



A big public investment push needed in least developed countries to meet Millennium Development Goals

The MDGs have reinvigorated the case for ODA by tying it to an ambitious strategy to reduce poverty and improve human welfare in the most disadvantaged countries and communities. The global financial crisis has been a setback to those efforts, but things were off track even before the crisis hit. In large part that was because while the goals were dependent on a significant rise in investment, particularly in the public sector, economic policy was working against such an increase. Looking ahead, as argued in this policy brief, LDCs need to refocus their efforts on measures to better mobilize domestic resources, but this will in turn require a serious rethink by the international community of both its policy advice and its use of ODA.

A major constraint on strengthening the development dimension of MDG strategies has been the dominant macroeconomic consensus. This consensus has obliged policymakers to focus their attention on maintaining *market stability and confidence* and, in particular, on containing price inflation. This policy brief argues that what is urgently needed is a macroeconomic framework more conducive to *inclusive growth and development*, by which fiscal policy has a central role to play in driving the development process, primarily through the management of scaled-up public investment. Contrary to current convention, monetary policy should be relegated to a secondary role, tasked primarily with ensuring moderately low real rates of interest and an ample supply of credit to stimulate private investment.

Making macroeconomic policies more development-sensitive is particularly important for least developed countries (LDCs). Prior to the global crisis, many LDCs were already running sizeable fiscal deficits. These deficits have widened since. However, because efforts to meet the MDGs will certainly require a significant rise in public investment, on the order of several percentage points of GDP, these countries will continue to need, well past 2015, an MDG-related development framework that incorporates significant external financing of fiscal deficits. The challenge for policymakers is to manage these flows in ways that help to stimulate domestic resource mobilization.

The scale of the public investment push is sure to vary from country to country. However, the shortfall is massive. In sub-Saharan Africa, for example, public investment as a share of GDP declined steadily, from an average of over 10% in 1981 to around 7% by 2001; the earlier level has not been recovered during the region's recent commodity-led growth spurt and seems set to drop with the global slowdown.

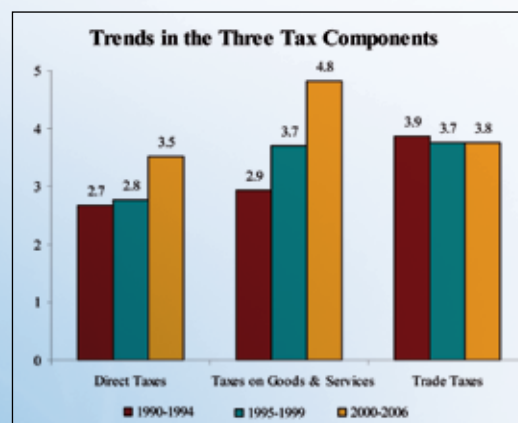
The fiscal constraint on poverty reduction

Success in generating public revenue in LDCs is largely determined by the level of income per capita and economic growth. As economic growth increases,

revenue should rise as a ratio to GDP as a larger share of the population pays taxes or current taxpayers receive more taxable income. This did happen as economic growth accelerated in LDCs, but the rise was less pronounced than has generally been assumed. Moreover, LDC revenues have subsequently slumped as a result of the impact of the global financial crisis and recession. African LDCs have, for example, seen a sharp drop in revenues.

What this means is that greater revenue does not automatically follow from higher rates of economic growth. Particularly in LDCs, where revenue levels are especially low, it is critically important to strive to raise them, either through better tax policies or more effective tax administration. The international development community, including the MDG campaign, has tended to overlook the importance of this challenge even though domestic revenue mobilization provides the only viable long-term financing basis for development expenditures.

Even before the crisis hit, the underlying trend pointed to troubling structural constraints on raising public investment, including that which is directed to meeting the MDGs. Between 1990-1994 and 2000-2006, tax revenue for a group of 22 African LDCs edged up from 10.1% to 12.2% (see figure).



Because trade taxes stagnated and direct taxes lagged income growth, indirect taxes have assumed



the burden of filling the fiscal gap. Conventional tax advice has highlighted the need to institute value-added taxes (VATs) as the chief means to recoup the losses from trade liberalization and the inability to broaden the base for direct taxes. But in the context of LDCs, VAT is not likely to be as efficient as in developed countries, in part because of the need for extensive bookkeeping and the prevalence of a large informal sector.

Much of the conventional advice on taxes has shifted in the past two decades. Instead of being regarded as a necessity for State-building, taxes have been assumed to be an inherent disincentive to private-sector initiative and a net loss to household welfare. Development rhetoric has thereby emphasized *direct* private income without recognizing *dynamic* benefits of revenue-financed public expenditures and investment.

National ownership of the development agenda in LDCs is not likely to emerge until the governments of these countries are able to command more domestic resources. And in order to generate more domestic revenue, they will have to take a more critical view of the conventional tax advice they have been offered. Any post-2015 MDG-related campaign should focus much greater attention on such issues, and shift the emphasis much more to building national capacities for domestic resource mobilization instead of supplanting such resources (and the efforts to assertively mobilize them) by a heavy reliance on ODA, which is in any case likely to decline over the near future.

A more inclusive strategy

In percentage terms, both income poverty and human poverty are still the condition of a substantial majority of the population in LDCs. Hence, the common assumption that poverty or human deprivation affects only a minority of the population is often misleading. This perspective leads to narrowly focused Poverty Reduction Strategies along with social policies and safety nets that are restrictively targeted. This is one major reason why any new generation of MDG-related strategies should be formulated to move beyond a narrowly defined poverty focus to adopt a more encompassing and inclusive development approach (see *UNCTAD Policy Brief No. 14*).

There are deep-seated structural reasons for the widespread extent and depth of income poverty and human deprivation in LDCs. In this sense, inequality also has structural roots. The great majority of the labour force is confined to low-productivity activities, often informal and precarious, in either agriculture or urban services. Very few workers are employed in higher-productivity industrial sectors or decently paid modern service sectors. Invariably, formal-sector wage workers are a small minority of the national labour force. The share of workers who are located in vulnerable employment, i.e., as unpaid household workers or own-account workers, is frequently a substantial share of the workforce. Such pervasive underemployment leads to conditions under which the great majority of the population earn pitifully low incomes and have few avenues for escape from mass poverty.

A closer examination of inequality measures for many least developed countries can help clarify the need for a more inclusive development approach. Compared to the degree of inequality in some middle-income countries, such as Brazil and South Africa, LDCs appear to have relatively low levels of inequality. And statistics seem to suggest that they have made progress in reducing inequality. For example, the poorest 60% of the population in LDCs as a whole increased their share of total consumption from 28.6% to 31.3% between the periods 1990-1999 and 2000-2006. However, if one applies an 'inclusiveness'

criterion to these statistics, then it is apparent that a substantial majority of the population in LDCs still account for less than one third of all expenditures in the 2000s. Since average real consumption per person is very low in many of these countries, the absolute level of real consumption per person among the poorest 60% is abysmally low.

Average Under-Five Mortality Rate among the Poorest 60%, Selected Least Developed Countries

Country	Average Under-Five Mortality Rate	Year
Benin	185	2001
Burkina Faso	130	2003-4
Cambodia	123	2005
Chad	198	2004
Congo DRC	172	2007
Eritrea	123	2002
Ethiopia	139	2005
Guinea	211	2005
Haiti	116	2005-6
Madagascar	130	2003-4

Source: various demographic and health surveys (ranking by wealth index)

An 'inclusiveness' lens could also be applied to many MDG social indicators. For example, from disaggregated data from demographic and health surveys it can be determined that high under-five mortality rates are widespread in many of the LDCs.

Average under-five mortality rates for the poorest 60% of the population (ranked by aggregate household wealth), in 10 selected LDCs (see table), is well above 100 per 1,000 live births for the majority of the population. For example, in Congo DRC, the mortality rate is 172, in Benin 185, in Chad 198 and in Guinea 211. Hence, high mortality rates are not a problem confined to a minority of the population. They afflict a substantial majority. And the interventions adopted to deal with such a problem must be designed accordingly. A focused Poverty Reduction Strategy will simply not be adequate to this challenge.

Rethinking ODA

Utilizing ODA to finance widened fiscal deficits should not represent a controversial position. After all, that has always been one of its basic rationales. What is more contentious, and more fundamental, is the kind of development expenditures that ODA should be financing.

There has been too much focus on the imperative of scaling up ODA in order to promote social development in LDCs, and low-income countries in general. The resulting tendency to neglect investment in productive sectors needs to be reversed. However, one of the overriding priorities of ODA should be to strengthen the revenue-mobilizing capacities of LDCs. Having the ability to mobilize domestic revenue could also provide the significant advantage that national development strategies would much more likely be aligned with national priorities, instead of donor priorities.

As long as development expenditures are dictated by the priorities of the donor community, they are more likely to reflect donor preconceptions about what is 'good for development'. This helps explain some of the recent bias of ODA towards financing social development (to the detriment of economic development) and supporting poverty reduction strategies instead of broadbased (and economically viable) development strategies.