



The Millennium Project: A Sound Strategy for Reaching the MDGs?

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The Millennium Project report *Investing in Development* invites developing countries to formulate expenditure plans based on what they will need to do to reach the Millennium Development Goals. Additional aid needed will be very substantial, even after allowing for re-allocation of current aid flows away from non-MDG related purposes. The report estimates that the additional requirement, over and above current net ODA of some \$65 billion p.a., will rise in constant prices from \$70 billion in 2006 to \$120 billion in 2015.

Is this 'Big Bang' strategy realistic? This note welcomes the prospect of more aid for the world's most important project, points to some problems in getting started and to some pitfalls to avoid, and emphasises the need to sustain momentum in poverty reduction after 2015.

Timing: many target countries; some not ready

The Report rightly calls for aid to be focused on the 70 poorest countries which are not 'on track' for achieving the Goals. Richer countries should be largely ineligible; in an echo of the World Bank's approach to 'low income countries under stress', many poor countries are said to be not yet ready for intensive assistance:

- Middle income countries should receive only a small (\$9-12 billion p.a.) share of the additional aid, to be devoted to outstanding pockets of deep poverty.
- Low income India would receive little (and might even be a donor) because it has resources of its own and is 'on track' to meet the goal of halving poverty by 2015.
- Poor countries in conflict, and those which are performing poorly through their own fault ('lack of volition') are not yet ready to use MDG-related aid effectively, except what can be handled by NGOs.
- Other poor countries with well-intentioned governments lack administrative ability. Their absorptive capacity has to be built first, before funds can flow on a large scale into MDG-related programmes.

Thus, the proposed extra aid to low income countries for MDG-related programmes (\$80 billion in 2006, rising thereafter) will initially go mostly to 'two dozen' well performing countries, mostly small- medium-sized. These 'fast track' countries are unlikely to be able to use so much so soon.

Of the remaining low income countries 20-22 are also among the (46) low income countries which now have agreed full or interim Poverty Reduction Strategy Papers outlining their policy and reform commitments. If they persevere in these, they should in due course qualify for high-volume assistance. For the remainder, sensible aid flows may fall short of the MP's estimate of need.

In short, we must expect a phased start.

Chosen instrument: public expenditure

The Report says that countries should raise their public development expenditure to the level needed to meet the Goals by 2015. (Only the best-off third of the population is assumed to pay its share of the incremental cost of infrastructure through user charges). Country needs assessments show that two-thirds of public expenditure on MDG-related programmes in 2005-2015 in Ghana and Tanzania, and 60% in Uganda, will have to be aid-financed.

Experience of scaling up expenditure from developed as well as developing countries identifies some common teething problems:

- Voted funds may remain unspent while implementing agencies make ready.
- Technical efficiency (ratio of output/input) may fall, as inexperienced staff are employed to operate the expanded services.
- Unit costs of inputs and staff may rise - because of supply shortages, lack of competition between contractors, and the high logistical costs of, and incentive payments for staff, working in remote areas.
- Intended beneficiaries may not be reached - because of their income, access costs, attendance time etc.

The Report emphasises that the capacity to manage programmes and to deliver public services must expand very quickly. Programme design, planning, piloting, monitoring and accountability must also improve. Much depends on institutional capacity, not just individual skills. Institutional improvement requires much nurture, and may be slow to come, though outsourcing management and technical functions can force the pace.

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We should not be surprised if the path to scale is rocky.

Growth is a prerequisite

Pro-poor public services, once expanded to deliver the education, health and environment MDGs, must be sustained. The example of primary education expansion following school fee abolition in Tanzania and Madagascar in the 1970s shows what happens when essential services are underfunded: service quality deteriorated, enrolments fell, and fees were reintroduced. (The Report shows that Tanzania has now reintroduced free primary education, this time successfully). To reach and surpass the MDGs, poor countries will need expanding budgets financed by continuously growing domestic incomes and revenues, and by sustained external support.

Economic growth is a prerequisite to sustained poverty reduction. But it does not emerge sustainably from public expenditure alone; nor is it in the gift of the donors, however much they give. It comes jointly from savings, investment in human and physical capital, the expansion of enterprises, innovation, and the migration of labour and capital from lower to higher productivity activities, guided by market signals. These processes are easy to discourage through bad policies which create uncertainty and erode confidence; but they can be very slow to revive, even with good policies and strong incentives.

The Report's authors acknowledge the essential role of private sector development. But they controversially attribute low growth, even in heavily aided countries, to low-savings, low-revenue, low-investment 'poverty traps', from which escape is easy by 'raising the economy's capital stock to the point where the downward spiral ends, and self-sustaining economic growth takes over'. The Report advocates 'a big push of basic investments between now and 2015 in public administration, human capital ... and key infrastructure'.

This package needs a health warning. Economists know that investment alone is no panacea for growth. Developing countries have been littered with the debris of over-ambitious, underperforming and ill-maintained public investment programmes dating from the 'big push' development strategies widely adopted in the 1960s and 1970s. 'Self-sustaining growth' is a naïve concept which antedates our current understanding of what it takes to build an economy of expanding enterprise and falling poverty.

Enormous care is needed in launching ambitious programmes to ensure that they will yield economic benefit in real life, and not just in planners' books of blueprints. Pro-growth policies, pursued with patience and perseverance, are vital.

Making aid effective

Big-spending government can even frustrate growth. Some research suggests that public expenditure, especially recurrent, becomes more harmful for growth the bigger it becomes

relative to GDP: higher taxes deter investment, bigger public payrolls compete with the private sector for skilled labour, and higher public borrowing raises interest rates.

Higher aid inflows stave off these negative impacts, but only to a point. With aid, taxes and public borrowing can be lower, which helps the private sector, while expenditure on pro-poor services expands. However:

- MDG-related aid must now be more predictable and stable, than hitherto. High aid dependence has exposed countries to the risk of episodic funding shortfalls for salaries, materials and supplies, and of macroeconomic instability.
- Aid changes economic structures – raising public employment, competing for skills with the private sector, and producing Dutch Disease effects. Without safeguards, it creates more opportunities for rent-seeking, misappropriation and corruption.

The Report is not complacent about these, but does not dwell long on economic management. It echoes some of the development community's new consensus on governance reform, and 'fixing the aid system'. However, while recommending that donors differentiate their aid policies according to country needs, the Report gives pride of place to mobilising and re-directing aid to achieve the international MDG agenda, not to countries' strategic priorities and country ownership.

Better aid and better aid- and economic- management are natural partners on the road to the MDGs.

After 2015?

Top-sided, aid-dependent, growth reduces poverty so long as aid increases. Public expenditure creates jobs and raises incomes, directly and indirectly. Productivity should increase as the labour force becomes more literate, numerate and skilled, especially if the business environment is competitive.

But if, after 2015, aid is reduced, there will be a serious adjustment problem threatening MDG achievements. Export sectors may have atrophied, and be unable quickly to substitute for falling domestic expenditure, leading to unemployment and falling real wages.

2015 will not be the end of the road for poverty reduction; for low-growth poor countries it will at best be the end of the beginning. The Millennium Project must be a through train to continuing growth and poverty reduction, and not an express to a terminus called 'adjustment'. In 'fast track' countries, post-2015 aid inflows should taper gently and predictably. For slow starters, there should be assurance that post-2015 aid will continue to rise.

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