UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

THE LEAST DEVELOPED COUNTRIES REPORT 2002

OVERVIEW

by the Secretary-General of UNCTAD

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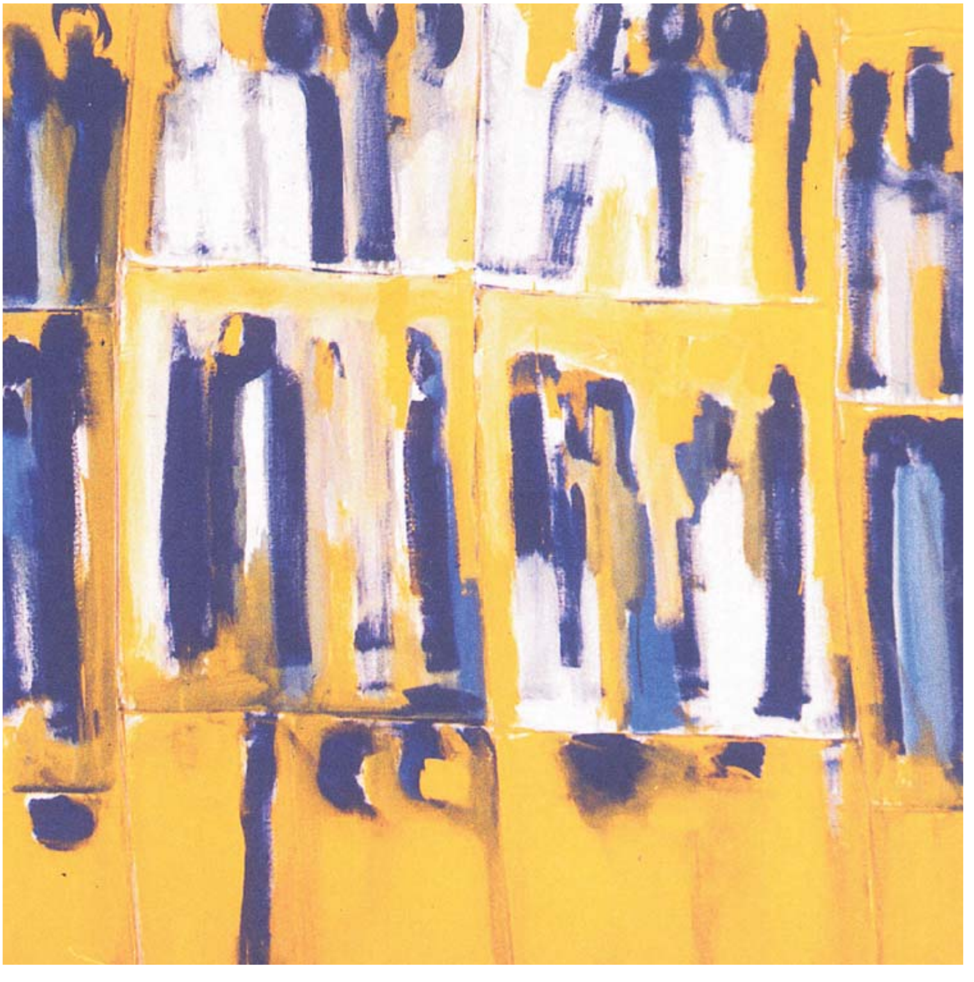

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
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Overview

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Overview

A real turning point?

In his speech opening the Third United Nations Conference on the Least Developed Countries (UNLDC III), the Secretary-General of the United Nations, Kofi Annan, urged Governments to ensure that the meeting, unlike its two predecessors, would mark "a real turning point in the everyday life of poor people in the poorest countries". The purpose of this Report is to contribute to that vision by providing a better analytical basis for national and international policies designed to promote poverty reduction in the least developed countries (LDCs).

In recent years the international community has adopted poverty reduction as a central goal of international development cooperation. Within this context, an "overarching goal" of the Programme of Action for the Least Developed Countries for the Decade 2001–2010 agreed at UNLDC III is for the LDCs to make substantial progress towards halving the proportion of people living in extreme poverty by 2015. The Programme itself consists of a long list of actions that the LDCs and their development partners are urged to undertake. Implementing these actions in a way which supports the goal of poverty reduction will require a strategic perspective based on a better knowledge of the nature and dynamics of poverty in the LDCs, and also a more complete understanding of what policies can best reduce poverty in the particular yet diverse socio-economic conditions of these countries.

The inadequacy of the analytical foundations for effective poverty reduction in poor countries in general, and in the LDCs in particular, is not generally recognized. Current international poverty statistics are flawed in various ways and woefully inadequate in the LDCs. Yet calls are being made to allocate aid between countries according to the numbers of poor people. Analysis of the relationship between globalization and poverty is still at a rudimentary stage. Yet sweeping and simplistic policy conclusions are being drawn by anti-globalization activists, who are arguing that poor countries are getting too much globalization, and by pro-globalization zealots, who are arguing that they are getting too little. The world's foremost experts on poverty find it difficult to agree on the nature of the relationship between economic growth and poverty in developing countries and its place in an overall poverty reduction strategy. Yet over one billion people, including 400 million in LDCs, are now living in countries whose Governments are preparing Poverty Reduction Strategy Papers (PRSPs) as a condition for access to concessional aid and debt relief, a process which a World Bank official has described, with both honesty and accuracy, as "an experiment".

The idealistic impulse to improve the standard of living of the poor is the right one. But unless the actual policy solutions are well grounded in a deep understanding of the causes of poverty, and how those causes have been, and can be, effectively addressed, they could end up with worse results than in the past. As Simon Kuznets warned in the famous 1955 article in which he hypothesized that income inequality would increase in the early stages of economic development and subsequently decline, policies to help the poor that are "the product of imagination unrestrained by knowledge of the past" are likely to be "full of romantic violence". That is to say, in spite of the best intentions, policies based on inadequate knowledge are likely to increase rather than reduce poverty.

This Report aims to avoid romantic violence. Its central message is that there is a major, but currently underestimated, opportunity for rapid reduction in extreme poverty in the LDCs through sustained economic growth. However, this opportunity is not being realized in most LDCs because they are stuck in an international poverty trap. It should be possible through the PRSP approach to promote poverty reduction more effectively than in the past. But this requires: (a) a more complete transition to genuine national ownership and increased policy autonomy; (b) a shift from the adjustment-oriented poverty reduction strategies that are emerging in the initial phases of the PRSP approach to development-oriented poverty reduction strategies; and (c) a more supportive international environment. The Report proposes an alternative approach to the design of poverty reduction strategies that focuses on doubling average household living standards through growth-oriented macroeconomic policies, the building of domestic productive capacities and strategic integration into the global economy, whilst at the same time incorporating policies which reduce the risk of particular social groups and regions within the country being excluded from the benefits of economic growth. It also argues that international policy needs to give more attention to breaking the link between primary commodity dependence, pervasive extreme poverty and unsustainable external debt, and that policies to counter the increasing polarization of the global economy are necessary in order to reduce the socio-economic marginalization of the poorest countries. With improved national and international policies, a real turning point can occur.

The new poverty estimates

This Report analyses the relationship between poverty and development in the LDCs in the context of increasing global interdependence. Before the present Report, such analysis was impossible. Internationally comparable poverty estimates that were publicly available covered too few LDCs over too few years. This Report overcomes this problem by using a new set of poverty estimates for 39 LDCs over the period 1965–1999. This data set has been constructed specially for the Report. But it has important implications for the global analysis of poverty and also for the achievement of Millennium Development Goals and International Development Targets, as well as the achievement of the UNLDC III development targets.

The new estimates are based on a simple notion of what poverty is. Poverty is understood in absolute terms as the inability to attain a minimally adequate standard of living. The standard of living is measured by the level of private consumption, and those who are poor are identified by adopting the $1-a-day and $2-a-day international poverty lines which are now conventionally used to make internationally comparable estimates of global poverty. These international poverty lines specify the level below which private consumption is considered inadequate, and are measured, again in line with current practice, using purchasing power parity (PPP) exchange rates, which seek to correct for differences in the cost of living between countries.

Many now argue that poverty is multidimensional, constituted by an interlocking web of economic, political, human and sociocultural deprivations, and characterized not simply by a lack of economic opportunity, but also by insecurity, vulnerability and powerlessness. The Report does not reject the multidimensional definition of poverty. Indeed, it is clear that this view offers an accurate description of the human experience of poverty. However, it uses a narrower definition as this enables greater analytical power, both to put national poverty dynamics in a global context and to understand the multidimensionality of the processes underlying these trends. The approach is best seen as complementary to approaches based on a multidimensional definition of poverty.

Although it uses a traditional definition of poverty, it innovates in the way in which the poverty estimates are derived. Current global and national poverty estimates which use the $1-a-day and $2-a-day international poverty lines are based on survey data of household income or consumption. The poverty estimates used in this Report are different. They are based on national-accounts-consistent poverty estimates which calculate the proportion of the population in a country who are poor using (i) average annual private consumption per capita as reported in national accounts data, and (ii) the distribution of private consumption amongst households as reported in household survey data.

It should be noted that national-accounts-consistent poverty estimates diverge from the World Bank's poverty estimates, which adopt the $1-a-day and $2-a-day international poverty lines but use household survey data to estimate both the average level and the distribution of private consumption. The nature of this divergence is important for global efforts to reduce extreme poverty. National-accounts-consistent poverty estimates suggest that the severity of poverty has been hitherto underestimated in the poorest countries, particularly in Africa, that the poverty-reducing effects of economic growth have equally been underestimated, and that the domain in which the $1-a-day international poverty line is most relevant is countries with a gross domestic product (GDP) per capita of less than $700.

The divergence between the household-survey-based and national-accounts-consistent poverty estimates should be a matter of concern for all engaged in more effective poverty reduction in developing countries. It implies that there is an urgent need to improve poverty statistics. This will require investment in statistical capacities for national accounts as well as household surveys, and a major effort is required in the LDCs in both respects. However, in the meantime, it is necessary to proceed with policy analysis.

This Report bases its analysis on national-accounts-consistent poverty estimates because these provide as plausible estimates for the international comparison of poverty as purely household-survey-based poverty estimates. Data from neither national accounts nor household living standard surveys are perfect. But it is likely that national accounts procedures are more standardized between countries than household surveys, and this is particularly important as the purpose here is international comparison of poverty. Preliminary research also shows that national-accounts-consistent poverty estimates are more highly correlated with some non-monetary indicators of poverty than current household-survey-based poverty estimates.

Finally, national-accounts-consistent poverty estimates are adopted for a pragmatic reason. With these estimates, the Report has found a close statistical relationship between the average level of private consumption per capita and the incidence of poverty. It is so close in fact that one can use national accounts data on private consumption, which are widely available, to make statistically robust estimates of the expected incidence and depth of poverty in countries and years in which there are no household survey data. It is these estimates which are used throughout this Report. They are the only way now available to describe levels of poverty in a large number of LDCs and to analyse their trends over time. The new poverty estimates open, for the first time, the opportunity to analyse empirically the relationship between poverty, development and globalization. The Report creates and seizes this opportunity.

The nature of poverty in the LDCs

The new poverty estimates prepared for this Report indicate seven major features of poverty in the LDCs.

Firstly, most LDCs are characterized by a situation in which absolute poverty is all-pervasive throughout society. During 1995-1999, for the group of LDCs for which we have data, 81 per cent of the population lived on less than $2 a day and the average level of consumption of these people was only $1.03 a day (in 1985 PPP dollars). Fifty per cent of the population in the LDCs lived in extreme poverty, that is on less than $1 a day, and their average level of consumption was just 64 cents ($0.64) a day. Extrapolating these patterns for LDCs for which we do not have data, it may be estimated that the total number of people living on less than $1 a day in all the 49 LDCs during 1995-1999 was 307 million, and that the total number of people living on less than $2 a day was 495 million. The total population of the LDCs at that time was 613 million.

Secondly, the incidence and the depth of poverty are particularly severe in African LDCs. In the second half of the 1990s, for the group of African LDCs for which we have data, 87 per cent of the population was living on less than $2 a day and the average consumption of these people was only 86 cents a day. Sixty-five per cent of the population in the African LDCs lived on less than a $1 a day, and the average consumption of these people was just 59 cents a day. In only 5 out of 29 African LDCs for which we have data are less than 80 per cent of the population living on less than $2 a day. These numbers suggest that the severity of the poverty problem in African LDCs has been hitherto underestimated.

Asian LDCs, in contrast, have poverty rates which, although extremely high in a global context, are relatively less severe. In the second half of the 1990s, for the group of Asian LDCs for which we have data, 68 per cent of the population were living on less than $2 a day and the average consumption of these people was $1.42 a day. Twenty-three per cent of the population were living on less than $1 a day, and the average consumption of these people, 90 cents a day, was much closer to the poverty line.

Thirdly, the incidence of extreme poverty is increasing in the LDCs as a whole. In the LDCs for which we have data, about 48 per cent of the population were living on less than $1 a day during 1965–1969, compared with 50 per cent during 1995–1999. This means that the number of people living in extreme poverty in the LDCs has more than doubled over the last thirty years, from 138 million in the second half of the 1960s to 307 million in the second half of the 1990s. The proportion of the population living on less than $2 a day was more or less the same in the second half of the 1990s as in the second half of the 1960s. This means that the number of people living on less than $2 a day in the LDCs has also more than doubled over the last thirty years.

Fourthly, the trends in extreme poverty in the LDCs contrast markedly with those in a sample of 22 other developing countries for which we have made national-accounts-consistent poverty estimates. The trends in the incidence of extreme poverty in the other developing countries, which are strongly influenced by what is happening in large, low-income Asian countries, particularly China, India and Indonesia, were sharply downward from the 1960s to the 1990s. As a corollary, the problem of extreme poverty in the world is increasingly becoming an LDC problem. Indeed, according to the new poverty estimates, the LDCs have already become the primary locus of extreme poverty in the global economy.

Fifthly, there is a major contrast between trends in extreme poverty in Asian LDCs and African LDCs. The proportion of the population living in poverty in Asian LDCs for which we have data fell from 36 per cent during 1965–1969 to 23 per cent during 1995–1999. Over the same period, the depth of poverty also fell, with the average consumption of those people living on less than a $1 a day rising from 84 cents a day in the second half of the 1960s to 90 cents in the second half of the 1990s. Although not as impressive as the sample of other developing countries, this record in poverty reduction is far superior to what has been happening in the African LDCs. The proportion of the population living in extreme poverty there increased from 56 per cent during 1965–1969 to 65 per cent during 1995–1999. After an initial improvement, the depth of poverty has also increased in African LDCs since the mid-1970s. The average consumption of those living on less than $1 a day declined from $0.66 a day during 1975–1979 to $0.59 a day during 1995–1999.

Sixthly, amongst the LDCs, there is a close association between the incidence of extreme poverty and dependence on exports of primary commodities. Sixty-nine per cent of the population in non-oil commodity exporting LDCs were living on less than $1 a day during 1997-1999, and in mineral-exporting LDCs the proportion was over 80 per cent. The share of the population living on less than $1 a day was on average lower in service-exporting LDCs (43 per cent). It was even lower in LDCs that have managed to diversify into exporting manufactured goods (25 per cent), although excluding Bangladesh, which weighs heavily in the overall average, the share of the population living on less than a $1 a day in LDCs exporting manufactures was 44 per cent.

Seventhly, and lastly, in LDCs whose major exports are non-oil primary commodities, the share of the population living in extreme poverty increased from 63 per cent during 1981–1983 to 69 per cent during 1997–1999. The increase was particularly marked in mineral-exporting LDCs, in which the share of the population living in extreme poverty increased from 61 per cent to 82 per cent. In LDCs exporting services the incidence of poverty has also been rising, though more slowly than in the non-oil commodity exporting LDCs. In LDCs which have diversified into exporting manufactures, the incidence of extreme poverty has fallen from 30 per cent during 1981–1983 to 25 per cent during 1997–1999. The average incidence of poverty has fallen in this group of countries whether or not Bangladesh is included.

As a corollary of these trends, commodity-dependent LDCs are the predominant locus of extreme poverty in the LDC group. During 1997–1999, 79 per cent of the total number of people living in extreme poverty in the LDCs lived in countries which specialize in primary commodity exports. The number of people living in extreme poverty in commodity exporting LDCs increased by 105 million between 1981–1983 and 1997–1999, whilst the numbers living in extreme poverty in LDCs which have diversified into exporting manufactures and/or services increased by 10 million. The distinction between commodity-exporting LDCs and manufactures-exporting LDCs overlaps with the distinction between African and Asian LDCs, but is not completely identical.

THE INTERNATIONAL POVERTY TRAP

In most LDCs absolute poverty is generalized in the sense that the majority of the population live at or below income levels which are sufficient to meet their basic needs, and the available resources, even when equally distributed, are barely sufficient to cater for the basic needs of the population on a sustainable basis. Poverty is also generally persistent. *The central argument of this Report is that poverty is pervasive and persistent in most LDCs because they are caught in an international poverty trap*.

The overall argument can be summarized in five propositions:

- In societies where there is generalized poverty, including the LDCs, sustained economic growth normally has strong positive effects in reducing poverty, particularly extreme poverty.
- However, generalized poverty acts as a major constraint on economic growth, particularly through the way in which generalized poverty affects the domestic resources available for private investment and all public goods, including governance, and also affects environmental assets.
- International economic relationships can play a key role in helping LDCs break the cycle of generalized poverty and economic stagnation.
- However, in many LDCs, particularly those dependent on primary commodity exports, an interrelated complex of international trade and finance relationships is reinforcing the cycle of generalized poverty and economic stagnation which is, in turn, reinforcing the negative complex of external relationships.
- The current form of globalization is tightening rather than loosening this international poverty trap.

The opportunity for rapid poverty reduction through sustained economic growth

In situations of generalized poverty, sustained economic growth normally has strong positive effects in reducing poverty, particularly extreme poverty. The typical pattern of change is evident in the relationship between average national levels of private consumption per capita and the proportion of the population living on less than $1 a day and less than $2 a day. The new poverty estimates indicate that the incidence of poverty falls in a regular and predictable way as the overall level of private consumption per capita rises. This relationship is much closer than was previously imagined on the basis of household-survey-based poverty estimates. The new poverty estimates also indicate that the incidence of extreme poverty will fall much more rapidly than was previously imagined. Current predictions of the potential for future poverty reduction are thus over-pessimistic.

For a country where average private consumption per capita is about $400 a year (in 1985 PPP dollars) one would typically expect that about 65 per cent of the population would be living on less than $1 a day. If the average private consumption per capita doubled to $800 a year, one would expect less than 20 per cent of the population to be living on less than $1 a day.

The potential for rapid poverty reduction in very poor societies through economic growth should not come as a surprise. One should expect that the growth–poverty relationship in situations of generalized poverty differs from that in rich countries where only a minor part of the population live in absolute poverty, or in middle-income countries which have already achieved a measure of prosperity, but where a significant proportion of the population have been left out of the development process. In the rich countries, economic growth is unlikely to be sufficient to reduce absolute poverty because, no matter how high an economy's per capita income may be, there will always be individuals or households that, because of their own special circumstances or because of sectoral shifts or cyclical fluctuations, fall below the poverty line. Poverty reduction in these circumstances necessarily involves income transfers, social welfare systems or targeted job creation programmes. In the middle-income countries, redistributive measures are also vital. But in situations of generalized poverty, where the available resources in the economy, even when equally distributed, are barely sufficient to cater for the basic needs of the population on a sustainable basis, poverty reduction can be achieved on a major scale only through economic growth which raises household living standards.

This conclusion follows necessarily from the typical relationship between the incidence of poverty and average levels of private consumption per capita which the Report identifies. The form of this relationship already includes within it the effects on poverty of increases in inequality which typically occur in low-income countries as average incomes and consumption rise. But, of course, the incidence of poverty will not fall if rising GDP per capita is not accompanied by increases in private consumption per capita.

The cycle of generalized poverty and economic stagnation

Although there is a major opportunity for rapid poverty reduction in conditions of generalized poverty, it is very difficult to realize that opportunity precisely because absolute poverty is generalized. In these circumstances, not only does economic growth affect the incidence of poverty, but also the incidence of poverty affects economic growth. In societies where there is generalized poverty, poverty itself acts as a major constraint on economic growth.

A major mechanism through which this occurs is the negative feedback effects of generalized poverty on domestic resources available to finance investment and public goods, including governance. Where the majority of the population earn less than $1 or $2 a day, a major part of GDP must be devoted to the procurement of the necessities of life. During the period 1995–1999, for example, the average per capita income in the LDCs when measured in terms of current prices and official exchange rates (rather than 1985 PPP dollars) was $0.72 a day and the average per capita consumption was $0.57 a day. This implies that on average, there were only 15 cents a day per person to spend on private capital formation, public investment in infrastructure and the running of vital public services, including health, education, administration and law and order.

With such limited domestic resources, it is difficult to finance new investment from domestic resources. Economic vulnerability is high as domestic resources are insufficient to cope with climatic and external shocks. Finally, there is an underfunding of public goods and services, including administration, law and order and the whole system of governance. Providing the necessary physical capital stock, education, health and other social and physical infrastructure to keep pace with population growth is a constant problem.

The higher the incidence of poverty is, the greater this constraint of domestic resource availability. Focusing on the LDCs in our sample where over 80 per cent of the population live on less than $2 a day, it is apparent that the domestic savings rate is on average no more than 2 to 3 per cent of GDP, total government consumption expenditure (which includes health and education) was on average $37 per person a year during the period 1995–1999, and health expenditure was on average $14 per person per year over this period.

These low levels of government expenditure per capita are primarily not the result of weak mobilization of resources by the public sector. For LDCs for which we have data, government revenue (excluding grants) as a share of GDP was on average about 16 per cent of GDP during the period 1995–1999, which was not much lower than in other developing countries. However, given the very small size of the GDP of most LDC economies, this average translates in real per capita terms into very low levels of public service provision.

The extremely limited availability of resources implies that Governments of LDCs are constantly faced with making difficult choices about the provision of different vital public services. Most of the public services such as health, education, agricultural support services, general administration and law enforcement, which form the foundations of modern economic development, are held back by serious supply constraints in the LDCs. No doubt there is room for improvements through reallocation of public expenditure. However, beyond that, what is required is the release of the constraint on domestic resource availability.

In many LDCs, not only are the domestic resources available to finance investment and public services pitifully low, but also a forced process of environmental degradation is taking place. This occurs when survival necessitates eating into the natural and environmental capital stock. In the poorest LDCs, "genuine domestic savings" — a measure of savings which subtracts from domestic savings the reduction in national wealth associated with the depletion of environmental resources and the depreciation of man-made capital stock — are on average minus 5 per cent of GDP. Many of these countries are not simply stuck in a low-level trap of underdevelopment, but have fallen into a downward spiral. Environmental assets on which most livelihoods depend are being eroded, and high population growth rates, environmental degradation and increasing poverty are mutually reinforcing each other.

The opportunity for economic growth through global integration

International economic relationships can play a key role in helping LDCs to break out of the domestic vicious circles which cause generalized poverty to persist.

Firstly, access to foreign savings can play a catalytic role in helping poor countries to break out of the low-level equilibrium of low incomes, low domestic savings and low investment. Once growth starts, foreign savings also permit a faster rate of growth of private consumption without the degree of belt-tightening which would be necessary if growth were financed wholly through domestic savings.

Secondly, generalized poverty implies that national demand is very limited, and national markets tend to be undynamic and usually segmented in ways which enable people to survive. Exporting to international markets enables land and labour resources, hitherto underutilized owing to domestic demand constraints, to be productively mobilized.

Thirdly, increased access to available modern technologies enables latecomer economies to realize significant productivity increases without having continually to reinvent. Exporting can facilitate this because a major channel for technology transfer to poor countries is through imports of machinery and transport equipment. Foreign direct investment can also serve as an important channel for technology acquisition under the right circumstances.

Fourthly, increased international migration enables poor people in poor countries to find employment even if opportunities are limited in their own country.

The fact that international relationships can play a major role in breaking the cycle of economic stagnation and generalized poverty has led some analysts to conclude that the key policy problem for LDCs is that they are not sufficiently integrated into the global economy. But this is a false inference.

International trade is already of major importance in the economies of LDCs. During 1997–1998, exports and imports of goods and services constituted on average 43 per cent of their GDP. The average level of trade integration for the LDCs is around the same as the world average, and also almost the same as the average for the group of countries which have been identified in the recent World Bank report *Globalization, Growth and Poverty* as "more globalized developing countries". The average level of trade integration is actually higher than that of high-income OECD countries.

Similarly, LDCs already rely very heavily on external finance to supplement their meagre domestic resources. During the period 1995–1999, the size of the external resource gap, measured as the net trade balance in goods and services, was equivalent to about 90 per cent of gross domestic investment and about 125 per cent of government consumption expenditure in the LDCs where over 80 per cent of the population was living on less than $2 a day. For the other LDCs, the proportions were somewhat lower. But the budgetary and accumulation processes are still dominated by external resources, particularly foreign aid inflows.

The problem for the LDCs is not the level of integration with the world economy but rather the form of integration. The current form of integration, which includes weak export capacities, is not supporting sustained economic growth and poverty reduction. Indeed, for many LDCs, external trade and finance relationships are an integral part of the poverty trap.

International trade, external finance and the cycle of poverty

The way in which international trade and finance relationships are an integral part of the poverty trap is most clear in those LDCs which depend on primary commodities as their major source of export earnings. As we have seen, it is in these countries that the problem of extreme poverty is most severe. It is also in these countries that the problem of socio-economic marginalization in the world economy is most dramatic. Weighted by population and estimated in PPP terms, the average income per capita in the world's 20 richest countries was 16 times greater than that in non-oil commodity exporting LDCs in 1960, but by 1999 it was 35 times greater. Trends in those LDCs which had by the end of the 1990s diversified into manufactures and/or services exports have been different. The average income per capita in the 20 richest countries was 8 times greater than that of this group of LDCs in 1960 and 12 times greater in 1999. During the 1990s, there was actually very slow convergence between income per capita in the richest countries and that in the manufactures and/or services exporting LDCs.

These income convergence trends mirror the poverty trends identified earlier. In the light of the importance of economic growth for poverty reduction, the persistence of extreme poverty can be properly seen as the result of the failure of commodity-dependent LDCs to share in global economic growth.

Within the commodity-dependent LDCs, the cycle of generalized poverty and economic stagnation is reinforced by a negative complex of external trade and finance relationships. This complex has three interrelated elements:

- Falling and volatile real primary commodity prices;
- Unsustainable external debt;
- A donor-driven aid/debt service system.

There has been a long-term downward trend in real non-fuel commodity prices since 1960. Comparative research shows that the commodity prices recession of the 1980s was more severe, and considerably more prolonged, than that of the Great Depression of the 1930s. In 2001, the UNCTAD combined non-fuel commodity price index, deflated by the price index of developed countries' manufactured exports, was at one half of its annual average for the period 1979–1981. Most commodity-dependent LDCs have been particularly exposed to the adverse consequences of these trends because productivity is low and they generally export a very narrow range of undynamic and low- value-added products. With very high rates of extreme poverty and low levels of education, it has been difficult to mobilize investment resources and know-how to upgrade production. Losses in market share have thus reinforced the effects of falling real commodity prices.

A further problem is that there is a close link between commodity dependence and the build-up of an excessive external debt burden. During 1998–2000, all except four of the commodity-dependent LDCs (Bhutan, Eritrea, Solomon Islands and Uganda) had an external debt burden which, according to international norms, is unsustainable. There are obviously many reasons for the build-up of the debt, including domestic mismanagement and corruption. But the degree of probability that commodity-dependent countries with generalized extreme poverty run up an unsustainable external debt is so high that the debt problem is properly regarded as systemic, rather than simply a national issue. Common factors are at work which affect all countries of this type.

Once a country has an unsustainable external debt, this has a number of negative features that further reinforce the trap of generalized poverty. First, as a very large proportion of the debt is owed by Governments rather than the private sector, debt servicing reduces resources available for public investment in physical and human capital. Second, the debt overhang acts as a deterrent to private investment, particularly because of uncertainty. Domestic interest rates may also be very high. Third, debt service payments tighten the foreign exchange constraint. Fourth, high levels of external debt also deter private capital inflows, contributing to a general perception of risk that discourages lenders and investors. Although highly indebted countries still receive foreign direct investment (FDI), they have been effectively marginalized from international capital markets. One important consequence of this is that it is difficult to access short-term loans in order to moderate the effects of external and climatic shocks.

Unsustainable external debt also undermines aid effectiveness. This is partly through the effects of external debt on private sector investment and on government capacities to provide public goods. But during the 1990s, the failure to put in place adequate debt relief for countries whose debt was mainly owed to official creditors led to the development of an aid/debt service system in which aid disbursements were increasingly allocated, implicitly or explicitly, to ensure that official debts could be serviced. This compromised the developmental effectiveness of aid, which has in turn reinforced and rationalized aid fatigue.

Globalization and the international poverty trap

Globalization — the increasing flows of goods and resources across national borders and the emergence of a complementary set of organizational structures to manage these flows — is tightening the international poverty trap of commodity-dependent LDCs and intensifying the vulnerabilities of LDCs which have managed to diversify out of primary commodity exports into exports of manufactures and/or services. This is happening directly, through the way in which globalization is changing the world commodity economy, and indirectly through the effects of globalization on more advanced developing countries which are then impinging on the development prospects of the LDCs.

Important changes in the world commodity economy which have occurred recently include: an increasing concentration of international trade, with a dramatic reduction in the number of firms with significant market shares, and vertical integration of large firms; an increase in the minimum requirements for capital resources, sophisticated technology and human skills for competing in more open but more sophisticated markets; the dismantling of marketing boards, trade barriers and restrictions on the operation of foreign firms in the LDCs; and the establishment of global commodity supply chains by supermarkets in developed countries. The full effects of these changes are not well known. But there is a danger of increasing exclusion of LDC producers from global markets as buyers within commodity chains upgrade their volume, reliability and quality criteria for purchasing, and as more stringent market requirements call for ever larger investments to meet buyers' quality requirements and specifications.

The current form of globalization is also affecting the relationships between LDCs and more advanced developing countries. These can be mutually supportive or competitive. But various asymmetries in the international system, together with global financial instability, are currently making it difficult for the more advanced developing countries to deepen industrialization and move up the technological ladder and out of simpler products being exported by the poorer countries. As the more advanced developing countries which have achieved a small measure of prosperity meet a "glass ceiling" which blocks their development, LDCs find it increasingly difficult to get on and move up the ladder of development.

It is significant in this regard that along with the marginalization of the poorest countries there is increasing polarization in the global economy. UNCTAD research has shown that the middle strata of developing countries, namely those with incomes of between 40 and 80 per cent of the average in the advanced countries, are thinner than in the 1970s. Also, the IMF has observed that "the forces of polarization seem to have become stronger since the early 1980s". In these circumstances, it is difficult for the LDCs to advance in a sustainable way.

Heightened competition with other exporters of low-skill manufactures is a major process increasing the vulnerability of those LDCs that have sought to escape the poverty trap by diversification out of commodities. Although these LDCs are doing better on average than the commodity-exporting LDCs, poverty levels are still unacceptably high when viewed on a global scale and the growth path and poverty reduction trajectory of those countries remain fragile. LDCs exporting manufactures have, like those exporting commodities, experienced the adverse effects of falling terms of trade in recent years. Moreover, they also tend to have a narrow export base which is concentrated in low-skill products with few backward linkages within the domestic economy and low levels of local value-added. Textiles and garments exports from LDCs have often expanded on the basis of special preferences, including in particular quotas within markets of industrialized countries under the Multi-Fibre Arrangement (MFA), which will be eroded in the near future. Although the international poverty trap is not as clear for LDCs which have diversified out of primary commodities into manufactures and/or services exports, they remain vulnerable, and the sustainability of poverty reduction processes associated with the expansion of manufacturing employment is still in question.

The potential and limits of the PRSP approach

The point of delineating the international poverty trap is not to promote pessimism about the future prospects of the LDCs. It is rather to enable a better identification of the national and international policies which are required to promote poverty reduction in the diverse but particular circumstances of the 49 LDCs.

In recent years, concerns about persistent and unacceptably high poverty rates in the poorest countries have led to a rethinking of international development cooperation. The new approach, which has been developed by the IMF, OECD/DAC and the World Bank, had its origins in the broad consensus that unsustainable external debt was acting as a major impediment to growth and poverty reduction, and in the elaboration of the enhanced HIPC Initiative as a response to this problem. But it has gone far beyond debt relief now. National Governments have been asked to take responsibility for poverty reduction within their countries by developing nationally owned poverty reduction strategies. Donor countries are selectively focusing their aid and debt relief on those countries that have good poverty reduction strategies, and good systems of governance for formulating and implementing policies and mobilizing and managing public resources. Donors are seeking to work with these countries in a spirit of development partnership, keying their assistance to national priorities. There is also a move to increase the coherence of international policies to support poverty reduction in the poorest countries by providing greater market access for products from poor countries, increasing trade-related technical cooperation and, though this is much less developed, by encouraging developmental FDI and other beneficial private capital flows to the poorest countries.

The centrepiece of this new approach to international cooperation is the preparation and implementation of Poverty Reduction Strategy Papers (PRSPs). The PRSP is, simultaneously, the vehicle through which national Governments are expected elaborate nationally owned poverty-reducing policies, through which the IMF and the World Bank identify satisfactory policy environments, and through which bilateral donors are expected to align their assistance for poverty reduction. It is through the PRSP that national elements of the UNLDC III Programme of Action are being implemented in most LDCs. Effective poverty reduction will depend on how this experimental device works in practice, or rather, as the PRSP approach is not a blueprint but a process in the making, on how it can be made to work.

The analysis of this Report suggests that the potential of the PRSP approach is being undermined by three key problems:

- The incomplete transition from donor-driven policy to national ownership and policy autonomy;
- The policy content of the PRSPs;
- Resource constraints.

These problems are not an inevitable consequence of the approach, nor are they insoluble. However, if something is not done to address them, there is no reason to expect any better results than those produced by the policies of the past, and outcomes may even be worse.

The incomplete transition from donor-driven policy to national ownership and policy autonomy

Potentially the most important change which is occurring with the introduction of the PRSP approach is the transition from donor-driven policies to national ownership and policy autonomy. This transition is founded on the strengthening of the national ownership of policies. This means that policies should be domestically formulated and implemented, rather than driven by donors or imposed by the IMF or the World Bank, and that the Government should develop policies through participatory processes which involve national stakeholders and, more generally, civil society.

It is clear that with the introduction of the PRSP approach there is increasing national leadership in the technical processes of policy formulation and there is increasing, though usually circumscribed, dialogue with civil society organizations. However, enhancing national ownership and policy autonomy is proving extremely difficult. The ever-present possibility of withdrawal of concessional assistance and debt relief makes it very difficult for government officials to take the risks which would enable the full potential of the PRSP approach to be realized, and is inhibiting what national authorities feel they can say.

The transition to policy autonomy is also being hampered owing to the dearth of national capacities in key areas, including understanding the complex relationships between poverty, development and globalization, and the translation of these relationships into concrete policies. Confidence in the room for independent action is also undermined by the fact that in the initial stages of the PRSP approach, there has been a wide divergence between Interim PRSPs and conditionalities for HIPC completion point. This may well reflect the early phases of the application of the PRSP approach, but the symbolic message is that if the PRSP does not conform to what the IMF and the World Bank consider right, then what are considered the appropriate conditionalities will be established anyway.

The policy content of the PRSPs

In these circumstances, the poverty reduction strategies which are emerging in the initial stages of the PRSP approach are tending to be adjustment-oriented poverty reduction strategies. They seek to integrate pro-poor public expenditure patterns with deeper and broader structural reforms and the macroeconomic policies adopted in earlier structural adjustment programmes. Past experience suggests that for countries where productive capacities, markets and the entrepreneurial class are all underdeveloped, and where absolute poverty is generalized, such programmes are not going to be sufficient to escape the poverty trap. The policy model is wrong for achieving that particular purpose.

A large number of LDCs undertook structural adjustment programmes in the 1990s and as a result the policy environment in many LDCs changed significantly. This has had some positive macroeconomic effects, notably in reducing excessively high rates of inflation and by correcting overvalued exchange rates, and exports have also often increased. But domestic investment and savings rates have generally not increased much, private capital inflows have not been attracted, and although the decline in market share in traditional exports has often been halted, there has been no progressive structural change towards more dynamic exports. In fact, rather than an upgrading of primary commodity exports, there has been a collapse of local processing of commodities before export and also, in some cases, a decline in quality.

In general, the implementation of adjustment policies has not been followed by a steady downward trend in the incidence of poverty. For the LDCs undertaking Enhanced Structural Adjustment Facility (ESAF) structural adjustment programmes, the proportion of the total population living on less than $1 a day rose from 51 per cent in the three years before the adoption of a programme to 52 per cent in the first three years after and 53 per cent in the next three years. Given rising total population, this means that the people living in extreme poverty increased under these programmes.

The new poverty reduction strategies seek to make economic growth more pro-poor when the problem is that adjustment policies generally have not delivered, and cannot deliver, sustainable economic growth at rates sufficient to make a significant dent in poverty. As a result, there is a danger that the PRSP approach could leave countries with the worst of all worlds. The policies adopted in the new poverty reduction strategies will increase exposure to intensely competitive global markets but without facilitating the development of the productive and supply capacities necessary to compete. At the same time, there will be increased arm's length regulation and administrative guidance of social welfare through international development cooperation.

Resource constraints

The scope for poverty reduction through the PRSP approach is also being hampered by severe resource constraints. These are rooted in: (i) the failure to resolve the external debt problem, (ii) low levels of aid and the emergence of poverty reduction financing gaps, and (iii) the "one-eyed" approach to aid effectiveness. These issues will be taken up in the last section of the Overview, which deals with international policies.

National development strategies and poverty reduction

From the foregoing analysis, as well as the understanding of the nature of the international poverty trap, one must conclude that there is excessive optimism with regard to the likely impact of the new national and international policies which are being put in place with the introduction of the PRSP approach. But equally there is excessive pessimism with regard to the opportunity for rapid poverty reduction through pragmatic and practical alternatives. It should be possible, through the PRSP approach, to elaborate poverty reduction strategies that provide a real and improved alternative to past economic reforms and adjustment policies. But this will require genuine national ownership and policy autonomy based on a rebuilding of State capacities, a real break in national policies which moves beyond the adjustment policies of the 1990s, and more supportive international policies.

A central recommendation of this Report is that *it is necessary to shift from adjustment-oriented poverty reduction strategies to development-oriented poverty reduction strategies.*

This can be achieved if poverty reduction strategies are anchored in long-term development strategies rather than elaborated as extensions of past adjustment policies. In this approach priority policy actions within the PRSP, including trade issues, which currently are not treated in depth, would be derived from the overall development strategy. Private enterprise should play the leading role in the achievement of the goals of such strategies. But the development process should be catalysed and guided by a pragmatic developmental State which, through good governance of markets, harnesses the profit motive for the purposes of national development and poverty reduction. Creating capable and effective States, and also a dynamic domestic entrepreneurial class willing to commit its resources to domestic investment rather than to luxury consumption or holding private wealth abroad, is a central institutional issue which also must be addressed in a developmental approach to poverty reduction.

It is for individual Governments themselves to make their strategic choices. But the analysis of generalized poverty in the present Report suggests four general policy orientations that are likely to have wide, though contextually specific, application. These are:

- The central importance of promoting rapid and sustained economic growth;
- The establishment of a dynamic investment-export nexus;
- The elaboration of productive development policy options;
- The adoption of policies to ensure that social groups and regions are not left behind as growth takes place.

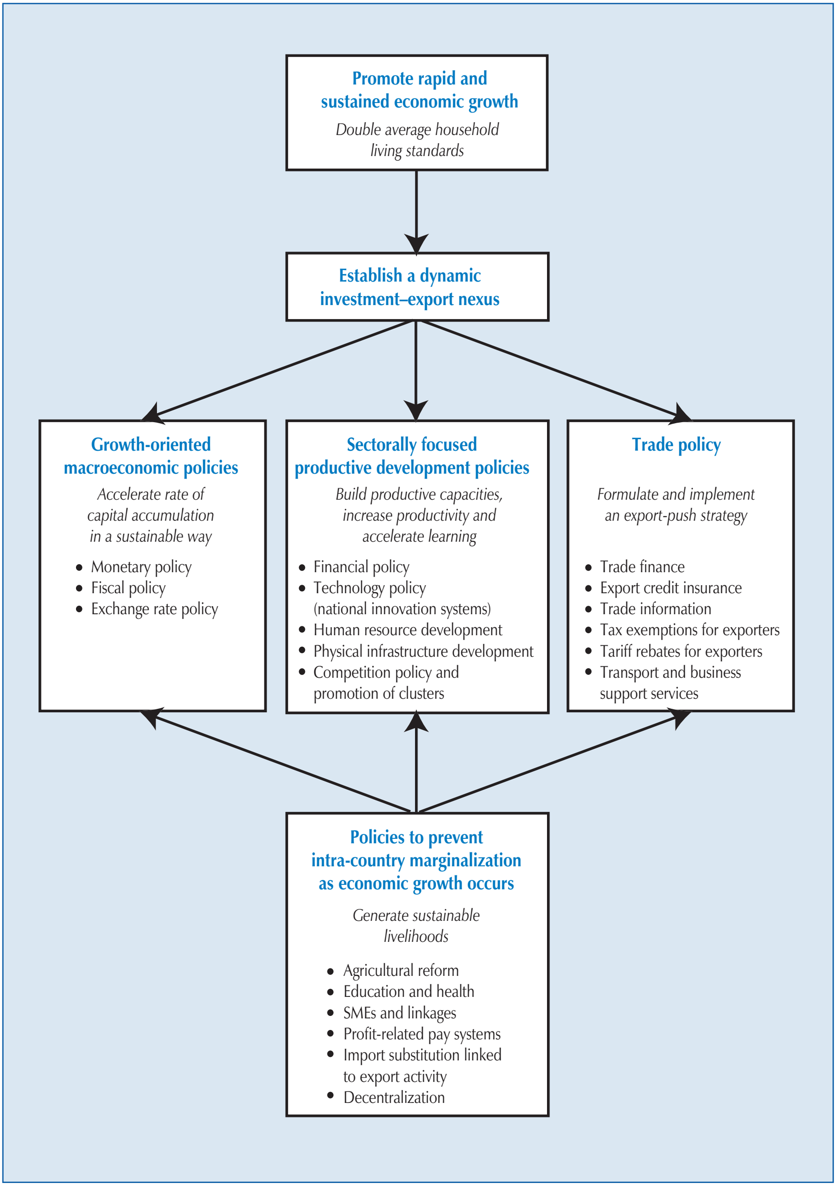
The overall approach seeks to reduce poverty through economic growth and sustained development based on building productive capacities.

The importance of rapid and sustained economic growth

Governments need to give priority to promoting rapid and sustained economic growth. Given that the average level of private consumption per capita is so low, the primary goal must be, quite simply, to *double the average household living standards as quickly as possible.*

What is required for this to occur is not simply expansion of GDP, but a type of economic growth which is founded on the accumulation of capital and skills and productivity growth, and the expansion of sustainable

Elements of a development-oriented poverty reduction strategy in LDCs



livelihoods and employment opportunities, and which thereby expands the consumption possibilities of households and individuals.

The new Programme of Action for the LDCs has a set a 7 per cent GDP growth target. This is ambitious. But if it were achieved, and if private consumption grows in line with GDP, the number of people living in extreme poverty in 2015 in the LDCs could be 200 million lower than if current trends persisted.

The paramount importance of economic growth for poverty reduction in the LDCs does not mean that inequality and exclusion can be ignored. Efficiency-expanding redistributions of assets and income are important for sustained economic growth and poverty reduction in situations of generalized poverty. The behaviour of the small proportion of the population who are rich is also relevant. Sustained economic growth depends on them using their high incomes and wealth in ways such as reinvesting profits in domestic production, which support capital accumulation, productivity growth and employment expansion. Respect for rights also matters. But the simple priority should be to double average household living standards.

The need to establish a dynamic investment–export nexus

It is necessary to establish a sustainable growth mechanism which supports a doubling of the average household living standard. The Programme of Action envisages increased rates of investment as a basis for higher growth rates. But experience suggests that a sustainable growth process requires mutually reinforcing interactions between investment growth and export growth. Moreover, although external finance, usually aid, is vitally important in the initial stages of building an investment–export nexus, particularly to jump-start the process, the sustainability of growth will be best ensured if domestic savings start to grow along with investment and exports, and over time increasingly drive the process.

Establishing a dynamic investment–export nexus requires the creation of profitable investment opportunities, reducing the risks and uncertainty of investment activity, and ensuring the availability of finance so that entrepreneurs are able to invest in expanding production. Policy interventions of various kinds must play a key role in setting the general conditions for a faster pace of capital accumulation and in correcting specific market failures which impede access to finance and technology. It is also necessary to give export activity a special push with special incentives. There are a range of well-tried export promotion measures, which for LDCs are still WTO-compatible, including: tariff rebates, so that export companies have access to imported goods at international prices; tax exemptions; preferential credits allowing exporters access to finance at internationally competitive rates; export credit insurance; the provision of information through export promotion agencies; and subsidized infrastructure. Important strategic issues which must be addressed are: whether trade expansion is best founded on upgrading primary commodity exports, or on labour-intensive manufactures, or on services such as tourism, or on some combination of these; the role of import substitution in the investment–export nexus (through backward linkages and the development of exports out of import-substitution industries); and any potential conflicts between export activity and food security.

Productive development policy options

Sound macroeconomic policies are an essential element of long-term development strategies. But short-term macroeconomic objectives of internal and external balance should be pursued through means which are consistent with long-tem development objectives and which do not require investment levels which are so low as to compromise future growth. Too tight credit ceilings can effectively undermine the ability of local firms to obtain the finance they need to expand production and improve supply capabilities. Low and stable interest rates to finance productive investment and competitive exchange rates are ingredients of a growth-oriented approach. Fiscal measures can also be used to increase corporate profitability and to encourage retention in order to accelerate capital accumulation.

Alongside growth-oriented macroeconomic policies it is important to adopt mesoeconomic and microeconomic policies that are designed specifically to improve supply capabilities and productive capacities. This is the third basic element of the policy orientation here. Such policies, which are called productive development policies in Latin America, include financial policy, technology policy, human resource development and physical infrastructure development. They are designed to accelerate capital accumulation, productivity growth and learning in specific sectors, and thereby throughout the economy, and to manage the dynamic complementarities, both between sectors and between productive enterprises, which can block profitable investment in any single one. Improving agricultural productivity is likely to be a particularly important initial sectoral focus in many LDCs as most of the population derive their livelihoods from farming.

The Government must ensure that any subsidies or rents which are provided as part of productive development policies are designed to encourage the development of supply capabilities. It is possible to do this by making subsidies or rents conditional on investment, exports, technological learning and productivity targets, by making them temporary, by focusing them on overcoming specific market failures, and by establishing "contests" amongst the private sector as an allocation mechanism. This is not a matter of hand-outs to business, but creating rent opportunities that induce economically efficient developmental actions that private markets would not otherwise undertake.

Policies to prevent marginalization within LDCs

As economic growth occurs, it is highly likely that some groups or regions will be left behind in poverty. The fourth element of the approach advocated here is therefore the adoption of policies to prevent marginalization within countries. The surest way to ensure that economic growth is more inclusive is through the wide distribution of assets, the expansion of productive employment, creating linkages that incorporate marginal sectors into the space of productivity growth, and linking import substitution with export promotion.

Particular policies are best identified through a structural approach to poverty analysis which directs attention to the generation and sustainability of livelihoods, their location within the structure of the economy and the way in which they are affected by the relations of the national economy with the rest of the world, as well as to the vulnerability of individuals and groups to impoverishment. Gender relations are included in a structural approach as an intervening variable in all economic activities, influencing the ways in which factor and product markets work, the productivity of inputs and the economic behaviour of agents, and the joint determination of the growth and distribution of income. Policies which may be important to prevent marginalization within countries include: agrarian reform and rural development policies (land tenure, agricultural productivity growth, rural industries and rural labour markets); micro-credit; support for small and medium-sized enterprises; promotion of backward linkages from export activity; broad-based human resource development through investment in education and health; establishment of profit-related pay systems; and decentralization. Application of principles of good governance can also help to ensure inclusion through greater accountability.

International policies for effective poverty reduction

Good national policies are a sine qua non for effective poverty reduction in the LDCs. But a major implication of the conclusion that the poverty trap is international, and that the current form of globalization is tending to tighten it, is that international policies are equally important. A multi-level approach is thus required.

The analysis in this Report reaffirms long-standing concerns of the LDCs regarding aid, aid effectiveness, debt relief and market access, which are major elements of the Programme of Action for the Least Developed Countries for the Decade 2001–2010. But the interdependencies identified in the analysis of the poverty trap also suggest that greater attention should be paid to two key policy issues:

- How to break the link between primary commodity dependence and the debt problem;
- How to break the link between the polarization of the world economy and the socio-economic marginalization of the poorest countries.

Increasing levels of aid

In real per capita terms, net ODA disbursements to the LDCs dropped by 46 per cent between 1990 and 2000. Aid inflows have been falling whether or not countries have what is regarded as a good policy environment. Net ODA disbursement per capita to HIPC-LDCs that have reached decision point (which requires a good policy track record in terms of the IMF and the World Bank) fell by 35 per cent in real terms between 1990 and 2000, and has fallen by 25 per cent since 1995, the year before the HIPC Initiative. There is also evidence that debt service reductions have been financed through reduction in levels of aid.

One of the major potential benefits of the PRSP approach is that it will facilitate a reversal of these trends. But countries are currently expected to submit PRSPs which are "realistic" in terms of external financing projections. This derives from a major aim of the PRSP approach, which is to ensure that government revenue and aid are used more effectively for poverty reduction, and are shown to be used more effectively. This is certainly a vital aim. However, in the context of low levels of aid, the requirement of realism results in a loss of opportunity for poverty reduction and of the ability to explore that opportunity.

Much greater poverty reduction could be achieved by increasing the resources available for poverty reduction as well as by improving the poverty-reducing efficiency of public expenditure. If prior commitments of substantial donor assistance are obtained as programmes are being formulated, higher public spending, compatible with a prudent fiscal stance, could be built in at the outset. But in practice, this is not happening. Poverty reduction financing gaps are thus emerging as Governments prepare their PRSPs. The pace of poverty reduction is then being scaled back to ensure that the PRSP is deemed realistic and thus worthy of donor support.

Donor countries' agreement within the Programme of Action to provide, within a menu of options, ODA equivalent to 0.15 per cent or 0.20 per cent of their GNP to LDCs could have powerful positive effects given the domestic resource constraints on poverty reduction. It is important that donor countries clarify what their commitments actually are and move speedily to implement them. Simple scenarios indicate that assuming the same pattern of commitments which prevailed after UNLDC II continues, and assuming that donors move to achieving the targets by 2007, a 63 per cent increase in aid flows over the 2000 level could be achieved by 2005. A doubling of aid flows, which UNCTAD has estimated is essential for accelerated growth and reduced aid dependence in the medium term, and which, according to the World Bank, would be necessary for achieving international poverty targets, could be achieved only if Japan and the United States, which are the largest donors to the LDCs in absolute terms, but which have not committed to either the 0.15 per cent or 0.2 per cent of GNP target, also come on board.

Increasing aid effectiveness

It is widely agreed that more effective aid is required as well as more aid. However, current efforts to increase aid effectiveness are based on a "one-eyed" approach which locates the problem of ineffective aid in recipient country policies, but is largely blind to the weaknesses of donor country policies. This "one-eyed" approach is the basis for the belief that the way to increase aid effectiveness is through increased selectivity, that is to say focusing aid disbursements on countries which have the right national policy environment. It is of course certainly true that aid will be more effective if national policies are right. But the emphasis placed on selectivity simply leaves out of the frame of analysis the ways in which donor policies also reduce aid effectiveness.

The introduction of the PRSP approach can potentially bring significant benefits in this regard. In the 1980s and 1990s, the process of structural adjustment, as it was carried out, itself undermined aid effectiveness. In that period, there was no mechanism for coordinating aid inflows and thus the aid delivery system was characterized by a multiplicity of fragmented aid-funded programmes and projects that generated high transaction costs for recipient countries and were weakly integrated into national economic and administrative structures. Donor alignment behind nationally owned PRSPs would effectively resolve this problem. However, progress in donor alignment has thus far been uneven, across donor countries and recipient countries.

Donor assistance should be delivered through government systems unless there are compelling reasons to the contrary; where this is not possible, any alternative mechanisms must be time-limited, and develop and build, rather than undermine or bypass, government systems. Aid effectiveness will also be enhanced through (i) increased stability and predictability of aid inflows, (ii) expeditious implementation of the OECD/ DAC recommendation to untie aid to the LDCs, and (iii) the use of aid to promote technical progress and to rectify the adverse consequences of international capital market failures. Articulating the relationship between ODA and FDI is important in the last regard. Aid should also not only be concerned with social sectors, on the grounds that these are easily monitorable as being pro-poor. In the context of increasing aid disbursements, more attention needs to be given to using aid to support production sectors, particularly agriculture, and to improve economic infrastructure.

An important institutional innovation which can promote increased aid effectiveness in the context of the principle of partnership is the introduction of donor performance monitoring indicators at the recipient country level. The approach developing in the United Republic of Tanzania may provide a working model for this.

Improved market access and its effectiveness

An important thrust of the new Programme of Action is to improve market access for LDCs and to provide trade-related technical assistance through the Integrated Framework to help LDCs take advantage of these opportunities. But improving market access for the LDCs is not simply a matter of providing quota- and duty-free access, but also of making trade preferences commercially meaningful. For example, in 1999, before the "Everything but Arms" Initiative, 99 per cent of total imports into the European Union from non-ACP (African, Caribbean and Pacific) LDCs were eligible for General System of Preferences (GSP) treatment in the EU, but only 34 per cent of the imports eligible for preferential treatment actually received it. Making trade preferences commercially meaningful requires attention in particular to the security of preferences, product coverage, rules of origin and supply capacities. It is clear that trade preferences should not be seen as a substitute for aid inflows in countries where supply capacities are weak. The Integrated Framework (IF) can help if trade-related technical assistance activities are broadly defined and focused on strengthening export supply capacities, if the principle of ownership is fully respected in the mainstreaming of trade issues into PRSPs, and if both financial assistance and technical assistance are provided. After five years of existence, the IF must now move speedily to implementing concrete capacity-building projects and demonstrating tangible benefits for the LDCs. The "disconnect" between the accumulated knowledge in providing technical assistance for commodity-dependent economies and the work of the IF needs to be speedily bridged.

Re-enhanced debt relief

Unsustainable external debt is a central ingredient of the cycle of stagnation and generalized poverty in poor countries. The HIPC Initiative was introduced following recognition of this relationship. But the debt relief provided within the framework of the HIPC Initiative, even after the latter's enhancement in 1999, opens little extra fiscal space for poverty reduction and is insufficient to enable a durable exit from the debt problem. Out of 20 HIPC-LDCs which have already reached HIPC decision point, four countries will have annual debt service payments due in 2003–2005 which will actually be higher than annual debt service paid in 1998–2000 and annual debt service payments will be reduced by less than $15 million in a further 6. In only three countries will annual debt service payments due in 2003–2005 be over $50 million less than those paid in 1998–2000.

Increased and accelerated debt relief is an important requirement for effective poverty reduction in many LDCs. As the members of the Panel which prepared the Zedillo Report emphasized, a re-enhanced HIPC Initiative merits serious consideration. This requires serious attention to be given to the problem of financing further debt relief, as it is this, rather than the needs of the countries in relation to promoting economic growth and poverty reduction, that is dictating the scale of debt relief which is being provided. In order to avoid future debt problems, it is also necessary to explore ways and means of breaking the link between falling and volatile commodity prices and the build-up of unsustainable external debt.

International commodity policy

For more than a decade after 1974, price-stabilizing international commodity agreements were the focus of international commodity policy. The success of this approach has been mixed at best, and its revival appears unlikely. The need to address the specific problems faced by commodity-exporting countries, however, is evident. Three issues are central to an international commodity policy which is concerned to promote development and poverty reduction. The first is the availability in producing countries of exportable products in sufficient volumes that would interest buyers and that meet the consumers' increasingly stringent requirements. Second, exporting countries need to enter supply chains for these products at points where higher degrees of value added are generated. The third issue is world primary commodity prices. Excessive instability in primary commodity prices, at least its negative impacts, needs to be mitigated and the problem of a continual downward trend in these prices must be addressed.

Given the abundance of supplies in world markets of many commodities of interest to LDCs, improvement of supply capacities should be interpreted to mean provision of better-quality and higher-valued products, possibly in their processed forms, rather than an outright increase in the quantities put on world markets. Technical assistance needs to be provided towards this end, and financing can be mobilized by increasing the resources available through the Common Fund for Commodities (CFC) or directly through the relevant international organizations. In areas such as research and development, quality control and assurance, a subregional approach may be adopted.

The new structure of supply chains leads to the generation of increasingly high proportions of value added at the marketing and distribution stages. The new approach to international commodity policy must include measures that would enable developing countries, particularly LDCs, to participate more fully at these stages of the supply chain. Research by international organizations, in cooperation with international commodity bodies (ICBs), is required in order to understand better the structure of supply chains, to identify the specific stages of high-value-added generation, to assess exporting countries' potential for entering these activities, and then to develop appropriate policies to enable LDCs to capture a higher proportion of the value added of the final products.

Mitigating excessive instability in world primary commodity prices, at least its negative impacts, and dealing with the problem of the continual downward trend of these prices also require concerted action by international commodity bodies and international organizations, supported by governmental policies. Past efforts to mitigate excessive instability through economic measures in international commodity agreements (ICAs) have been successful only for limited periods of time. In view of this mixed record and the current lack of political will to implement such economic measures, their reintroduction into ICAs appears unlikely. One possible approach in this respect seems to be the promotion of arrangements between buyers and sellers that are based on longer-term commitments rather than on daily dealings. All parties must accept, however, that attaining some degree of stability may mean forgoing short-term gains. The introduction of at least some aspects of "fair trade" principles into mainstream trade may be an avenue to explore in this connection. For this to happen, incentives need to be provided by Governments and there needs to be cooperation between the NGO community and large business concerns.

Price risk management instruments are a way to limit the incidence of instability for producers and traders. But for risk management instruments to be used successfully in the LDCs, innovative organizational forms will be needed to reach small farmers. A considerable investment in training will also be required and there is a need to establish the requisite institutional and legal frameworks. Ongoing application of these instruments in some LDCs is likely to reveal both the problems and the potential of this approach.

Compensatory financing is another means of mitigating some of the negative impacts of instability in prices and earnings. The international community, in discussing a new developmental approach to international commodity policy, must urgently reconsider the use of compensatory financing for export earnings shortfalls as part of an effort to address what the new Programme of Action calls "the structural causes of indebtedness".

Tackling the long-term decline in world commodity prices is perhaps the most difficult issue. International commodity policy should include modalities whereby regular consultations among international organizations, ICBs and Governments, as well as improved transparency, would help in directing efforts to increase production away from crowded markets to more dynamic products. In this connection, support is needed to assist high-cost producers in overcoming exit barriers that may prevent them from reacting rationally to declining prices, and to help those producers for whom the exit barriers cannot be eliminated. International commodity policy should also consider mechanisms for voluntary supply management schemes. In considering such mechanisms it is necessary to evaluate carefully the different objectives (elimination of accumulated stocks and reduction of production) and different instances of supply control (discouragement of new entrants, of increased production or of exports, and encouraging exit from production), as well as what is expected of consumers. In relation to declining prices, international commodity policy must also accord sufficient importance to increasing consumption of commodities, both through generic promotion and through new and innovative uses.

South–South cooperation and the problem of polarization of the global economy

Effective poverty reduction in the LDCs also requires enhanced South–South cooperation. The new Programme of Action recognizes that it can play an important role in the development of the LDCs, and encourages the use of "triangular mechanisms", through which "successful South–South cooperation may be attained using financial contributions from one or more donors, and taking advantage of economic complementarities among developing countries".

Increasing differentiation among developing countries should be seen as an opportunity for mutually beneficial interactions. Possible areas for South–South cooperation noted in the Programme of Action include the encouragement of regional trade and investment dynamics, which, as is evident in this Report, can be an important element in the development of new export capacities in the LDCs, as well as technical assistance and exchange of best practices in a range of areas (such as the Minimum Income for School Attendance Initiative based on Brazil's Bolsa Escola scheme). A number of LDCs are landlocked or transit countries, and for these countries a regional approach to transport infrastructure financing and to the development and management of transit systems is likely to be a particularly important aspect of building a dynamic investment–export nexus.

It is important that South–South cooperation be a complement, and not a substitute for North–South cooperation. It is also important that enhanced South–South cooperation takes place in a context in which the various asymmetries in the international system that are making it difficult for the more advanced developing countries to deepen industrialization and move up the technological ladder are addressed. It will be difficult for the LDCs to get on and move up the ladder of development if the more advanced developing countries face a "glass ceiling" which blocks their development.

In the end, addressing the socio-economic marginalization of the LDCs will require addressing the polarization in the global economy. Gains from differentiated treatment will be particularly strong for LDCs if an approach is adopted which enables all developing countries to advance. Indeed, this may very well be essential in order to prevent more developing countries from slipping into the LDC category.

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