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Background

This is a summary of the report of an expert group meeting on resource mobilization for poverty eradication in the least developed countries held at United Nations Headquarters in New York on 19 and 20 January 2004. The first part of the report provides an overview of the current challenges faced by the LDCs in reducing the high rates of widespread poverty. The second part discusses innovative approaches to domestic resource mobilization in LDCs, and addresses how domestic resource mobilization can be managed more innovatively and with greater effectiveness. The third part examines new approaches to debt relief and debt sustainability. It provides a brief overview of the debt situation in LDCs, and examines the need for innovate ideas to reduce foreign debt. The last section discusses specific measures to accelerate poverty reduction in LDCs. The report is intended to contribute to the debate on resource mobilization for poverty eradication in the LDCs, leading to practical solutions, policies and actions by all concerned.

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The poverty reduction challenge in LDCs

Al Binger

Most LDCs are characterized by the large number of poor people, identified as those living on less than US$ 2 a day. For instance, in the period 1995-1999, for the group of LDCs for which data is available, 81 per cent of the population lived on less than US$ 2 a day, while 50 per cent lived in extreme poverty, such as less than US$ 1 a day. An extrapolation of these patterns indicates that, with a total LDC population of 613 million people, the number of people living on less than US$ 1 a day in all LDCs was 307 million, while the number living on less than US$ 2 a day amounted to 495 million.

Poverty in LDCs is pervasive: the number of people living in poverty has more than doubled over the past thirty years. This lack of progress towards poverty reduction is most noticeable in the African LDCs. Poverty is, in general, more severe in rural than in urban areas, with the poorest of the rural poor living in remote areas. In sub-Saharan Africa, three fourths of the poor, particularly the extremely and chronic poor, work and live in rural areas, and more than half are expected to do so in 2025. The remoteness, but also the lack of natural, physical, human and social resources, as well as social and political exclusion, are aspects of persistent rural poverty. People in irrigated zones within rural areas face a much lower poverty risk.[a]

The poverty situation in LDCs indicates that a significant proportion of the population has been left out of the development process. In the developed and some middle-income developing countries, poverty reduction involves income transfers, social welfare systems or targeted job creation programmes. But, in situations of generalized poverty (as in the majority of LDCs), where the available resources in the economy, even if 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.

The majority of LDC economies are highly dependent on the export of commodities for earning foreign exchange and generating economic growth. For these countries, the export value of primary commodities and the incidence of extreme poverty are closely related. To illustrate, from 1997-1999, 80 per cent of the people experiencing extreme poverty in the LDCs lived in primary commodity exporting economies. The number of people living in extreme poverty in the commodity-exporting LDCs increased by 105 million between the periods 1981-1983 and 1997-1999. In contrast, over the same period of time, the number of people living in extreme poverty in LDCs with more diversified economies increased by only 10 million. Moreover, for the latter group of countries, the incidence of extreme poverty fell from 30 per cent during 1981-1983 to 25 per cent during 1997-1999.

The international economy can play a key role in helping LDCs break the cycle of generalized poverty and economic stagnation. However, the current form of globalization is tightening rather than loosening the poverty trap. For the vast majority of LDCs, sustained economic growth will require significant foreign resources to reverse the existing negative net resource transfers that results from their high indebtedness.

A major challenge for the LDCs is to take the necessary steps to create an enabling environment that makes these countries attractive for foreign investors. The elements of a conducive enabling environment would include such factors as sound macroeconomic polices, good governance, rule of law and protection for investors. However, for LDCs, the establishment of such a supportive environment is an essential but insufficient requirement for mobilizing the necessary investments. It is also necessary for these countries to put in place additional policies and incentives that foster the development of their private sector and provide the ability to exploit the opportunities of international trade. This means a more productive agricultural sector, which now provides the major source of employment and livelihood in these countries; the development of more effective small and medium-sized enterprises; and, where possible, the expansion or establishment of larger-scale enterprises.

Mobilizing domestic financial resources for the development of the private sector in LDCs is difficult for a number of reasons: the high cost of finance and debt servicing reduces the availability of financial resources at the national level; the financial sector is underdeveloped, risk averse, and offers only a limited range of products; and, there is limited access to financial services in the more remote areas. There is, therefore, a need for LDC Governments to become innovative in mobilizing domestic financial resources to support the development of the private sector. Additionally, international development partners will need to live up to their commitments to provide both debt relief and development assistance. This would provide LDC Governments with the resources to finance social expenditures and the infrastructure critical for sustained economic growth, as well as to invest in developing the capacity needed to ensure good governance.

Innovative approaches to domestic resource mobilization in LDCs

There is a need for innovation and greater effectiveness in domestic resource mobilization, with a particular focus on the linkages to poverty reduction and growth. In this context, a sound fiscal policy, responsible social spending, and a well functioning and competitive financial system are crucial elements for economic and social development.

Financial sector reform policies for growth and poverty reduction

Measures should be taken to put in place a solid financial infrastructure that enables enterprises to enter the market and operate effectively, as well as to help restructure firms to operate efficiently in competitive national and global markets. Furthermore, with respect to the poor, who usually operate either in the non-monetized system or in the informal financial sector, there is a need to encourage participation in the formal financial sector. The approach to be adopted should focus on two areas: reducing the risk associated with lending; and providing incentives for financial institutions to diversify financial products in order to cope with the operational requirements of businesses and households. In these two areas, the following actions are recommended:

- Development of collective investment schemes should be promoted—directly or indirectly—in order to open up investment opportunities for small-savers and increase the mobilization of domestic savings.
- Capacity-building in formulating viable projects should be strengthened (for example, advising on feasibility studies and project write-up) to meet the requirements of banks.
- Small businesses should be encouraged to form consortia or business associations (including farmer associations) that can guarantee certain loans to the businesses operated by members.
- Local governments in most LDCs are often too dependent on tax revenues and should, therefore, explore other sources of revenue. One alternative is market-based borrowing, such as issuing marketable instruments (or “certificates”) which could attract household

savings and investments from the corporate sector and financial institutions. The success of this approach would depend on the financial conditions of the local government, i.e. whether it is operating under a balanced budget and maintaining up-to-date audited annual accounts and a highly transparent system of public accounts.

- Closer links between formal and informal financial markets should be developed by encouraging formal financial institutions to mobilize deposits and allocate credit through informal and community-based banks and microfinance agents in areas where the reach of formal banks is limited. Fiscal policies, as well as regulatory and supervisory structures, should be designed to encourage these developments.
- Not-for-profit financial cooperatives, such as credit unions and savings and credit cooperatives should be encouraged to further support savings mobilization. Banks could improve their services to small-scale farmers and enterprises by syndicating small loans with financial cooperatives and community banks, thereby promoting resource mobilization and financial intermediation. In this context, there is a need for continued improvement in the legal framework governing links between financial cooperatives and locally based financial institutions, such as community banks and other financial institutions. Improvement in internal auditing and the procedures of financial cooperatives are also recommended.
- Action should be taken to restructure and recapitalize existing development financing institutions to spearhead national and regional investment financing, and enable firms to make long-term investments in a competitive environment. Furthermore, central banks should be encouraged to promote the growth, efficiency and geographical spread of development finance institutions. This could be achieved by providing equity capital, or by creating an enabling environment for existing financial institutions to diversify their products.
- There is also a need to diversify financial instruments and products available for financing productive investments. In particular, the development of capital markets, leasing activities, venture capital, bond markets, securitization (structured finance), derivatives (financial contracts whose value is derived from the value of another asset), factoring (a form of receivables finance) and microfinance are some of the instruments that can be developed to fill gaps in the existing financial system.

- Capital markets should be revitalized to enable them to raise larger amounts of finance for companies. Action needs to be taken to introduce institutional procedures and mechanisms to create confidence on the part of investors. Corporate and financial sector governance needs to be improved, in particular in the areas of regulation and supervision, transparency, and contract enforcement. This could entail improving the conduct of public companies, disclosure requirements, and shareholders' rights, as well as the regulatory and supervisory role of central banks.
- The small size and limited diversity of many LDC economies suggest that a regional approach to resource mobilization is needed to lower transaction costs and the risks involved in financial sector development and other forms of domestic resource mobilization. For instance, mechanisms should be established to link emerging domestic capital markets with regional and international capital markets.[b] Also, to the extent possible, regional monetary authorities should be created as they stand a better chance of enjoying independence and credibility than national central banks.
- Action should be taken to build local capabilities in risk management. This encompasses development of trust and policy credibility, as well as governance procedures. Macroeconomic risks can be reduced by pursuing sound macroeconomic policies, improving coordination between fiscal and monetary policies, and careful management of government borrowing. Market risks can be mitigated by improving capital market efficiency, reducing interest rate volatility, developing secondary markets for treasury bills and improving liquidity management by Governments. Microeconomic risks can be lowered by improving the accuracy, reliability and timeliness of financial information, enforcing financial contracts, providing efficient and reliable payment systems, risk-sharing and credit risk insurance schemes, and enhancing diversification in small markets.
- Furthermore, the development of credit rating agencies stands out as one of the possible options that would help reduce risk and check the high lending rates charged by financial intermediaries in the country. Credit rating agencies can help the financial intermediaries overcome asymmetric information and its related problems: adverse selection (a phenomenon under which potential borrowers with higher credit risks are the ones who most actively seek and get loans) and moral hazard (the risk that borrowers might divert

loans and therefore lower the probability of repayment). Equally important, credit rating agencies could help to de-emphasize the high importance attached by financial intermediaries to track records, a requirement that results from mistrust and lack of information about potential borrowers.

Microfinancing

Microfinance has been introduced in a number of countries to enhance the access to finance by small businesses. Its effectiveness has been limited by its narrow coverage and a weak, and not always appropriate, regulatory system. One problem with microfinance institutions (MFIs) in the past has been that they were often paternalistic. Some MFIs have been used for political ends and most have been subsidized in ways that were detrimental to achieving sustainability. In the changed environment of political and economic liberalization in most LDCs, the situation is likely to be different. To create a conducive environment for a proper functioning of MFIs, it is important that LDC Governments take into consideration country conditions. Key areas in this respect include: access to services; a regulatory and incentive framework; proper financing for institutions; and the use of 'second-tier' institutions (financial intermediaries or networks providing financial and institutional support services to retail intermediaries), where appropriate.

Experience around the world has shown that micro-entrepreneurs do not need subsidies and that micro-lenders cannot afford to subsidize borrowers. Low-income entrepreneurs want rapid and continued access to financial services, rather than subsidies. Most micro-enterprise clients see the "market interest rate" as the rate charged by the money lender or curb market, which is often double the interest rate charged by micro-lending institutions. Subsidies in the form of lower interest rates often send the signal to borrowers that the money comes from government or donors who regard the poor as objects of charity. Borrowers may perceive this as a signal not to repay.

Microfinance offers the potential for sustainability and growth. Due to its demonstrated success in providing benefits to the poor, international donors and Governments are increasingly willing to support MFIs. Many Governments have set up facilities that channel funds from multilateral agencies to MFIs. Scaling-up this successful approach will require partnerships among civil society, government and donors to provide seed money for expansion. For example, despite their high liquidity, private banks in Thailand were reluctant to lend without collateral — a situation that also exists in LDCs. In order to increase the availability of credit, the Thai Government became the guarantor so that banks made loans directly to communities, who then decided how they could utilize such funds. Furthermore, scaling-up microfinance may also require commitments of grant resources to help offset the overhead cost associated with operating these facilities. For instance, in the case of Bangladesh's Grameen Bank, a pioneer in this field, experience has shown that MFIs may remain constrained by high expenses per unit transacted, and a reliance on donors and socially conscious investors.[c]

Generally, in building policies, regulations and incentives for financial institutions that serve the poor, several principles and practices are essential:

- Institutions lending to micro- and small enterprises should be encouraged to enter the market and expand, and be free to set their own lending interest rates. Incentives should be provided to these intermediaries;
- Entry thresholds, such as minimum capital requirements, should be kept low enough to allow specialized institutions that meet performance standards to operate as recognized financial intermediaries;
- Supervisory and reporting requirements should be kept simple and focus on key performance indicators.

Government assistance

To help build financial institutions that serve the majority of the population, LDC Governments should adopt and promote new approaches to funding, such as:

- Grant funding over a period of time to finance the operating costs and loan portfolios of promising start-ups;
- Capitalization for financial institutions that meet performance standards;
- Access to refinancing from development banks and other second-tier intermediaries (financial intermediaries or networks providing financial and institutional support services to retail intermediaries (see below)); and,
- Partial loan guarantees to encourage the build-up of leveraged credit lines by local banks to specialized financial intermediaries. When an institution has reached the scale and

efficiency to cover costs and manage fully commercial sources, it will be able to access international commercial funds.

Use of 'second-tier' institutions

Second-tier institutions (financial intermediaries or networks providing financial and institutional support services to retail intermediaries), such as development banks, have major roles to play over the next five to ten years as wholesalers of capitalization, sources of refinance, and institutional development support, in the following areas:

- Building an agreed set of standards of eligibility criteria for accessing support services;
- Organizing performance benchmarking systems;
- Encouraging an exchange of experiences among participating retail institutions;
- Serving as a wholesaler or broker of seed funding, capitalization funds, refinance of loan funds, and institutional development support;
- Encouraging linkages between commercial banks and specialized financial intermediaries; and
- Helping ensure that the appropriate legal, regulatory and supervisory structures and incentives are in place.

Mobilizing resources through fiscal policies and tax reform

Many LDCs are experiencing unsustainable fiscal deficits, high debt-service costs and declining official development assistance, all of which adversely affect their development process. A particular challenge for these countries is the application of fiscal measures for domestic resource mobilization through tax and non-tax instruments. Fiscal policies should be equitable and create minimal disincentives for economic efficiency. However, most tax administrations lack the resources required to function in an efficient manner and most taxpayers have limited capacity to keep the necessary accounts. That has often led to the tax administration to focus on businesses that are the least resistant and easily identifiable. These types of businesses tend to be overtaxed, which, in turn, leads to tax evasion and corruption. Interest groups of taxpayers may also make it difficult to reform a tax system which would increase their tax burden. Another major challenge is that of capturing tax revenues from the informal sector, which often requires a reform of the tax system to ensure compliance among taxpayers.

A desirable feature of a tax reform is that it should not introduce changes in relative prices and should leave the allocation of resources undisturbed. This is achievable by broadening the tax base and keeping tax rates as uniform as possible. Reforms should also focus on establishing an efficient and simple tax structure with the following common elements: low rates, a broad base, few exemptions, few surcharges, few temporary measures and, where there are exceptions, clear guidelines. A successful reform of the tax administration additionally requires political commitment and a well-trained staff. It is also important to find the appropriate incentives for taxpayers and tax administrators. These incentives should go along with measures that minimize the cost of tax compliance and establish procedures for detecting violations and imposing appropriate penalties.

Mobilization of resources through fiscal policies should be accompanied by efficient spending of fiscal resources. In particular, the allocation of government spending should be poverty sensitive. Furthermore, domestic resources can be mobilized by reorienting fiscal expenditures towards areas that attract private savings and investment. This could, for instance, involve public expenditure policies for infrastructure development, communication, and human capital development. In LDCs, fiscal spending on, and investment in, rural roads and utilities would have a positive impact, not only in opening up the rural economies and thereby improving rural incomes, but also in creating a favourable environment for financial service providers to operate in rural areas, thus further stimulating the mobilization of resources.

New approaches to debt relief and debt sustainability in LDCs

Overview of external debt in LDCs

The build-up of foreign debt is not only a result of the high levels of external borrowing, but also a consequence of varying exogenous and endogenous factors, such as adverse movements in the terms of trade for agricultural commodities and some minerals (particularly in relation to strategic imports such as petroleum), governance failures, unsuccessful macroeconomic and structural reforms, poor debt management and internal conflicts. In general, the build-up of debt and the resulting debt-servicing obligations have taken up large parts of the scarce budgetary resources of the LDCs that could otherwise have been directed to productive and social areas.

Since the mid-1980s, the debt overhang of developing countries has become a major item on the agenda of official creditor nations. Traditionally, the Paris Club approach has been to reschedule debt-servicing payments, often combined with new lending from the IMF and multilateral development banks.

The Heavily Indebted Poor Countries (HIPC) Initiative, which was launched in 1996 in response to the growing international pressure for debt forgiveness for the poor countries, was intended as a comprehensive approach to address the external debt problem of poor countries. However, the World Bank itself, at the technical level, has been critical of the HIPC Initiative, pointing out procedural and conceptual flaws. The procedural weaknesses have resulted in a slow disbursement of funds, due to the various conditionalities that must be met in order to access the HIPC resources. Conceptual weakness included the assumptions that went into defining the level of the debt sustainability target. Some have argued that the concept of the debt sustainability level was not based on sound economic principles, and that projections of economic growth and export performance were over-optimistic. Additionally, questions were raised about the generic “one-size-fits-all” approach, and about the extent to which the debt-relief proposal was linked to sustainable development. The HIPC Initiative has also failed to take into consideration the extent of capacity weaknesses in the participating countries, and the need for effective governance in such key areas as transparency, rule of law and security for the investor. Lastly, the HIPC Initiative did not represent a source of the new financial flows which are required to stimulate economic growth and thereby generate the resources for sustainable debt servicing.

In most LDCs, such basic infrastructure as well-defined property rights, roads, schools, hospitals, and clean water are inadequate to serve as a basis for profitable economic activity. Since the principal problem of these countries is a lack of infrastructure, it is unlikely that debt relief will stimulate inflows of private foreign capital, nor that there will be higher investments and growth. These are reasons to suggest that LDCs should not be targeted for debt relief but for direct aid, to assist these countries in building their institutions and infrastructure, and eventually to make them attractive for both domestic and foreign investment. In this context, there has also been concern that debt relief may crowd out existing aid flows, in that it does not necessarily represent new financial resources. To illustrate, aid flows to the HIPCs increased continually from 1970 to the mid-1990s. Since 1996, however, aid flows have decreased significantly. As a share of GDP, the decline is also salient: while in the early 1990s, aid flows were about 17 per cent of the GDP of the recipient countries, since 1996, they have only been about 12 per cent. Together, the fall in aid flows and the postponed reduction in debt service have caused a significant decline in the net resource transfers to the HIPCs.

The apparent weaknesses of the original HIPC Initiative raises the question whether trying to retool and launch an enhanced HIPC is the best available option to the international community, and points to the need for innovative ideas to reduce foreign debt.

Using annual debt-service payments to establish public-private partnerships for national energy efficiency initiatives

With the exception of those LDCs with significant oil and gas production, expenditures on imports of oil and gas represent a large share of the limited foreign exchange available to most LDCs. Additionally, in the case of the landlocked developing countries and small island developing countries, the high cost of transportation contributes to high domestic energy prices, negatively impacting on poverty reduction, directly through the high cost of energy services, as well as indirectly, through its negative impacts on economic growth and competitiveness.

In many developing countries, petroleum is used less cost-effectively than in the developed world. In the majority of LDCs, opportunities exist for improving energy efficiency, and consequently for a reduction in the amount of energy resources imported. But, on many occasions, a major constraint to undertaking energy efficiency initiatives is the high cost of domestic financing and the absence of supportive government policies. In this respect, foreign creditors should be encouraged to use annual debt repayments as investment resources in energy efficiency projects in LDCs, which could yield rates of return higher than the commercial interest rates in the creditor countries. Over time, the savings in foreign exchange from reduced petroleum imports would provide LDCs additional resources for repaying their outstanding foreign debt and making the associated interest payments.

Using debt-service payments to establish public-private partnerships for renewable energy development

By virtue of their geographical location, the vast majority of LDCs has significant renewable energy resource endowments in the form of solar, wind, biomass, ocean and hydro power. One of the major recommendations from the World Summit on Sustainable Development

(WSSD) for fostering sustainable development in LDCs is the development of renewable energy resources, to reduce both dependency on petroleum imports and its negative impact on global climate change, as well as to create local employment.

There are opportunities to lower the cost of petroleum imports by raising energy efficiency but, for LDCs, the cost of capital and the absence of supportive government policies often act as obstacles. The development of public-private partnerships for renewable energy development could make a contribution to reducing the pressure of foreign debt on the economy, while providing employment, environmental and social benefits. This would include additional markets for rural farmers who could become producers of biomass fuel for electricity.

Using annual debt-service payments to establish public-private partnerships for infrastructure and new export markets

Limited infrastructure development is an obstacle to economic growth and poverty reduction in a large number of LDCs. To illustrate, as a result of high transportation costs, the cost of inputs and everyday necessities are high, and farmers are often unable to transport their products to markets (resulting in high levels of waste). Experiences from a number of developing countries in the use of public-private partnerships to finance roads and water supply projects represent a possible approach for LDCs. For instance, toll roads, constructed through private investment, could improve the weak infrastructure that makes poverty reduction more difficult in rural areas. As with the energy proposals above, capital investment could come from the conversion of debt payments into capital investment. Repayment of loans would be drawn from the profits from the fees charged to users of the infrastructure.

A significant number of LDCs are either coastal countries or SIDS and, as such, they often have significant resources in their exclusive economic zones. However, the limited availability of financial resources restricts the benefits they are able to derive from what is, for some countries, a large natural resource endowment. For example, fisheries are constrained by small boats and inadequate equipment that involve high personal risks and provide limited economic benefits to fishing families. As the traditional fishery resources of the developed countries become depleted, there is a growing opportunity for profitable investments to service an established and relatively risk-free market. Similarly to the foregoing proposals on energy efficiency and renewable energy development, private–public partnerships converting debt payments into capital investments could provide financial resources for establishing profitable ventures in some LDCs.

Specific measures to accelerate poverty reduction in LDCs

In a number of LDCs, adverse economic conditions are increasing the number of the poor. Especially in the rural areas, where the majority of the poor try to make their livelihood, the macroeconomic changes recommended by the multilateral financial institutions have, so far, not resulted in sufficient levels of economic growth to increase employment and income. Actions to accelerate production and productivity should provide the foundation for increased opportunities for the unemployed and under-employed, generating income earnings and making existing livelihoods more rewarding and sustainable.

Increasing access to financial resources

Evidence from microfinance clients in developing countries has demonstrated that access to financial services enables poor people to increase their incomes and build assets, offers the potential for growth and helps safeguard poor households against vulnerability. MFIs have been credited with addressing the structural determinants of poverty, the economic and social status of women, and other sources of vulnerability. In general, MFIs offer a range of financial services, including credit, savings and insurance to poor enterprises and households, often helping to even out income fluctuations and maintaining consumption levels during lean periods. Typically, MFIs are located near their clients, and utilize lending technologies that are simple and inexpensive for both the client and lender.

The early MFIs were launched by non-governmental organizations and banks such as the Grameen Bank (Bangladesh, 1976), the Kenyan Rural Enterprise Programme, Banco Solidario (Bolivia, 1992), and Bank Ratyat Indonesia (BRI, 1984). In Ethiopia, formal MFIs began emerging in 1995. By 2001, there were 19 MFIs serving over 600,000 clients, which represented 15 per cent of poor rural households registered with the National Bank of Ethiopia, deposits with MFIs totalled about US$ 20 million and the sector was growing steadily.[d] In West Africa (in Burkina Faso, Guinea, Mali and Senegal, for example), where MFIs are in the early stages, MFI programmes demonstrate the viability of making financial services available to the rural poor.

Additional examples of MFIs operating in rural areas are BRAC in Bangladesh, SHARE in India and Zambuko Trust in Zimbabwe. An impact assessment study of BRAC in Bangladesh showed that members who participated in the programme for more than four years increased household expenses by 28 per cent and assets by 112 per cent. Access to financial services enabled BRAC clients to reduce their vulnerability by smoothing their consumption, building assets, and receiving services during natural disasters.[e] A study of SHARE in India revealed that three fourths of the clients saw improvements in their economic well-being and half the clients graduated out of poverty. Participation in the Zambuko trust had a positive impact on the consumption of high protein foods in extremely poor client households. In general, experiences from an increasing number of successful MFIs show that with new methods of lending, often involving small loans without collateral and at full-cost interest rates (repayable in frequent instalments), the vast majority of clients repaid on time.[f]

Establishment of farmer support services facilities in rural areas to improve agricultural sector incomes

The objective of any policy to reduce poverty in rural areas involves raising the incomes of farmers, by increasing their productivity and the income received from their products. In the case of African LDCs, the need for an increase in productivity is apparent from the fact that the population of sub-Saharan Africa increased by more than 3 per cent annually in the 1980s and early 1990s, while food production increased by less than 2 per cent.

The constraints in sub-Saharan Africa are agro-ecological and socio-economic. There is a lack of water and the soils are often hard to cultivate. About 38 per cent of the land base in eastern and southern Africa is arid or semi-arid desert. Of the remaining 62 per cent (where at least 86 per cent of the rural population lives), just under half can produce one rain-fed cereal crop per year. Socio-economic constraints include subsidized food imports from Organization for Economic Cooperation and Development (OECD) countries, food prices which have been kept low in order to favour consumers over producers, lack of market transparency, lack of access to such resources as land and credit, and inadequate knowledge and limited research to improve agriculture.[g]

In view of these constraints, Governments, with the support from international donor agencies, in partnership with NGOs and the private sector—particularly those involved in agricultural inputs, marketing, or agro-industry, should consider establishing farmer support services in rural areas. These services should assist farmers with access to credit, technical assistance, capacity building, marketing information crop and product diversification.

Development of rural infrastructure

In many LDCs, weaknesses in basic national infrastructure (such as transport, utilities and communications) are major constraints on agriculture. Infrastructure constraints affect the cost and continuity of production and the quality of products. For instance, numerous studies have indicated that the provision of roads reduces the costs of inputs and outputs, and leads to an increase in agricultural output, crop area and yield. Infrastructure helps make the more remote rural areas part of a broader market, contributing to the marketability and profitability of agriculture. It also promotes information flows between communities and rural and urban areas, and thus has the potential of linking farmers to markets for goods, input supplies and agricultural services. More generally, rural infrastructure plays a vital role in empowering people, connecting isolated communities and providing rural people with access to political and decision-making entities. In this context, LDCs and their development partners need to identify critical infrastructure requirements and address them on a priority basis.

Make international aid a catalyst for economic development in LDCs

Several of these measures to accelerate poverty reduction require external financial assistance in the form of aid and loans. Without an increase in development assistance to the LDCs to develop financial services for the poor, improving infrastructure, implementing land reform, building mechanisms for good governance, and supporting small and medium enterprises to create a diversified and modern rural sector, the chances of achieving the Millennium Development Goals appear limited for the majority of LDCs.

It is important to consider both the quantitative and qualitative aspects of aid. To enable donors to test the effectiveness of their support, new approaches (such as the performance-based conditionality being implemented by the European Union) are required, focusing on outcomes in key economic and social sectors (rather than on the implementation of specific policy measures or actions). Mechanisms focusing on outcomes in key economic and social sectors, and a good governance regime as a prerequisite for assistance, should create an enabling environment for a new partnership between the international donor community and LDCs to promote economic growth, which is the only sustainable means of reducing poverty.

Accountability of Multilateral Financial Institutions

The relationship between economic growth and poverty in developing countries is complex, and, so far, no general understanding has been reached over the best approach to achieving poverty reduction. 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 concessional aid and debt relief. Efforts to improve the standard of living of the poor should continue, 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. In the past, the lack of accountability of the development partners of LDCs may have contributed to additional hardships in a number of these countries. In this respect, as part of the overall accountability of Governments for good governance, and to improve the effectiveness of the World Bank and the IMF, multilateral financial institutions should be held accountable for the policy advice that they provide to LDCs.

Other measures to accelerate poverty reduction in LDCs

Other measures to accelerate poverty reduction in LDCs range from the establishment of agricultural commodity insurance, to strategies to promote export diversification, to action to end the dumping of surplus food production from developed countries in LDCs. The key elements of such measures should be formulated in further detail, but fall beyond the scope of this report.

Conclusions

Several challenges need to be addressed in order for the vast majority of LDCs to achieve the international poverty reduction goal envisioned by the Millennium Development Goals. Despite implementing macroeconomic reforms and fiscal polices recommended by the multilateral financial institutions, economic growth in many LDCs is inadequate. In order to address the resource constraints which limit the ability of LDCs to foster economic growth and poverty reduction, Governments need to develop innovative approaches for mobilizing domestic financial resources. Domestic resource mobilization can be managed more innovatively for greater effectiveness. This report makes a number of suggestions ranging from providing better access to financial services for the poor, through microfinancing systems, to financial sector reform policies for growth and poverty reduction.

Foreign debt remains a major challenge not just for LDC Governments but for the international community as a whole. For many LDCs, previous initiatives like the HIPC Initiative have not been successful in providing adequate debt relief, reflecting weaknesses in design and erroneous assumptions about the ability of the LDCs to grow at high enough rates to escape the debt trap. The report makes a number of suggestions for new approaches to managing external debt by using it as a source of investment in low-risk, public-private partnerships. In addition to reducing economic vulnerability, these types of partnerships would increase employment and help drive economic growth.

The structure of most LDC economies is based on a very limited range of exports which continues to decline in price against strategic imports. Policy makers and the international donor community should develop policies to counter this trend. LDC Governments have to become more innovative in mobilizing domestic financial resources to support the development of the private sector. Additionally, development partners will have to live up to their commitments to provide debt relief and development assistance, and liberalize trade in agricultural products.

Notes

[a] See *Rural Poverty Report 2001: The Challenge of Ending Rural Poverty*, International Fund for Agricultural Development, p 21.

[b] See V. Mulinde, "Financial Institutions and the Mobilization of Resources for Development", in *The African Economy: Policy, Institutions and the Future (Routledge Studies in Development Economics),* S. Kayizzi-Mugerwa, ed. (Routledge, London and New York, January 1999).

[c] See Jonathan Morduch, "The role of subsidies in Microfinance: evidence from the Grameen Bank", *Journal of Development Economics*, vol. 60, No. 1 (October 1999), pp. 229-248.

[d] See Daniel C. Hardy, Paul Holden and Vassili Prokopenko , "Microfinance Institutions and Public Policy", International Monetary Fund, Working paper WP/02/159.

[e] Elizabeth Littlefield, Jonathan Morduch and Syed Hashemi, "Is Microfinance an Effective Strategy to Reach the Millennium Development Goals?", Consultative Group to Assist the Poor, Focus Note, No. 24, January 2003.

[f] Evaluation Office, "Microfinance: A synthesis of lessons learned", *Essentials*, No. 3, United Nations Development Programme, December 1999.

[g] Henk Breman, J.J. Rob Groot and Herman van Keulen, "Resource limitations in Sahelian agriculture", *Global Environment Change*, No. 11(2001), pp. 59-68.