper middle-income countries. However, even when the MDGs are met (e.g., universal primary enrolment and completion), there may still be pressing issues of service quality to be addressed. There also remain major areas of human deprivation across lower and upper middle-income groups. In upper middle-income countries, in particular, they are more typically concentrated amongst specific groups or regions, where high levels of deprivation are associated with histories of social exclusion, institutional weakness or relatively weak income growth.

30. ODA can play an important role in these cases where: (a) its use is part of a national or local compact to tackle policy, institutional constraints to reducing these deprivations; and (b) there are creditworthiness reasons (at national, local government or non-government levels) that would make non-concessional borrowing inappropriate or less effective. There is a rising awareness of, and demand for, support for action at sub-national levels, as one important area for international support. Where there is at less some access to international capital markets, the form of the compact will be the same, but official non-concessional flows will play the primary role. These have fundamentally different properties than private flows in supporting the kinds of policy, institutional and structural changes that are typically necessary to tackle the constraints to accelerated efforts to reduce human deprivation.

31. Of course the bulk of the resources will have to come from domestic sources, at least in upper middle-income countries. Aid can help at the margin – when it reinforces and scales up domestic efforts. Official flows can also provide support for counter-cyclical action to reduce vulnerability, in return for short-term action on social safety nets and long-run action on financial strengthening, reducing debt burdens and building stronger fiscal systems. Official flows to middle-income countries should become increasingly non-concessional, and eventually be phased out, as income levels rise. In many cases, trade reform to open access to developed markets for goods and services can do more to support local efforts to raise growth in poorer regions, than incremental aid flows.

Annex Table 5: Low Income Countries (weak policies) and Middle Income Countries — Key Indicators

	Income per capita (2001 USD)	GDP growth (percent p.a., 1990-2001)	Population (millions)	No. of poor living below $1/day (millions)	No. of poor living below $2/day (millions)	ODA (2001 USD billions)	ODA/ GDP (percent)	ODA per capita (2001 USD)	Number of countries in the group
Low Income (weak policies)	**241**	**1.8**	**401**	**109**	**n/a**	**3.5**	**2.5**	**8.6**	**26**
China	890	9.4	1,272	205	602	1.5	0.1	1.1	1
Other Lower Middle-Income (relatively good policies)	1,776	1.9	767	48	197	8.9	0.7	11.6	29
Upper Middle-Income (relatively good policies)	4,040	2.8	403	28	74	2.9	0.2	7.2	20
Middle Income (weak policies)	5,044	2.7	82	5	n/a	0.6	0.2	6.8	6
Total Middle Income	1,797	5.8	2,523	286	872	13.8	0.3	5.5	56