Chapter II

Economic conditions and policies during MDG implementation

Summary

- Economic growth has generally been found to be supportive of progress towards achieving the Millennium Development Goals (MDGs). It increases individual incomes that are critical to satisfying basic needs and is a source of resource mobilization for Governments to invest in development.
- There have been two relatively distinct periods of economic growth. For the world as a whole, the period from 2000 to 2007/08 was a time of rising economic growth as well as increasing macroeconomic stability. The increased policy space of this period represented an opportunity for economic policies to enable progress towards achieving development goals.
- Fiscal balances and public debt improved in most developing countries. An important number of countries increased social public expenditure both in absolute terms as well as relative to total government expenditures, signalling that the economic bonanza made room for development policies. Even so, many countries' spending patterns resulted in important spending gaps for achieving the MDGs.
- The period 2008-2015 covers the global financial crisis, the subsequent "Great Recession" and, in some countries, the ensuing economic recovery. Policy space was more constrained and the effects of the crisis on the achievement of the MDGs were more or less drastic depending on the policy responses at the time.
- Some countries avoided drastic setbacks, owing to previous improvements in conditions. This came by way of increased foreign reserves, lower debt levels, already established social spending programmes, and other countercyclical measures. On the other hand, spending gaps to meet the MDGs became larger for many countries.
- The experience between 2000 and 2015 points to the general need to take advantage of periods of robust growth, pursue adequate policies for macroeconomic stability, improve the fundamental bases for weathering economic shocks, introduce the appropriate policies to reduce procyclicality in general, and devise and carefully assess alternative financing strategies to bridge public spending gaps without jeopardizing growth, macroeconomic stability and long-term development.

Introduction

This chapter reviews the economic conditions and policies that have prevailed during the years since the Millennium Development Goals (MDGs) were adopted and numerous efforts were implemented to pursue them. The focus is mostly, although not exclusively, on developing countries towards whom most of the MDGs were targeted. The review is necessary because economic conditions and policies have been critical to economic growth, which, in turn, has been shown to be correlated with the achievement of the MDGs (see section on economic growth and MDGs). Moreover, understanding the way in which economic conditions increase or undermine the policy space available is critical, since these economic conditions are usually changing and are highly influenced by the global macroeconomic environment, especially in the case of small and open economies.

There have been two periods since the MDGs were adopted: a growth and stability period and a crisis and recovery period...

There have been two relatively distinct periods since the adoption of the MDGs. The first period covers the years between 2000 and 2007/08, which, for the world as a whole, was a time of rising economic growth as well as increasing macroeconomic stability (see section on the growth and stability period). The second period covers the global financial crisis that unfolded in 2008, the subsequent Great Recession and, in some countries, the ensuing economic recovery up to the present (see section on the crisis and recovery period). Because economic conditions during these two periods were quite different, the policy space available in each period for pursuing development goals, including the MDGs, was defined differently. The first period was a time of increased policy space that represented an opportunity for economic policies to become enablers for achieving development goals. During the second period, policy space was more constrained and the effects of the crisis on the achievement of the MDGs were more or less drastic depending on the policy responses at the time.

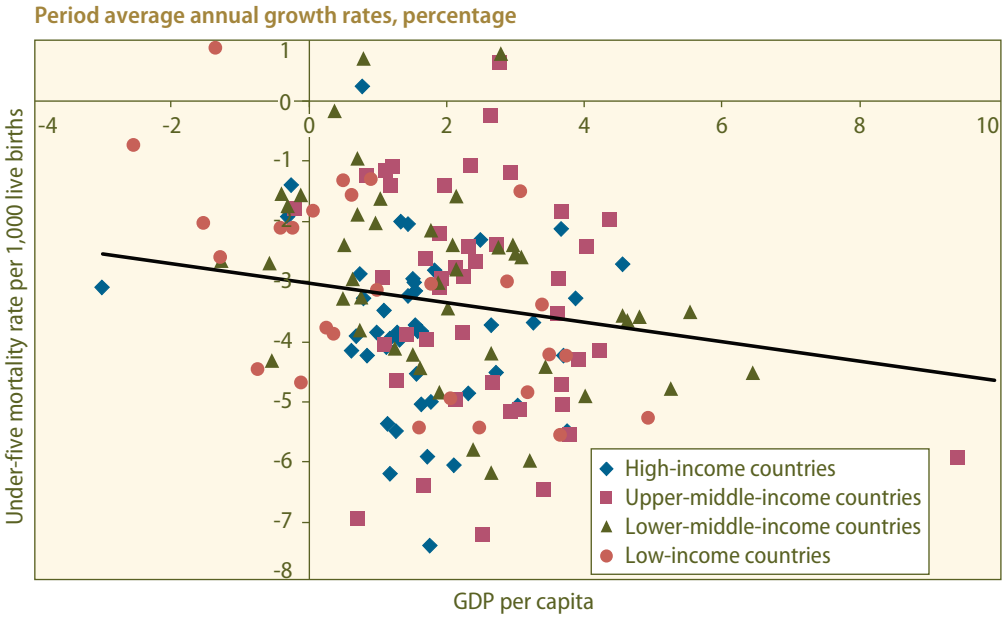
...each of which resulted in very different policy space availability for MDG achievement

Furthermore, it is important to note that the fiscal space created, especially during the first period, may not have been enough to achieve the MDGs in many developing countries that exhibited important public spending gaps. The discussion points to the importance of keeping in mind the potential macroeconomic trade-offs of any financing efforts to bridge such spending gaps within a coherent and comprehensive policy framework (see section on the challenges of bridging spending gaps). In the final section, the chapter recommends economic policy pathways for the future.

Economic growth and MDGs

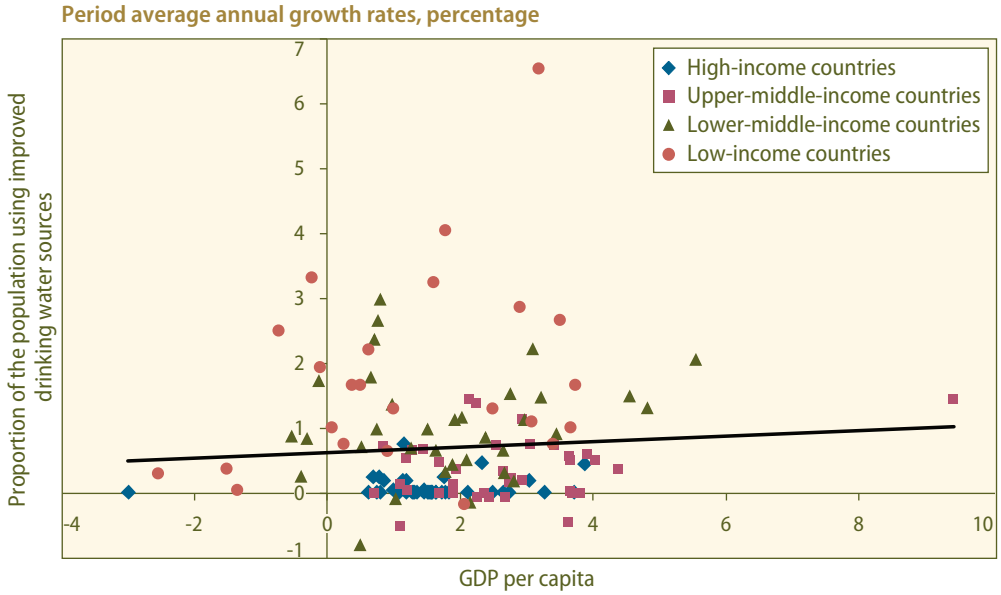
Sustained economic growth has been a critical enabler of policy space, albeit not the only one. In the 2011 Global Monitoring Report of the International Monetary Fund (IMF) and the World Bank, it is noted that, while countries that had higher per capita gross domestic product (GDP) in 1990 were more likely to have better performance in MDG indicators, an even better predictor is the rate of per capita GDP growth. "Countries that have reached or are on track to reach the targets show, on average, the fastest per capita GDP growth over 1990-2009" (World Bank, 2011a, p. 4). Economic growth is generally found to be supportive of progress towards achieving the MDGs. For example, as shown in figures II.1 and II.2, the increase in per capita GDP is associated with a decrease in child mortality and

Figure II.1
GDP per capita and under-five mortality by income group, 1991–2012



Source: UN/DESA, based on World Bank, World Development Indicators Database for GDP per capita and United Nations MDG Database for the under-five mortality rate.

Figure II.2
GDP growth and improved drinking water by income group, 1991–2012



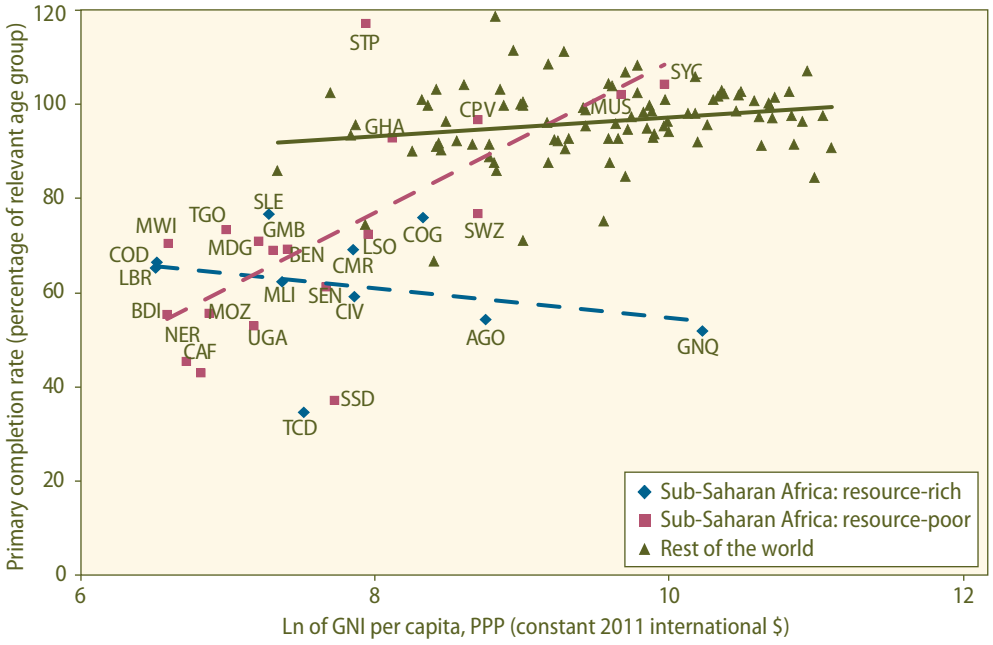
Source: UN/DESA, based on World Bank, World Development Indicators Database for GDP per capita and United Nations MDG Database for the proportion of the population using improved drinking water sources.

an increase in access to improved drinking water sources.[1] At the same time, it is important to recognize that growth in economic output is only part of the equation for improving development outcomes, and even then it can have very different effects and implications depending on specific conditions.

Nature of growth matters

For some MDG targets, the connection with economic growth may not always be so clear-cut. For instance, as shown in figure II.3 (updated based on figure 3 in Christiaensen, Chuhan-Pole and Sanoh, 2013), when income increases, the completion rate for primary school education tends to rise in most countries—as per a fitted linear trend, particularly in the resource-poor countries of sub-Saharan Africa. However, a slightly negative correlation is found between the two indicators among the resource-rich countries of sub-Saharan Africa—as per a fitted linear trend. Moreover, although per capita GDP growth in resource-rich countries in Africa was measurably higher than in resource-poor countries in the past decade, poverty reduction in the former was actually lower than in the latter. For example, in the second half of the 2000s, Ethiopia and Rwanda registered an annual average growth of 8 per cent and 10 per cent, reducing poverty by 1.3 and 1.7 percentage points annually,

Figure II.3
Income level and primary school completion rate, 2011



Source: Update of Figure 3 (p. 10) in Christiaensen, Chuhan-Pole and Sanoh (2013) using World Development Indicators.

1 Some of the figures in this chapter cover the 1990s to capture long-term trends that are critical for establishing some of the correlations presented as well as for making comparisons between that decade and the period following the Millennium Declaration. The latter covers a period of greater stability, whereas the 1990s included, for example, the Mexican Tequila crisis in 1994, the Asian Financial Crisis in 1997-1998 and the Russian Crisis in 1998. In this period, many countries saw more clear effects of the policies that are important for growth and stability (some of which were implemented in the 1990s, or even earlier).

respectively. By contrast, with similarly robust growth of 6-7 per cent, the United Republic of Tanzania reduced poverty by less than 0.5 percentage points in the same period, while Zambia, a resource-rich country, made even less progress in reducing poverty. In general, resource-poor countries in Africa outperform resource-rich countries in achieving MDGs, despite the fact that GDP growth rates in the former are, on average, half of those in the latter.

One factor behind this divergence is the nature of growth in resource-rich African countries: it is less inclusive than in resource-poor countries, as the resources sector is capital-intensive, and therefore does not create enough jobs. These economies have failed to connect the resources sector with other sectors. In resource-rich countries, the increase in resource rent accounts for a larger share of GDP growth than value added does in other sectors, such as agriculture, services and manufacturing. However, the share of employment in the resources sector is significantly smaller than in other sectors (World Bank, 2014a).

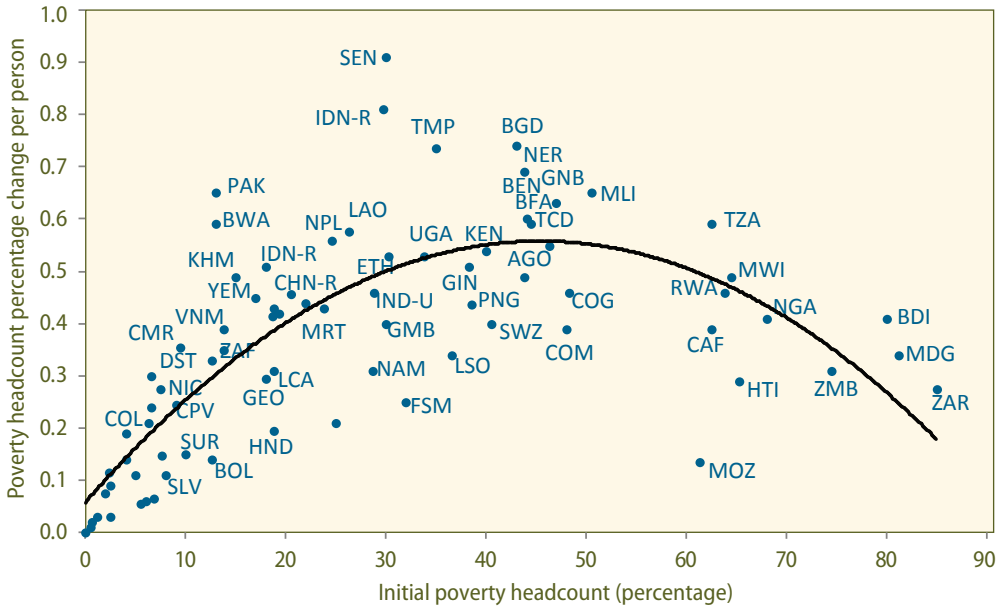
Initial level of poverty and income distribution

Growth effects on poverty reduction vary by location and period

The effects of GDP growth on poverty reduction also seem to vary considerably across countries and over time: the initial level of poverty and the income distribution are important factors behind such variability. As demonstrated in figure II.4, the poverty-reduction effect of growth seems to follow an inverted U-shaped curve with respect to the initial level of poverty across countries (World Bank, 2015a). The figure shows that the percentage change in headcount poverty (defined as income below $1.25 per day) as a result of a 1 per cent increase in per capita income, or *growth elasticity of poverty*, varies across countries depending on the initial poverty rate. For example, a 1 per cent increase in per capita income reduces the poverty rate by 0.5 percentage points in Uganda (UGA), which has a poverty rate of about 35 per cent, but by only 0.3 percentage points in Zambia (ZMB), which has a poverty rate of 75 per cent.

Figure II.4

Growth effect on poverty reduction across countries, 2010



Source: World Bank 2015b, Figure 1.1, p. 38.

The application of a *density function approach* reveals that changes in income inequality occurring as mean income grows are also important to keep in mind for understanding the effects of growth on poverty reduction (Hong, 2015). A correlation between higher levels of inequality and a lower response rate of poverty to growth has been observed for sub-Saharan Africa (Fosu, 2009). Views are divided, however, on the issue of whether growth and improvement in equality can go hand in hand or, on the contrary, follow different trajectories. The evidence supports both types of views. A study by Ostry, Berg and Tsangarides (2014), which applies statistical analyses using a sample of 150 countries for 40 years, finds that reducing income inequality could contribute positively to future growth. Utilizing the same data, Hong, Li and Peng (2014) show that reducing inequality could lead to higher growth in the countries with a Gini coefficient above 40 per cent.

In any case, economic growth supports relatively more progress towards achieving development goals when it is not only sustained but also fairly distributed. It increases individual incomes that are critical for satisfying basic needs in general, and for paying for education, health and sanitation, in particular. Increased individual incomes broaden the tax base as well, and, if private savings increase, they can potentially be a source of domestic resource mobilization for the government. The resulting tax and domestic-borrowing revenues can contribute to development if a share of them is allocated to invest in social sectors and public infrastructure, among others. This policy space will depend on the economic conditions, whether there is economic bonanza or turbulence, as further explained below.

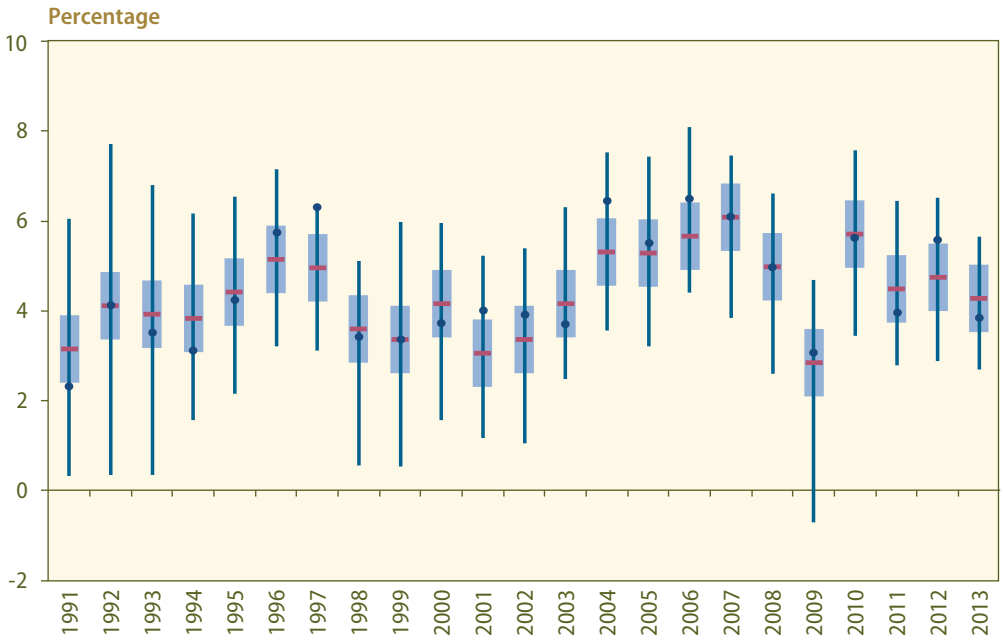
Growth and stability period (2000–2007/08)

During the period from 2000 to 2007/08, many countries saw increasing stability along with increasing growth rates. While this was not true of all countries, it was, unsurprisingly, a common factor among those that were able to make more progress in achieving the MDGs. Economic growth in general has been supportive of progress towards achieving the MDGs, as noted. There were a number of reasons behind the improving global macroeconomic environment, including increases in investment, structural change in many economies, rising commodity prices, changes in policies, growth in international trade, rising foreign direct investment (FDI) and increases in the stocks of foreign reserves in many developing countries, among others. While this chapter focuses mostly on developing countries, owing to the fact that most of the MDGs are targeted towards those countries, from a macroeconomic perspective the conditions in developed countries were important as well. Relevant links between developed and developing countries through trade, FDI, remittances and official development assistance (ODA) were all significant with regard to economic growth in this period.

In general, macroeconomic stability was improving between MDG adoption and the financial crisis

Macroeconomic stability in most developing countries improved, as compared with the decade of the 1990s. For example, average GDP growth in developing countries was appreciably higher in this period than in the 1990s, while the variation of GDP growth across countries was notably lower (figure II.5). Even in 2001, when median growth was lower than in any year of the 1990s, one can see that the dispersion of growth was lower than in most years of the 1990s. In particular, the lower bound of the vertical bar for the year 2001 in figure II.5 is well above zero, in comparison to many years in the 1990s which were nearly zero at their lower level, meaning that while median growth may have been higher, a number of countries in those years were experiencing almost zero growth (see also

Figure II.5
Distribution of GDP growth among developing countries, 1991–2013



Source: UN/DESA.
Note: Red bars represent the median growth rate and the blue dots represent the average growth rate. The vertical lines through those points represent the dispersion of growth rates across developing countries, with the blue boxes denoting the first and third quartiles.

figure II.7). Overall, according to data from the United Nations Department of Economic and Social Affairs (UN/DESA), average world gross product grew at a rate of 3.4 per cent per year between 2000 and 2008, but developing countries recorded average yearly growth of 6.0 per cent over that period.

During the period from 2000 to 2007, developed economies grew at a slower, but still steady pace of 2.5 per cent per year. Even so, economic growth in developed countries in absolute terms added trillions of dollars to the world economy, which contributed to growth in developing countries as well. This resulted in considerable rises in FDI and trade (see below) as well as rising ODA and a dramatic jump in remittances.

Inflation trended downward…

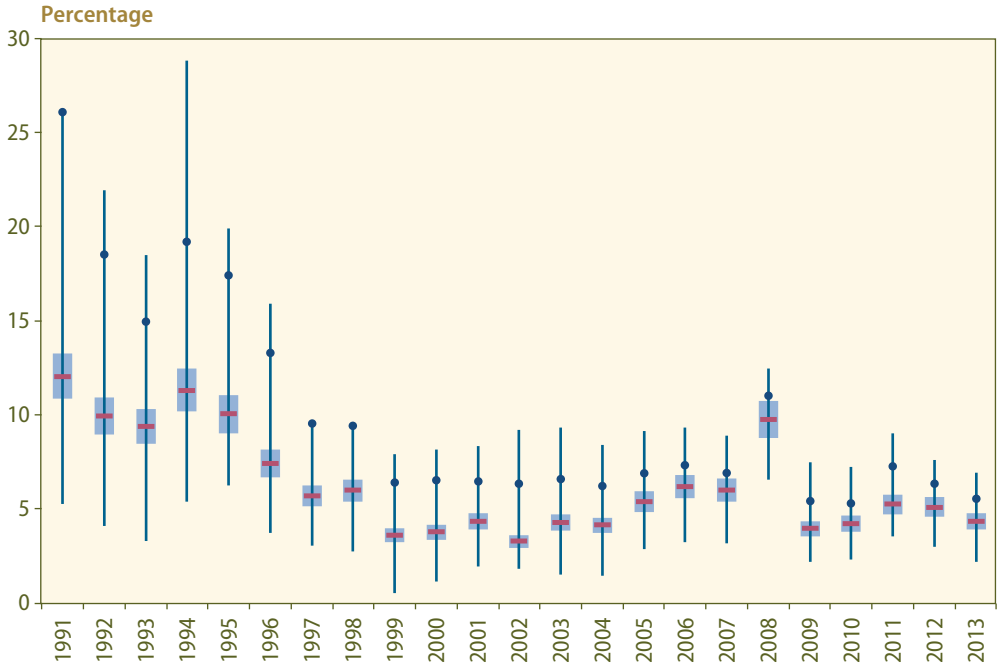
Domestic price stability of developing countries improved considerably since the 1990s. Inflation in most of these countries moderated significantly from the 1990s to the 2000s (figure II.6).[2] The inflation rate in a majority of developing countries has recently been below 5 per cent, with only a dozen developing countries witnessing inflation rates in double digits (United Nations, 2015c). Monetary policies were particularly important for price stability as further explained below. Meanwhile, the number of developing countries experiencing recession is also considerably lower during the period compared with the 1990s (figure II.7).

…while fiscal balances and public debt improved

By other macroeconomic measures, both fiscal balances and public debt in most developing countries have also improved in the past decade. The ratio of external debt to GDP of developing countries as a whole declined by several percentage points (with the exception of the Middle East and North African and emerging and developing Europe regions), and Governments managed to reduce their public total debt considerably across

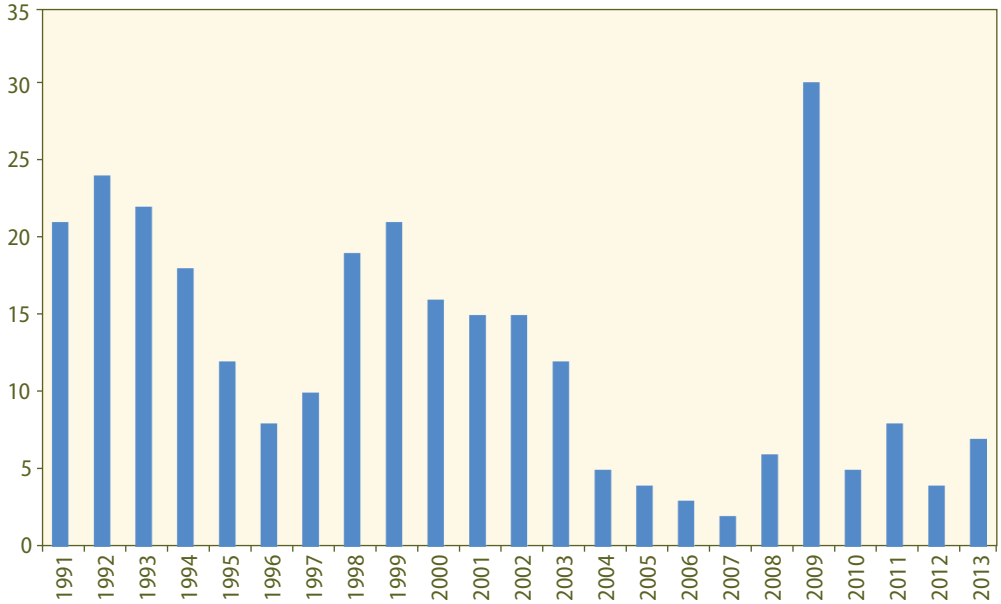
2 Domestic price stability followed a similar pattern in developed countries, but with much of the decline in inflation happening earlier, between the early 1980s and the early 1990s.

Figure II.6
Distribution of the inflation rate among developing countries, 1991–2013



Source: UN/DESA.
Note: Red bars represent the median growth rate and the blue dots represent the average growth rate. The vertical lines through those points represent the dispersion of growth rates across developing countries, with the blue boxes denoting the first and third quartiles.

Figure II.7
Number of developing countries that experienced recession, 1991–2013



Source: UN/DESA.

all developing regions (table II.1). Some of the changes in debt resulted from international debt relief initiatives such as the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI), which have reduced debt burdens for government budgets in least developed countries (LDCs) and other developing countries. At the same time, government revenue (as a percentage of GDP) also increased across developing countries partly because of the improved economic conditions as well as policy choices of Governments (see table II.1). It increased in developed countries, too, although to a lower extent. General government expenditure (as a percentage of GDP) decreased in

Table II.1

External debt and government statistics for select regional groupings, 2002, 2007 and 2013 (Percentage of GDP)

		2002	2007	2013
Advanced economies	General government gross debt	71.5	71.6	104.5
	General government revenue	34.3	36.7	36.4
	General government total expenditure	37.9	37.9	40.6
Emerging market and developing economies	External debt (public and private)	36.4	27.1	25.4
	General government gross debt	55.0	37.4	39.3
	General government revenue	23.5	27.8	29.2
	General government total expenditure	27.0	26.9	30.9
Commonwealth of Independent States	External debt (public and private)	45.6	39.9	39.7
	General government gross debt	38.4	9.3	16.6
	General government revenue	35.3	38.9	36.1
	General government total expenditure	35.1	34.0	36.9
Emerging and developing Asia	External debt (public and private)	25.5	17.2	16.0
	General government gross debt	51.6	43.8	42.8
	General government revenue	16.8	19.5	25.6
	General government total expenditure	21.1	20.6	27.7
Emerging and developing Europe	External debt (public and private)	50.1	54.5	66.3
	General government gross debt	55.3	39.2	46.4
	General government revenue	34.8	36.4	37.6
	General government total expenditure	43.2	38.6	40.1
Latin America and the Caribbean	External debt (public and private)	42.7	24.1	27.7
	General government gross debt	59.1	46.0	48.7
	General government revenue	24.0	28.3	30.0
	General government total expenditure	27.2	29.3	33.2
Middle East and North Africa	External debt (public and private)	31.3	33.4	26.3
	General government gross debt	61.2	28.7	25.5
	General government revenue	30.5	39.1	38.1
	General government total expenditure	31.1	28.2	34.0
Sub-Saharan Africa	External debt (public and private)	53.8	21.6	22.5
	General government gross debt	58.7	25.7	28.4
	General government revenue	21.8	24.2	20.9
	General government total expenditure	22.9	23.7	23.9

Source: International Monetary Fund World Economic Outlook database (April 2015 update). The data start in 2002 to maximize the available data points as many countries have missing data for the year 2000.

most developing regions, excluding Latin America and the Caribbean and sub-Saharan Africa.

Nonetheless, as will be shown below, an important number of countries, especially low-income and lower-middle-income countries increased public expenditure between 2000 and 2008. Furthermore, there has been a shift in government spending patterns as public social expenditure has increased both in absolute terms as well as relative to total government expenditures. These factors demonstrate the improving situation in the first period, which helped to provide critical policy space for countries to enact the policies that eventually enabled progress towards achieving development goals, including the MDGs.

International drivers of growth

One of the drivers of economic growth during the first period has, no doubt, been international trade, which grew relatively rapidly, particularly compared to GDP. World imports went up by an average of 6.5 per cent per year between 2001 and 2007—nearly double world GDP growth. As with GDP, developing-country growth in international trade was even higher than the world average, with exports growing by 8.8 per cent per year between 2001-2007, according to data from UN/DESA. Over the same period, developed-country trade expanded by 4.8 per cent. There were clear contributions from this broad growth in trade to developing-country economic growth and hence to these countries' opportunities to create space for development policy.

A number of factors led to higher growth, including trade expansion, rising commodity prices, growing FDI, reserve accumulation and increasing remittances

There were a number of factors that contributed to high levels of trade growth in this period, including trade policy changes over the past few decades, particularly those before the new millennium, as well as an increased integration of developing countries into global supply chains. Decreases in tariffs and reductions in barriers to trade with the expansion of multilateral trade frameworks and regional and bilateral trade agreements led trade growth to accelerate considerably in the period between the mid-1980s and 2000. This process continued into the new millennium, but slowed, leading to still high but declining trade growth. In addition, greater fragmentation of production leading to increasing integration of developing countries into supply chains over the decades prior to the new millennium led to substantially higher trade volumes. This process remained strong in the period since the MDGs were adopted, but growth of trade integration appears to have slowed more recently.

There was a broad-based rise in almost all commodity prices over this period, with fuels, minerals and agricultural prices all reaching new highs. According to statistics from the United Nations Conference on Trade and Development (UNCTAD), between early 2000 and mid-2008, prices for all commodities in aggregate almost tripled. At a somewhat more disaggregated level, there are fairly drastic changes, with petroleum more than quadrupling whereas tropical beverages did not quite double. Importantly, for many developing countries, food prices almost tripled over this period. This "commodity supercycle" was, to a large extent, triggered by the industrialization of China.

Rising commodity prices during that commodity supercycle period had a mixed effect, with some commodity exporters seeing notable benefits, while others saw pressure on their exchange rates and current-account balances as a result of rising import prices. This depended to some degree on whether countries were net commodity importers or exporters and also on countries' particular mix of commodity exports and imports. Developing countries fall across the spectrum of net commodity exporters or importers, with much of South America as net exporters, much of East and South Asia as net importers, and both net

importers and exporters found across Africa.[3] Both groups of countries—net commodity exporters and importers—saw notable growth over the period, but with different internal dynamics. Unsurprisingly, commodity exporters drew greater shares of their government revenue from those exports. For example, between 2000 and 2008, resource revenues rose as a share of government revenue from 20.8 to 39.3 per cent in Malaysia, from 4.1 to 22.8 per cent in Chile and from 43.2 to 67.1 per cent in Sudan.[4]

FDI to developing countries also grew considerably over that period, rising by 150 per cent—from $266 billion in 2000 to $668 billion in 2008 (United Nations Conference on Trade and Development, 2015). The bulk of that FDI went to East and South-East Asia and to Latin America and the Caribbean. From a percentage standpoint, however, there were still considerable increases in FDI to Africa and South Asia between 2000 and 2008, by more than 500 and 1,000 per cent respectively. While a minor fraction of overall FDI, investment in LDCs also rose considerably, by more than 350 per cent.

There are also indications that countries accumulated reserves over this period. This occurred to the greatest degree in East Asia in dollar terms, driven by surging manufacturing exports. Thailand saw its official reserve assets and other foreign-currency assets rise by 189 per cent between April 2000 and January 2008. Other countries, including commodity exporters also saw dramatic rises in their reserves. For example, Brazil's official reserve assets and other foreign-currency assets rose by over 380 per cent between December 2000 and January 2008 (UN/DESA calculation based on IMF data). These increases in reserves allowed these countries to weather subsequent shocks occurring during the global financial crisis and beyond. Reserve accumulation permitted policymakers the space to ensure more stable exchange rates, thereby limiting spillover effects that may have slowed growth and rolled back hard-won progress in achieving development goals.

Remittances have had important impacts, not only on the economy but also on poverty—generally helping to reduce it

Over this period, remittances inflows to developing countries also increased considerably; indeed, they more than quadrupled, from almost $74 billion in 2000 to $328 billion in 2008, according to World Bank data. This was important for a number of reasons, as remittances contribute to consumption and investment in developing countries, thereby reducing consumption poverty and boosting economic growth. As remittances often come in the form of foreign currency, they can also have significant effects on the exchange rate and foreign-exchange reserves. In addition, evidence points to remittances as countercyclical, meaning that they can have an important smoothing effect in times of crisis (Frankel, Végh and Vuletin, 2011). Remittances have also been shown to have important impacts at both the micro and macrolevels of the economy. Households that receive remittances have shown better outcomes with regard to health and education. Remittances are also associated with higher domestic savings rates and improved financial intermediation (Ratha, 2013).

The impact of remittances on poverty is well documented. An integrated economy-wide and micromodelling analysis found that a reduction of remittance inflows by half in seven Latin American countries would bring about adverse macroeconomic effects and a direct impact on household income and consumption, resulting in an increase in extreme poverty in a range from 0.1 per cent (Costa Rica) to 8.3 per cent (Nicaragua) (Sánchez and Sauma, eds., 2011). As further shown in box II.2, a similar quantitative

3 For more details, see, for example, *The Economist* (2014a).

4 Data from the International Centre for Tax and Development (ICTD) Government Dataset, available from www.ictd.ae/dataset.

analysis shows that a reduction of remittances in Nicaragua not only affects extreme poverty but also other MDGs. This evidence suggests that, on the contrary, an increase in remittances favours poverty reduction and may also contribute to making headway towards the achievement of other MDGs. Another study examining the impact of an appreciation in the Philippine peso during the Asian financial crisis of 1997-1998 found that the relative increase in income from the higher valued remittances led to reductions in child labour and increases in enrolment in education, particularly for girls (Yang, 2006). Studies at the subnational level corroborate the impact of remittances on education, gender and health. For example, a case study covering remittances to Kerala in India found that remittances made up 31.2 per cent of the State's net domestic product, and that almost 40 per cent of households receiving remittances used that income for education (Rajan, 2014).

Domestic policies

There were also a number of important domestic factors in laying the groundwork for the improvements in economic growth and macroeconomic stability that broadened the space for policies that have facilitated progress towards the achievement of development goals, including the MDGs. These cover a combination of monetary and fiscal policies, as well as more specific sectoral policies.

Monetary policy

A variety of different monetary policies have been important for engendering stability

Monetary policy instruments and targets for an economy should be defined in accordance with the stage of development of its banking and financial system and the specific economic circumstances. This means balancing out the need for maintaining low inflation while also minimizing exchange-rate volatility and ensuring that the economy has sufficient monetary resources for growth to proceed. This balance may differ depending on the level of development and the development priorities. In general, the stability engendered by these policies helps countries to enact long-term planning to implement development policies.

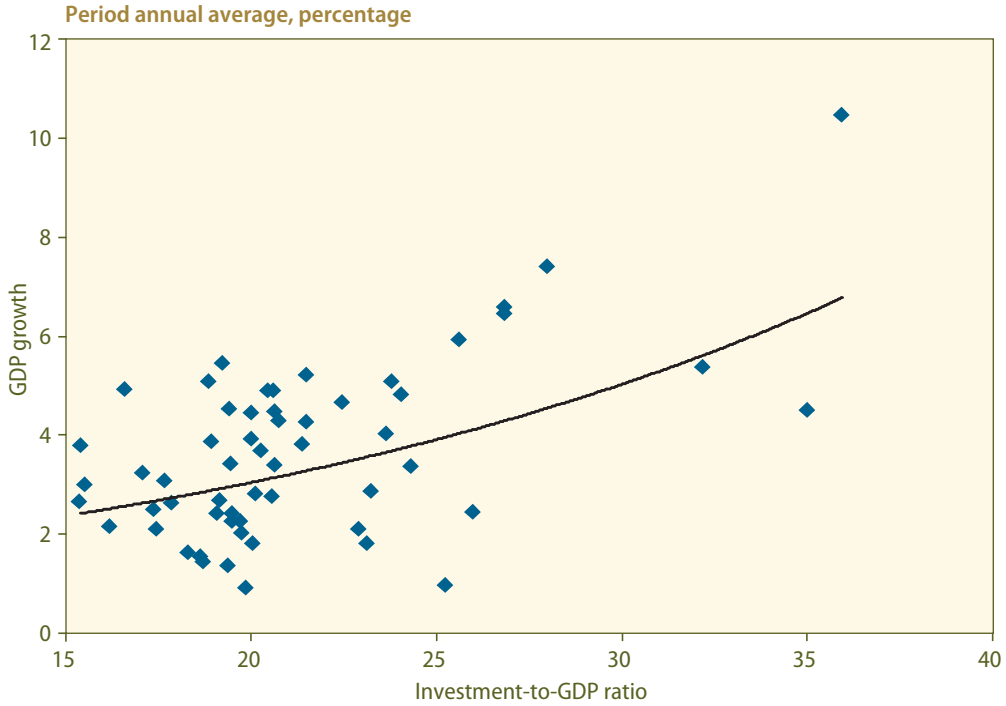
Maintaining relatively low and stable inflation has long been an important objective of monetary policy in all countries. In the past two decades, an increasing number of central banks have adopted a new monetary policy framework: targeting inflation. However, a large number of central banks also have mandates to set other targets for monetary policy, such as full employment or exchange-rate stability. Meanwhile, although short-term interest rates and open market operations have increasingly become the primary monetary policy instruments, a number of central banks in developing countries continue to rely on other instruments, such as reserve requirements, control of monetary aggregates and credit ceilings. These policies contributed to maintaining the relatively low and stable inflation rates shown in figure II.6.

Investment and sectoral policies

Policies related to investment have been another important factor in improving the growth rates of a number of countries over the past two decades. Sustained growth requires high rates of investment in productive capacities, including infrastructure, business structure, equipment and software, and research and development, as well as health and education or any other social investment that helps to build human capital. The economies with sustained

growth in the past decades often maintained an investment rate of 25 per cent of GDP, or higher (Commission on Growth and Development, 2008). For example, China maintained an investment rate above 35 per cent of GDP for three decades to achieve an average annual growth rate of 10 per cent.[5] In comparison, the average investment rate in sub-Saharan Africa has increased from 16 per cent to 23 per cent in the past decade (International Monetary Fund, 2013), leading to an increase in the region's growth rate to 5.3 per cent, second only to that of developing countries in East and South Asia, according to UN/DESA data. Among other developing regions, investment rates in most Latin American countries remain below 20 per cent. As shown in figure II.8, a number of economies that achieved an average growth rate above 6 per cent in the past two decades maintained an investment rate above 25 per cent, although a similar number of countries maintained an investment rate above 25 per cent but failed to achieve average growth above 6 per cent. This illustrates the complexity of the relation between growth and investment: a high level of investment is a necessary but not a sufficient condition for sustained growth. The types of investment matter, too, as countries with sustained high growth rates have also invested in important areas such as infrastructure, education and health.

Figure II.8
Investment and GDP growth nexus, 1991–2010



Source: UN/DESA.

5 There has recently been a debate about the high speed at which China has been investing. The effects of overinvestment on China (if that is in fact the case) are not expected to be harmful—albeit there is always some implicit cost—to the extent that investment is predominantly financed by domestic savings, which implicitly reduces the contribution of consumption in the economy. For more details, see Lee, Syed, and Xueyan (2012). These authors acknowledge that research is inconclusive as to the level and effect of Chinese investment.

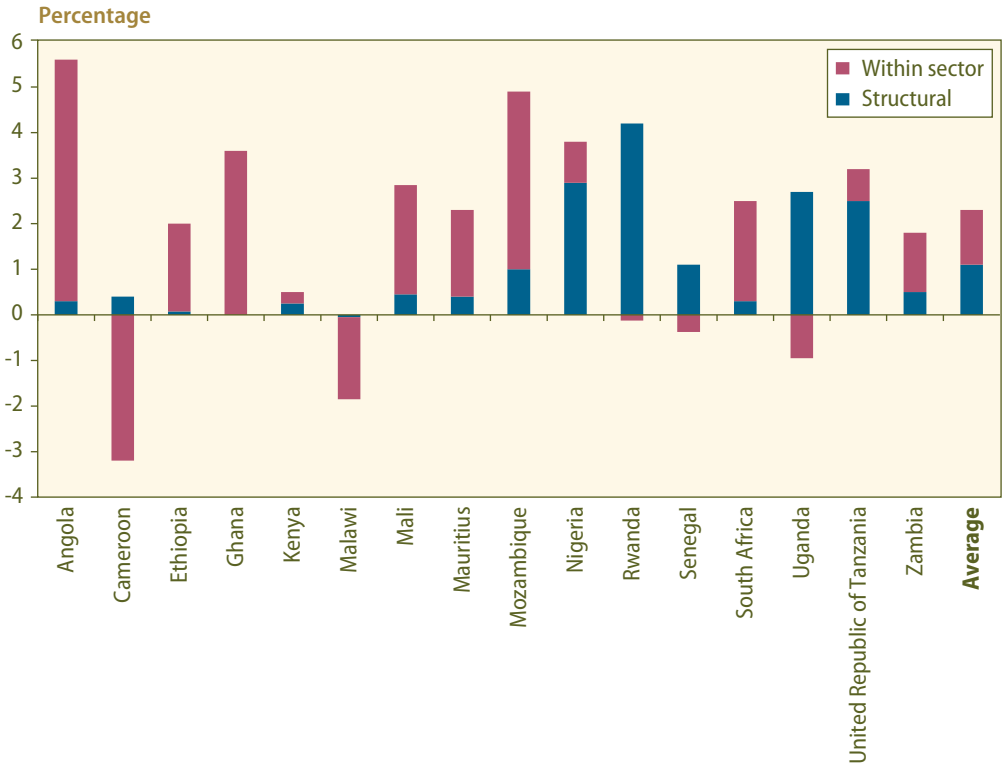
Sectoral policies, particularly related to increasing productivity and promoting the shift from agriculture to higher productivity sectors also continue to be an important aspect of improving growth prospects and reducing poverty in developing countries. For example, the remarkable achievement in poverty reduction in East Asia, including China, over the past decades, and more recently in South Asia, has been associated with policies promoting structural transformation, leading to the reallocation of millions of workers from the low-productivity agricultural sector to relatively higher-productivity manufacturing and services sectors. As a result of this transformation, a large number of farmers became factory workers and saw their productivity and earnings increase substantially (Dinh and others, 2012).

Sectoral policies, particularly for agriculture, have been an important factor in development

However, the agricultural sector continues to be important for both general economic growth and achievement of development goals—such as MDG 1—related to reduction of poverty and hunger. A study by Diao and others, eds. (2012) found that the poverty-reduction effect of agricultural growth was 53 per cent to 127 per cent larger than that of non-agricultural growth. By splitting the agricultural sector into subsectors, the study further shows that the poverty-reduction effect of productivity growth of smallholder staple crops is greater than that of export crops. A study by Hill and Tsehaye (2014) on the poverty-growth links found that agricultural growth was significantly related to the decline in poverty in Ethiopia: zones with the fastest increase in agricultural production saw the largest decline in poverty. By contrast, growth in manufacturing and services did not exert significant impact on poverty reduction. Rwanda's experience confirmed the same findings.

McMillan and Harttgen (2014) found that in a sample of 16 sub-Saharan African countries, labour reallocation across sectors accounted, on average, for about half of overall labour productivity growth during the 2000s (figure II.9), although there was substantial

Figure II.9
Structural changes and labour productivity growth in sub-Saharan Africa during the 2000s



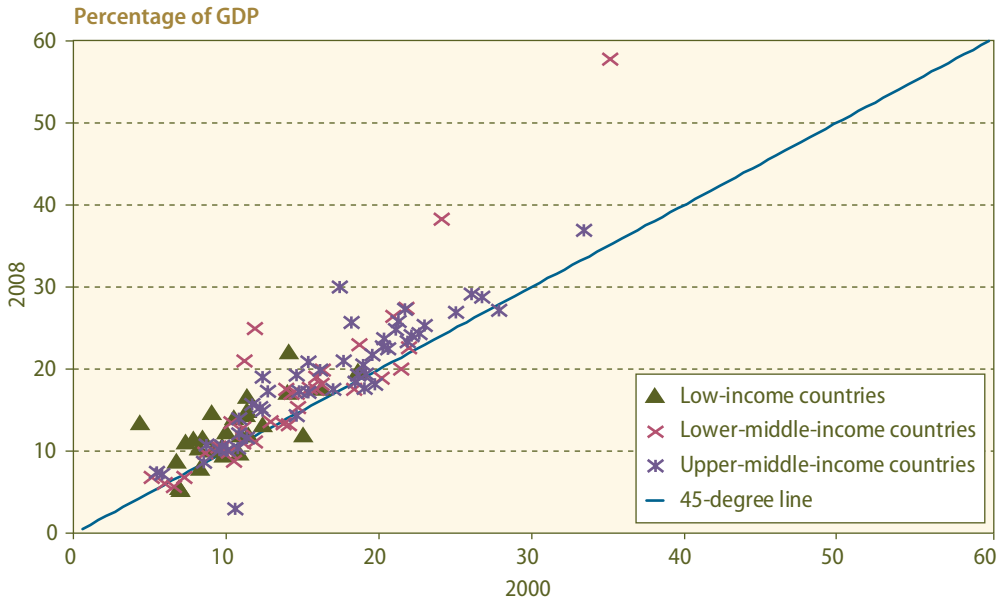
Source: McMillan and Harttgen (2014), presented in World Bank (2014a), figure 33, p. 35.

heterogeneity across countries. Another study by Christiaensen and Kaminski (2014) on Uganda found that 70 per cent of the decline in the poverty headcount during 2005-2009 resulted from an increase in agricultural incomes of people continuing to work in the agriculture sector. The other one third came from rural non-farm diversification. Fostering non-agricultural activities in rural areas appeared disproportionately important for growth, while fostering agricultural productivity appeared disproportionately crucial for poverty reduction. Structural transformation within the rural economy (including rural non-farm income diversification) benefited both poverty and growth.

Fiscal policy

Improvements in growth and stability, along with changes in governance, taxation and expenditure regimes, were important to the process of enabling a better environment for development policies during the period from 2000 to 2007/08. Higher economic growth has manifested in part through increasing revenue-to-GDP ratios between the beginning of the new millennium and the period before the crisis. As is apparent from figure II.10, where most observations sit above the 45-degree line, most low- and middle-income countries recorded higher total government revenues in 2008 compared with 2000. In general, middle-income countries were better able to increase revenues than low-income countries over this period.

Figure II.10
Total government revenue, 2000 and 2008



Source: UN/DESA, based on data from the International Centre for Tax and Development Government Revenue Database.
Note: the group of low-income countries excludes Zimbabwe.

A majority of countries saw an increase in government revenue over the 2000-2008 period…

In a sample of 158 countries, a majority saw revenue increases during the 2000-2008 period and most of these increases came as a result of a rise in both tax and non-tax revenue (table II.2). Increases in tax revenue in developing countries have come as a result of a number of different factors, including a shift away from trade taxes (beginning in the 1980s) towards consumption taxes (McNabb and LeMay-Boucher, 2014) and corporate income taxes (International Monetary Fund, 2011). In addition, improvements in economic

growth over the period also contributed to greater revenues. On the other hand, grants were a factor to varying degrees in increasing non-tax revenue in some countries, but in others resource revenues provided much more of the increase in non-tax revenue. The countries seeing considerable increases in resource revenue where that revenue made up a sizable fraction of overall government revenue tend to be oil exporters and some mineral exporters. Importantly, it has been pointed out that Africa has been the region with the most rapidly growing revenue mobilization over the period 1990 to 2010 (Prichard, Cobham and Goodall, 2014).

Table II.2
Sources of revenue changes between 2000 and 2008

	Number of countries	in which increase was due to:		
		Taxation	*Non-tax sources*	*Both*
Countries with revenue increases	113	31	14	68
High-income: non-OECD	16	9	1	6
High-income: OECD	11	1	4	6
Upper-middle-income	39	12	3	24
Lower-middle-income	23	5	3	15
Lower-income	24	4	3	17
Countries without revenue increases	45			
High-income: non-OECD	5			
High-income: OECD	19			
Upper-middle-income	6			
Lower-middle-income	11			
Lower-income	4			

Source: UN/DESA, based on data from the International Centre for Tax and Development Government Revenue Database.

…which allowed many countries to increase spending, particularly on social programmes

The increased revenue allowed many Governments to step up spending, although this was more frequent among low- and lower-middle-income countries (figure II.11). There was a significant increase in public expenditure on social protection, education, and health in some countries across all developing regions (Government Spending Watch, 2013), partly in response to the MDGs. This trend was even maintained during and after the global financial crisis (figure II.12). In some developing countries, mainly in sub-Saharan Africa where low-income countries tend to be concentrated, the increase in social expenditure was substantially supported by external assistance. Interestingly, in some regions, such as Latin America and the Caribbean where the most significant cash transfer programmes originated and expanded, the increase was mostly driven by higher spending in social protection; this breaks with the pattern for most low-income countries where social protection spending is usually small.

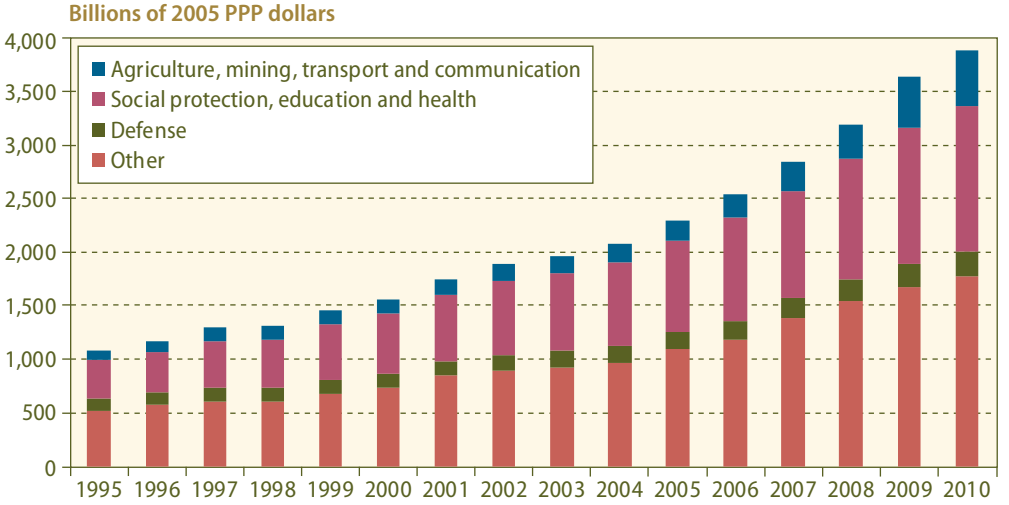
Social spending aided both in pursuing human development policies and in mitigating some of the effects of the financial crisis

The increase in public expenditure on social protection, education and health in developing countries was clear evidence that the economic bonanza during 2000-2007/08 made room for development policies. Social protection spending made it possible to finance a number of non-contributory schemes that enabled the targeting of people living in extreme poverty. It was also anticipated that education and health spending would have

Figure II.11
General government expenditure, 2000–2002 and 2008

Source: IMF World Economic Outlook database 2015.
Note: An annual average has been chosen for the first period to minimize yearly fluctuations and also to account for missing data for some years for some countries, excluding Kiribati as this was a notable outlier.

Figure II.12
Public expenditure by sector in low- and middle-income countries, 1995–2010



Source: UN/DESA, based on data from IFPRI's Statistics of Public Expenditure for Economic Development (SPEED).
Note: The figure includes 33 countries for which social expenditures are available in the database for the whole period. "Other": other economic affairs (including labour affairs, fuel and energy, construction and others); environmental protection (including sanitation); general public services; public order and safety; housing and community amenities; and recreation, culture and religion.

a positive and significant impact on education and health capital (Baldacci and others, 2008). Later, social protection programmes became one of the most important components of countercyclical policy responses to the global financial crisis. Overall, higher levels of public social spending appear to have led to better MDG outcomes (see chaps. III and IV), whether such levels were motivated by the MDGs or not, and likely helped to offset the impact of the global financial crisis on such outcomes in some countries.

Crisis and recovery period (2008–2015)

The second period (2008-2015), particularly the episode of turbulence marked by the global financial and economic crisis (2008-2009), brought about challenges that rolled back hard-won progress towards achieving MDGs in many developing countries. However, some countries were able to avoid more drastic declines—or any declines at all—in MDG progress owing to previous improvements in conditions. This came by way of increased foreign reserves, lower debt levels, already established social spending programmes, such as conditional cash transfers, and other countercyclical measures.

In addition, in the aftermath of the crisis, central banks adopted unconventional monetary policy instruments, such as large-scale quantitative easing to directly increase the monetary base, although these efforts mostly took place in developed countries. These efforts by developed countries' central banks have helped to forestall further deterioration in these economies and thereby minimize the spillover effects on developing countries. At the same time, there were other spillovers as capital flows to developing countries increased owing to the quantitative easing policies, with the ensuing risk of heightened volatility (United Nations, 2015c). In spite of all the measures, the repercussions of the crisis were damaging for economic growth in developing countries and tended to have adverse effects on their efforts to pursue development goals.

Effects on economic growth and MDGs

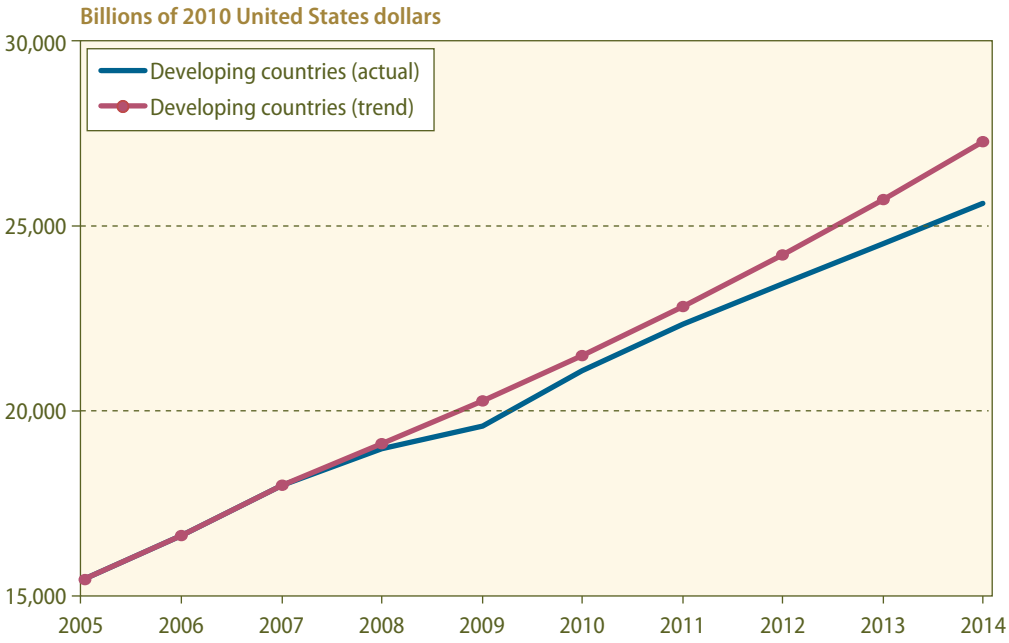
The global financial crisis lowered economic growth trajectories…

Although the global financial crisis originated in major developed countries, the growth path of many developing countries was substantially altered. This can be illustrated through an extrapolation of pre-crisis economic growth, keeping in mind that that period's robust growth may not have been sustained in any case for a very long period of time in the absence of crises. Six years after the onset of the global crisis, total output of developing countries is far below the trend line prior to the crisis, with a cumulative gap (over the period 2008-2014) of GDP by $1.7 trillion (6.5 per cent) (figures II.13 and II.14). The gap is about $250 billion (12.7 per cent) for Africa and $300 billion (12.5 per cent) for South Asia. The size of the gap for Africa is equivalent to the size of ODA flows Africa received in the same period.

…and resulted in setbacks in MDG achievement…

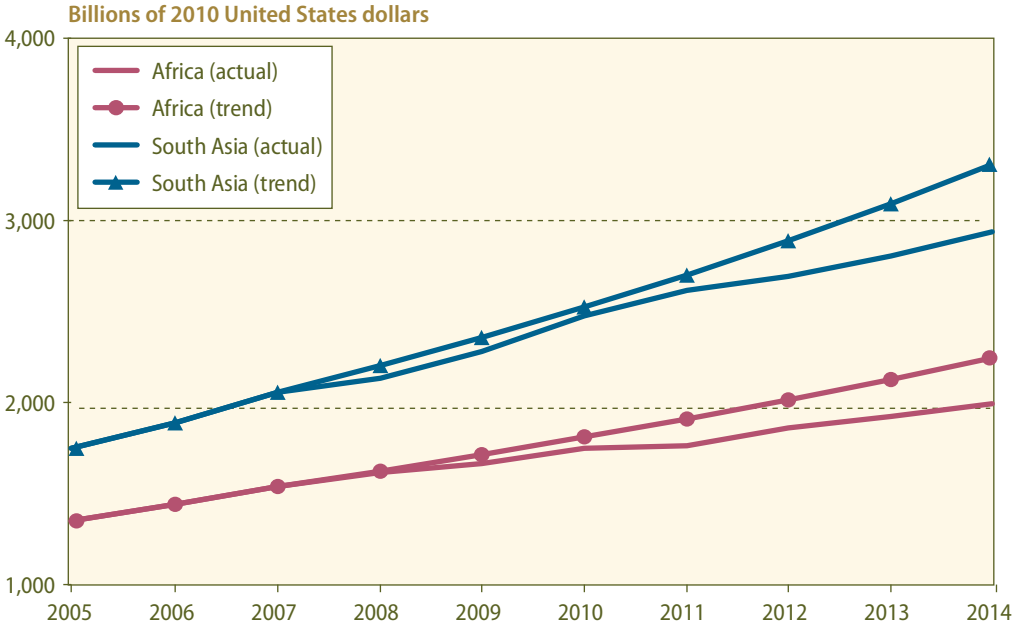
The economic downturn and the consequent increase in unemployment and vulnerable employment, compounded in some cases by retreats in social spending, caused important setbacks in the progress towards achieving the MDGs. Estimates presented in the 2010 issue of the *World Economic Situation and Prospects* pointed to the possibility of between 47 million and 84 million more people falling into or staying in extreme poverty because of the global crisis (United Nations, 2010). While significant, these setbacks were not large enough to change the likelihood of achieving the millennium target of halving global poverty rates by 2015 (from 1990 levels), which was met ahead of schedule. Although developing-country growth rates were lower than in the pre-crisis period, they continued to be higher than those in developed countries and a significant driver of more than 50 per cent of growth in world gross product (WGP), UN/DESA data suggest. Despite that, the crisis caused setbacks in the progress towards achieving the MDGs, especially in countries that could not sustain the growing pattern of public social expenditures of the pre-crisis

Figure II.13
GDP gap after the global financial crisis in developing countries, 2005–2014



Source: UN/DESA.

Figure II.14
GDP gap after the global financial crisis in Africa and South Asia, 2005–2014



Source: UN/DESA.

period. As shown below, public social expenditures in education and health lost weight within the budget in some countries as a result of the crisis. This significantly increased the challenge of achieving targets for universal primary education, reducing child and maternal mortality and improving environmental and sanitary conditions.

...although many countries directed spending to mitigate some of the crisis effects on vulnerable populations

Despite increasing fiscal constraints, nonetheless, many Governments in developing countries made laudable efforts during the crisis to protect the most vulnerable by directing a significant proportion of stimulus measures towards pro-poor and social protection programmes. Countries that managed to do so, such as Bolivia (Plurinational State of) and Ecuador, for example, were able to somewhat mitigate the impact of the crisis on education and health outcomes; nonetheless, they could not avoid certain setbacks. Accelerating progress towards achieving the MDGs became more challenging as a consequence, both in these cases and even more so in countries that did not manage to protect social spending during the crisis. The requirements for stepping up social spending to meet the MDGs posed significant macroeconomic and financial challenges even before the crisis, but they have become all the more pressing in cases where setbacks have been the greatest (box II.1). In Nicaragua, for instance, estimates of additional spending requirements for education, health, water and sanitation increased to about 9.5 per cent of GDP annually between 2010 and 2015 in order to meet the MDG targets, up from 8 per cent of GDP in a scenario absent the impact of the global financial crisis. In Ecuador, the additional requirements are significantly less, despite a stronger drop in GDP growth, as the Government managed to protect social spending more forcefully during the crisis.

The mood for fiscal tightening during the crisis and its aftermath took hold in many developing countries. The difficulties in most of these countries in sustaining (or increasing) expenditure patterns were caused mainly by substantial declines in tax revenue, especially in regions such as the Middle East and North Africa and sub-Saharan Africa (table II.1), even in the case of low-income countries which did not witness major declines in ODA. At the same time, many developing countries either had policies in place or enacted policies during and after the crisis that were more or less successful in mitigating the impact of the crisis and preventing potentially worse outcomes. It is important to draw lessons on these countries' experience.

Fiscal and budgetary policies

Fiscal policies have been critical in inducing and supporting economic growth and maintaining it during periods of economic turmoil. While they are an important aspect of macroeconomic stability, fiscal policy also provides public goods and redistributes income. Within the context of macroeconomic stability, a key challenge for fiscal policy is to reduce its procyclicality and enhance its countercyclicality. For decades prior to the formulation of the MDGs, many developing countries tended to follow procyclical fiscal policy—that is, increasing government spending (or cutting taxes) during periods when the overall economy is in expansion, but cutting government spending (or raising taxes) during periods of recession (Kaminsky, Reinhart and Végh, 2005; Ilzetski and Végh, 2008). For example, Kaminsky, Reinhart and Végh (2005) documented that among 94 countries during the period of 1960-1999, more than 90 per cent of developing countries showed procyclical fiscal policy, while 80 per cent of developed countries showed countercyclical fiscal policy. However, since 2000, an increasing number of developing countries have shifted fiscal policy from procyclical to countercyclical (Frankel, Végh and Vuletin, 2011).

Box II.1

Impact of the crisis and the ensuing financial challenge in meeting the Millennium Development Goals

Slower or negative per capita income growth as a result of the global financial crisis caused setbacks in the progress towards achieving the Millennium Development Goals (MDGs) in many developing countries. The exact magnitude of the setbacks depended on country conditions. In general, slower growth affects household incomes and job creation, which will have a direct impact on income poverty (MDG 1). Less income will also affect access to social services and hence progress towards achieving other MDGs. But that impact will further depend on the fiscal space countries have to protect spending on education, health and basic sanitation during a crisis. In cases where setbacks were unavoidable during the global financial crisis, it became more challenging for spending strategies and macroeconomic policies to accelerate progress towards meeting the MDGs.

In order to estimate the setbacks in achieving the MDGs that were caused by the global financial crisis—while taking into account the many interactions at work in such an estimation—an economy-wide modelling framework was applied to a number of developing countries.[a] As indicated in the body of this chapter, both the impact of the crisis on the MDGs and the resulting greater financial challenge of countries to meet the MDGs differ widely across countries. This is illustrated further by the six country cases discussed below.

Under a scenario of the observed impact of the crisis on output growth and government spending during 2008-2010 and a projected slow and gradual economic recovery towards 2015, it was estimated that Nicaragua suffered a setback of 2 percentage points in poverty reduction, whereas Bolivia (Plurinational State of), Ecuador and Kyrgyzstan experienced a setback of about 1 percentage point (table II.1.1). In the case of Uzbekistan, setbacks for all of the MDGs have been minimal as the country barely suffered any downturn and was thus able to sustain spending towards improvements in health, education, water and sanitation. In the other countries, differences in the impact on projected outcomes for primary school completion rates, child and maternal mortality and access to drinking water and sanitation by 2015 can be attributed in part to different responses to adjusting social spending during the crisis period. Bolivia (Plurinational State of) and Ecuador managed to protect spending better than Kyrgyzstan and the Philippines, where setbacks have been relatively larger. Based on announced social spending plans at the time, the impact in Nicaragua may also have been less severe (as shown in the table) than in a situation where social spending had been scaled down.

a The methodology involves, inter alia, a detailed microeconomic analysis of determinants of MDG achievement, which is used as an input to a dynamic economy-wide model called MAMS (MAquette for MDG Simulations). Results from MAMS with regard to factor income were imputed to household surveys to estimate income poverty outcomes, using a microsimulation model. For a description of the whole modelling framework, see Sánchez and others, eds. (2010, chaps. 1 and 3). The application of the modelling framework for each country was conducted by national researchers and government experts with technical support from UN/DESA and the World Bank.

Table II.1.1

Impact of the crisis on projected MDG achievement by 2015, selected countries

Percentage point increase in the gap towards the 2015 target, unless otherwise indicated

	Bolivia (Plurinational State of)	Ecuador	Nicaragua	Kyrgyzstan	Philippines	Uzbekistan
MDG 1: Poverty incidence	0.8	0.8	2.2	1.3	0.0	n.a.
MDG 2: Completion rate of primary education	0.6	2.4	0.3	0.1	6.4	0.0
MDG 4: Child mortality (deaths per 1,000 live births)	1.7	1.3	1.3	3.2	1.4	0.1
MDG 5: Maternal mortality (deaths per 1,000 live births)	8.0	6.1	4.7	5.3	12.0	0.1
MDG 7a: Access to drinking water	0.9	2.1	0.5	0.0	1.8	0.1
MDG 7b: Access to basic sanitation	2.2	4.8	1.8	1.8	0.7	0.2

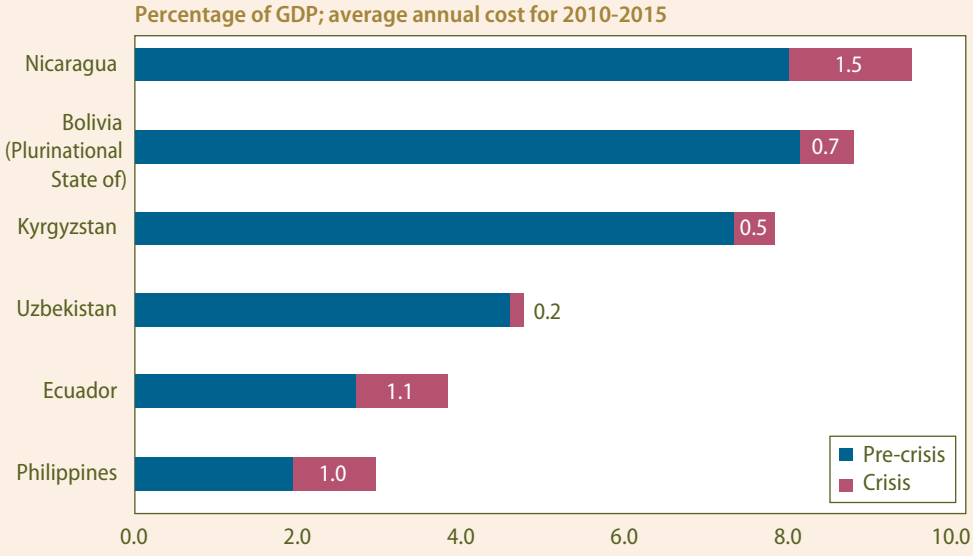
Source: UN/DESA, based on simulation results using MAMS and microsimulation models adapted to each country context.

Box II.1 (*continued*)

In the face of these setbacks, it was estimated that the Governments of Ecuador, the Philippines and Nicaragua would have needed to spend an additional 1.0-1.5 per cent of GDP per year between 2010 and 2015, under the crisis scenario, in order to meet the MDG targets for education, health and basic services, compared with the pre-crisis scenario (figure II.1.1). In the cases of Bolivia (Plurinational State of) and Kyrgyzstan, the additional cost of achieving these MDGs is estimated to have been 0.7 per cent and 0.5 per cent of GDP, respectively; the extra cost would be negligible in the case of Uzbekistan. While these additional costs may seem manageable, they come on top of the already considerable estimated spending requirements to achieve the MDG targets prior to the crisis (given pre-existing shortfalls). As a result, the challenge for Nicaragua would have been to increase spending for education, health and basic services by 9.5 per cent of GDP during 2010-2015. The required efforts would be slightly less, but were still large in magnitude in Bolivia (Plurinational State of) and Kyrgyzstan, while in Ecuador, the Philippines and Uzbekistan, the estimated additional macroeconomic costs in these policy simulations would have been in the range of 3.0-4.5 per cent of GDP. Such impacts may have been even larger in many countries that are poorer than these countries. Clearly, additional costs of this magnitude may stretch government finances and could lead to steep increases in public debt or demand infeasible increases in domestic tax burdens.

Figure II.1.1

Estimated additional public spending needed to achieve MDG targets for education, health and water and sanitation by 2015



Source: UN/DESA, based on simulation results using the MAMS model.

Fiscal policies in developing countries have been shifting from procyclical to countercyclical using a number of measures

According to some studies (World Bank, 2015a; Frankel, Végh and Vulentin, 2013), three major factors may have contributed to the shift towards a more countercyclical spending policy. First, robust economic growth and rising prices of primary commodities (for some countries) boosted government revenue in many developing countries in the 2000s, particularly emerging economies. Second, international debt relief initiatives such as the HIPC Initiative and the MDRI have reduced debt in LDCs and other developing countries. Third, institutional reforms, including new budget institutions, have improved fiscal management. As a result, when the global financial crisis erupted in 2008, a number of developing countries were able to adopt sizeable countercyclical fiscal stimuli in 2009-2010 and managed to reduce the shocks, which could have otherwise led to even larger and longer negative impacts on growth and progress towards the achievement of development goals.

Developing countries have reduced fiscal procyclicality since 2000 by adopting a few important institutional measures, including fiscal rules, medium-term expenditure frameworks, and stabilization funds. A *fiscal rule* sets targets for government budgetary indicators, such as debt-to-GDP ratio, budget balance, expenditures, or revenues. Fiscal rules have been shown to help reduce procyclicality of government spending when implemented under the proper governance structures (Bergman and Hutchison, 2015). Since the late-1990s more than 30 developing countries have adopted fiscal rules, along with some 30 developed countries. It has been necessary to adjust some fiscal rules over time as they may lead to more, not less, procyclicality, particularly in debt-to-GDP ratios in times of crisis (Bova, Carcenac and Guergil, 2014). In view of this, more flexible fiscal rules with cyclically adjusted targets have become increasingly popular in developing as well as developed economies.

Medium-term expenditure frameworks (MTEFs) were first used in developed countries to manage long-term fiscal policy priorities, but an increasing number of developing countries have also started adopting this framework since the late 1990s. Currently, about 70 per cent of the countries in the world have adopted certain forms of MTEFs (World Bank, 2013a). The main objective of MTEFs is to establish and improve credibility in the budgetary process. Most MTEFs translate macroeconomic goals into budget aggregates and spending plans, but others could simply target aggregate fiscal goals. Empirical studies suggest MTEFs could improve fiscal discipline and spending efficiency, but the experience in this regard is not uniform across countries. For example, the experience of some African countries showed that realistic expectations of revenues are needed in formulating MTEFs; otherwise, even well-designed MTEFs cannot succeed (Holmes and Evans, 2003). A cross-country empirical study by the World Bank found a significant positive effect of MTEFs on fiscal discipline and that MTEFs increased the fiscal balance by at least 0.9 to 2.8 percentage points of GDP—with the most advanced MTEFs achieving even larger improvements in fiscal balances (World Bank, 2013a). In some countries, there is also evidence of the impact on debts. While MTEFs may have improved macroeconomic stability and limited the impacts from the financial crisis, their contribution to MDG achievement is somewhat more mixed. However, MTEFs can reduce the volatility of social expenditures relative to total expenditures, as has been shown in the context of health expenditures (see Vlaicu and others, 2014). Lower volatility of social expenditures could be important for better weathering the impacts of external shocks. An issue is that, in practice, MTEFs are difficult to fully implement in the context of developing countries (see section on planning within a budgeting framework).

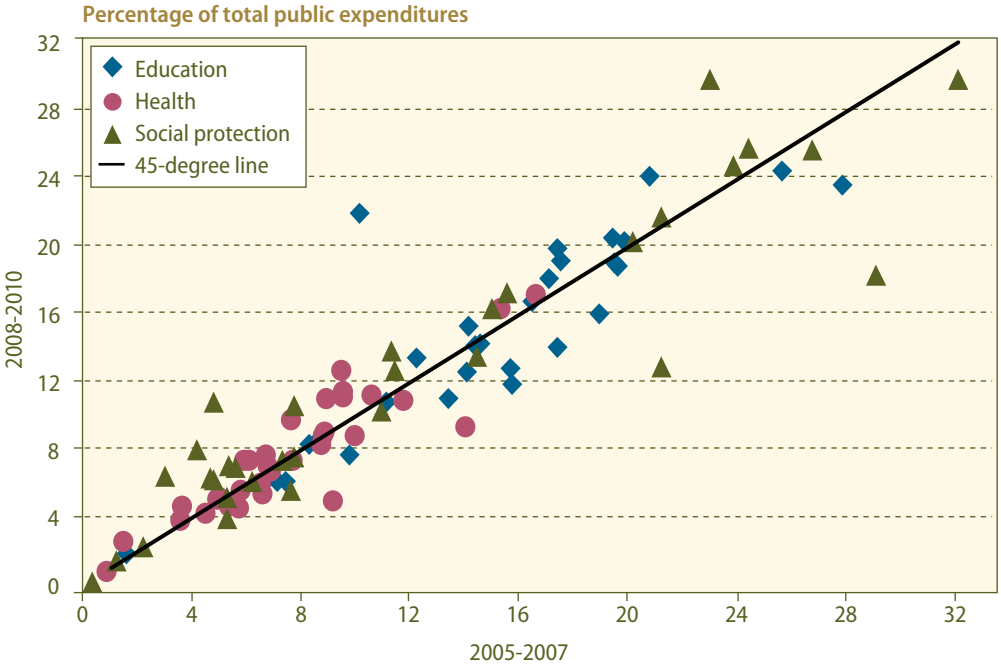
Despite the improvement regarding the cyclical nature of fiscal policy in many developing countries, the capacity for conducting countercyclical fiscal policy remains weak in LDCs and other low-income countries. For these countries, in addition to the strengthening of domestic budget institutions, the improvement in fiscal cyclicality will also depend on the improvement in the predictability of ODA flows they receive (see more discussion on ODA in chapter VII).

Many countries have maintained the growing pattern of public social expenditure seen before the global financial crisis

Fiscal policies directed towards social spending appear to also have been an important factor in mitigating the effect of the crisis on MDG progress. For example, a substantial number of countries announced stimulus measures during or following the crisis in order to offset falling growth. In a study of 182 developing countries, Ortiz, Chai and Cummins (2011, p. 10) found that, "on average about 24 per cent of the total announced stimulus amounts by developing countries was directed at social protection programmes".

Figure II.12 shows that the steadily growing pattern of public social expenditure seen before the global financial crisis was not disrupted as a result of the crisis in 33 low- and middle-income countries (for which data were available). Additional patterns are revealed when the data on public social expenditure used in the figure are further disaggregated. For example, observations above the 45 degree line in figure II.15 represent cases of public social expenditures whose share of total public expenditure increased during the crisis (2008-2010), compared with a pre-crisis period (2005-2007). Not only does this figure corroborate that the majority of countries (20 of 33) increased public social expenditures during the crisis period, but, interestingly, most countries (21 of 33) increased their share of social protection spending in public expenditure. In many instances, this was at the cost of reducing the allocation of spending to education or health owing to fiscal constraints, but this seems to have mostly been the case in countries with relatively higher spending.

Figure II.15
Public social expenditure in low- and middle-income countries, 2005–2007 and 2008–2010



Source: UN/DESA, based on data from IFPRI's Statistics of Public Expenditure for Economic Development (SPEED).
Note: The figure includes 33 countries for which social expenditures are available in the database for the whole period. Period averages chosen to minimize yearly fluctuations and also to account for missing data for some years for some countries.

Even so, the trend was that public social expenditures behaved countercyclically during the global financial crisis in many developing countries. These expenditures were eased in some countries by the accumulation of foreign-exchange reserves, especially because there was a more urgent need to direct a significant proportion of stimulus measures at pro-poor and social protection programmes. This permitted the amelioration of important potential impacts of the crisis on the progress towards achieving the MDGs—impacts with magnitudes perhaps similar to those estimated in box II.1.

External shock mitigation policies

The global financial crisis and the Great Recession exposed developing countries' key external vulnerabilities and the resulting need for mitigation policies...

As developing countries increasingly integrate their economies into the global economy, they are facing various external vulnerabilities through trade and financial channels: surges and reversals in short-term capital flows, vicissitudes of international prices of primary commodities, business cycles in the external demand from major developed countries, among others. The global financial crisis and the attendant Great Recession have sharply demonstrated these and other external vulnerabilities of developing countries.

The effects of external shocks can be quite damaging, particularly in small and open economies, and they have implications for the achievement of development goals. As shown above, the global financial crisis brought about setbacks in the progress achieved towards meeting the MDGs. There are a number of transmission mechanisms from external shocks to economic growth, including investment, exports, and private and public consumption. Mitigation policies are necessary to offset external shocks; in their absence, there can be setbacks in the achievement of development goals (box II.2)

...such as stabilization funds to mitigate commodity price volatility, capital-account management policies, and accumulation of foreign reserves

Stabilization funds have increasingly become a tool for mitigating the volatility in commodity prices, especially in countries where government revenues depend highly on exports of primary commodities. These funds are established using public revenues from natural resources, such as oil and natural gas, and can be used to stabilize the boom and bust cycles. Some 30 developing countries have such funds, and more than half of them were established since 2000. Many stabilization funds are integrated with government budgets with specified rules for their accumulation and withdrawal (Bagnall and Truman, 2013). Studies show these funds can smooth government expenditure and reduce volatility (Sugawara, 2014), but the effectiveness of these funds in shielding the domestic economy from the fluctuations in commodity prices will depend on government commitment to fiscal discipline and macroeconomic management, rather than just the existence of the funds themselves (Gill and others, 2014). Chile is an interesting example of a country that has combined fiscal rules with stabilization funds through its structural fiscal balance rule, initiated in May 2000 (Marcel, 2013). The rule incorporates general macroeconomic conditions and takes into account movements in copper prices, a major export and source of government revenue.[6] It has been cited as a major factor in the country's macroeconomic stability through both boom times and crises.

With respect to capital flows, in addition to the conventional monetary, fiscal and exchange-rate policies, a number of developing countries have introduced capital-account management measures to contain volatile short-term capital flows. Some countries, such as Croatia, Peru and the Republic of Korea, have used macroprudential measures to stem

6 Chile's mining sector contributions overall amounted to 27 per cent of government revenue between 2006 and 2010 (Korinek, 2013).

Box II.2

Impact of external shocks on poverty and human development goals: a simulation analysis

Nicaragua is a small and open developing economy that has historically been affected by external fluctuations. The implications of adverse external fluctuations for human development in this country can be illustrated drawing upon findings from an economy-wide modelling analysis documented in Sánchez (2015).

The starting point is a scenario where economic and budget conditions of the 2006-2013 period remain unchanged until 2020. The exception with respect to past conditions in this scenario is that government foreign borrowing increases to finance the spending needed to meet, by 2020, country-specific targets for extreme poverty, net (on time) primary completion, child and maternal mortality, and access to drinking water and basic sanitation. In this scenario, gross domestic product (GDP) growth is on average little more than 4.5 per cent per year.

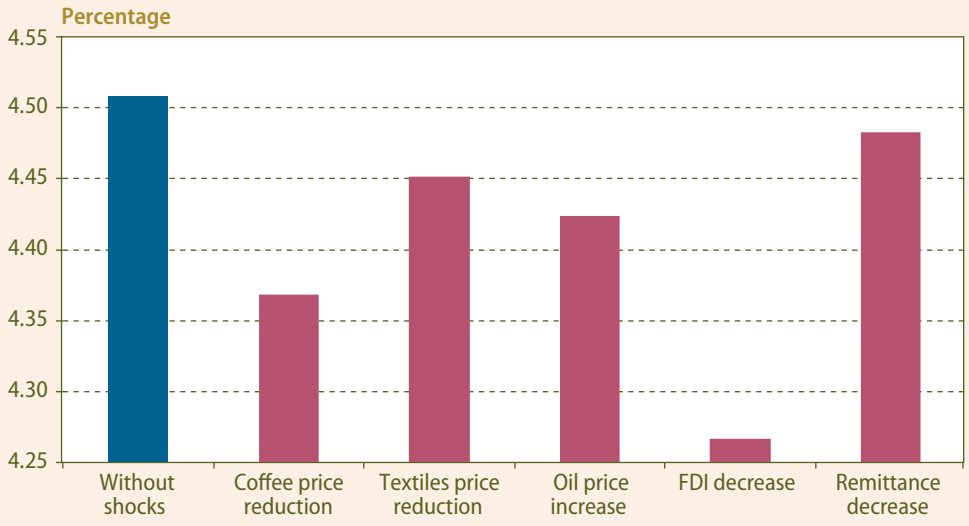
From this initial scenario, consider the simulated impact of the following external shocks on the Nicaraguan economy and the country's ability to meet said poverty reduction and human development targets by 2020:

Simulation 1: reduction of 20 per cent in the world price of coffee
Simulation 2: reduction of 20 per cent in the world price of textiles
Simulation 3: increase of 20 per cent in the world price of refined oil
Simulation 4: reduction of 2 percentage points of GDP in inflows of foreign direct investment (FDI)
Simulation 5: reduction of 2 percentage points of GDP in inflows of remittances from abroad

Even though these shocks are fairly modest, they have the potential of impacting GDP growth in a significant way. For example, a reduction of 2 percentage points of GDP in inflows of FDI can depress private investment and exports to a point where GDP growth falls almost by a quarter of a percentage point (figure II.2.1). The impact on growth from small reductions in world prices of key export commodities such as coffee is also not negligible.

Figure II.2.1

Nicaragua's GDP growth in a simulated scenario with and without external shocks, 2014–2020



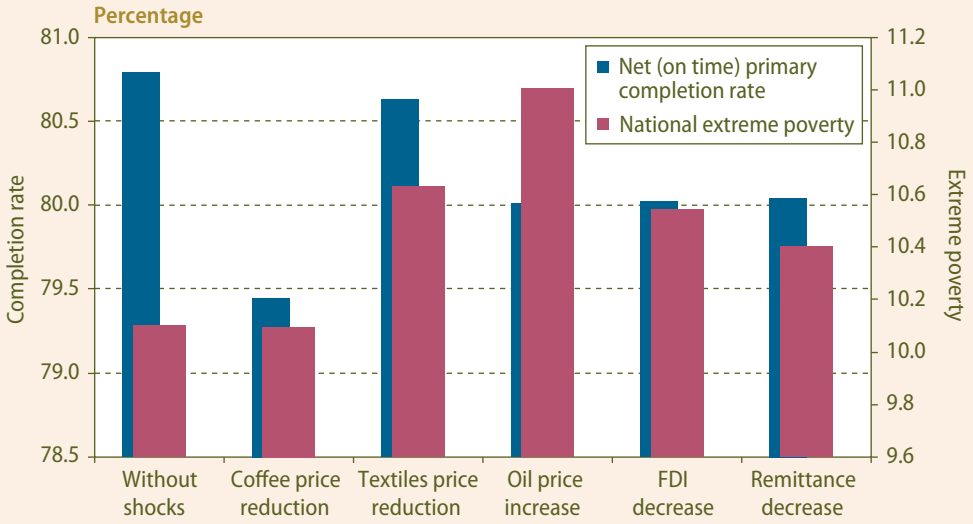
Source: Sánchez (2015, fig. 6).

Box II.2 (*continued*)

The decline in growth has an additional impact on key determinants of human development goals such as public and private spending in social sectors and household consumption per capita. As a consequence, projected progress towards the human development targets is sluggish compared with the scenario without shocks. For example, the target for the net (on time) primary completion rate is not met under any of the simulated scenarios with external shocks, and extreme poverty increases, especially because of the oil price shock (figure II.2.2). In this last case, the reduction in consumption per capita is the mirror image of household labour incomes falling owing to the slower economic growth.

Figure II.2.2

Nicaragua's net (on time) primary completion rate and extreme poverty in a simulated scenario with and without external shocks, 2020



Source: Sánchez (2015, fig. 7).

capital inflows and excessive credit growth. These policies include measures to maintain sound lending standards, countercyclical capital requirements to slow down credit expansion, and balance-sheet restrictions such as limiting the foreign-exchange positions of banks. While these measures appear to have lengthened the maturity and changed the composition of capital inflows, the effect on total net flows was limited. For example, in Peru, which has a considerably dollarized economy mediated through the banking system, macroprudential measures, such as limits on foreign-exchange mismatches, have been relatively effective at reducing risks. In the Republic of Korea, a package of macroprudential measures was introduced in 2009/10 and this appears to have brought about the intended deceleration in banks' foreign borrowing but did not stem the overall level of capital inflows.

Other countries, such as Brazil and Indonesia, have used more direct capital-account regulations. Most available studies find that capital-account management has been effective in changing the composition of inflows away from short-term debt in many cases, but the results varied from country to country (United Nations, 2015c, chap. III). More broadly, the effectiveness of measures depends on the specific circumstances of a country, including the quality of the existing regulatory framework and regulatory capacity, the structure and persistence of inflows, and the design and implementation of capital flow management

measures. Capital-account regulations may be particularly difficult to implement in countries where there is a large derivatives market, since speculators can often circumvent the restrictions through foreign-exchange futures, options and other derivatives. Thus some countries, such as Brazil, have implemented restrictions directly in the derivatives market, albeit at a low initial rate to test the market. Overall, there is no simple formula for effectively managing cross-border capital flows. Macroeconomic policies, macroprudential tools and capital-account regulations should be viewed as part of a package of measures that would vary in line with the specific circumstances of individual countries.

Developing countries are also challenged by the needs for both stability and flexibility in exchange rates. After the Asian financial crisis of the late 1990s, an increasing number of developing countries moved away from fixed exchange-rate regimes towards more flexible regimes. However, since the global financial crisis of 2008, there has been a notable tendency for more countries to shift away from flexible exchange-rate arrangements, reflecting the recurring pressure on the currencies of emerging market economies as a result of capital flow volatility (International Monetary Fund, 2014).

Another trend since the MDGs were adopted has been the accumulation of foreign-exchange reserves in developing countries, as noted above. Accumulation of foreign reserves has been undertaken in order for countries to be properly positioned to deal with shocks coming from open capital accounts and volatile international capital flows (United Nations, 2015c). For example, reserves can be used to mitigate trade shocks, if they are used to create stabilization funds, to refinance short-term external debt, or to deal with reversals of short-term capital flows and unwinding of carry trades. Evidence points to several of these types of factors motivating reserve accumulation over time, with different factors motivating different countries at different times (Ghosh, Ostry and Tsangarides, 2012). Foreign-exchange reserves continued to accumulate, even after the crisis, rising overall by about 10 times during 2000-2014, only reversing slightly since late 2014. This has strengthened the capacity of many developing countries to withstand external shocks; for example, commodity-exporting countries with stabilization funds have been found to have lower government expenditure volatility, as noted above (Sugawara, 2014). In the context of the crisis, Chile's Social and Economic Stabilization Fund was able to mitigate some of the effects through countercyclical spending (World Bank, 2010b). At the same time, this reserve accumulation comes with costs. The build-up of reserves for self-insurance purposes is also an indication of deficiency in the current international financial architecture. It exacerbates global imbalances and systemic risks and overall it represents a net transfer of financial resources from the developing to the developed world (United Nations, 2015c).

Challenges of bridging spending gaps

Although public social expenditure has risen, it still constitutes a small portion of the budget in some developing countries

Going forward it will be necessary to scale up social spending and allocate it effectively. An obvious reason is the necessity to continue building the human capital that developing countries need for creating policy space via robust economic growth. Evidence points to the positive effects of social spending on economic growth. For example, using a data panel for 118 developing countries in 1971-2000, Baldacci and others (2008) projected that education and health spending would have a positive and significant impact on education and health capital, with important effects in supporting higher growth during the period in which the MDGs were going to be implemented. More recently, it has been estimated that past investments in education and health during the period in which the MDGs have

been implemented could lead to GDP growth gains in the range of 0.2-1.0 percentage points during the 2015-2030 period (Sánchez and Cicowiez, 2014). Social spending needs to be stepped up also because there are existing gaps, as a result of which many developing countries have failed to achieve the MDGs by the deadline.

Macroeconomic trade-offs

Public social expenditure has risen, as noted above, but still only constitutes a small portion of the budget in some developing countries, especially in those with the greatest need. For many of the low- and middle-income countries for which data are presented in figure II.15, public social expenditures tend to be clustered near the origin of the graph. About half of the countries included in the figure do not allocate more than 30 per cent of their total public budget to spending on social protection, education and health. The gaps are greater for low-income countries. Within the developing world, Latin America and the Caribbean is the region with the largest ratio of public social expenditures to overall budget expenditures at nearly 50 per cent, which is not too distant from the share in high-income countries. By and large, in all countries—aside from those in Latin America and the Caribbean where it was already fairly important—social protection spending has been gaining importance within the budget. Spending on productive sectors appears to absorb the largest share, irrespective of the developing country's region (figure II.12).

In spite of the progress towards achieving the MDGs and the efforts to spend more in sectors that are essential to meet these goals, at the current rate of spending and progress, many MDGs, especially the health goals, are likely to be achieved globally only well beyond 2015. This probability exists despite policies in some countries to safeguard "priority" social spending in times of crisis. The challenges ahead are reflected in an insufficiency of government spending that is worth noting going forward, especially because important investments in school infrastructure, health systems, water and sanitation, and other areas will be required.

Macroeconomic trade-offs resulting from the sources of financing for social spending are an important consideration for sustainability

Regional and global targets for health spending are not being met by a number of countries (Government Spending Watch, 2013). According to studies for 27 developing countries, additional public spending requirements for meeting a number of MDG targets in education, health, water and sanitation are estimated to range from less than one per cent of GDP to a high of 10 per cent of GDP (box II.3). The studies warn that the financing of such magnitudes of additional public spending could impose a serious burden on countries' budgets, particularly in LDCs. The huge size of investment requirements for some of the countries will require a financing strategy that may result in macroeconomic hardships and, depending on the financing source, could also result in debt sustainability problems. For instance, if the additional spending were to be financed through foreign borrowing, significant real exchange-rate appreciation would have a negative impact on export and investment growth. Similar macroeconomic trade-offs would be induced if additional aid inflows covered the additional costs of achieving the MDGs—although with no debt accumulation. Alternatively, if the tax burden were increased or, if possible, the Government borrowed from domestic capital markets, then private consumption or investment spending (or both) could fall, thus lowering aggregate growth effects. These macroeconomic trade-offs are worth studying going forward.

The macroeconomic trade-offs of financing public spending to meet development goals need to be addressed in tandem with options to achieve the rapid and sustained economic

Box II.3

Spending gaps for meeting MDGs and macroeconomic trade-offs

Achieving all the Millennium Development Goals (MDGs) by 2015 necessitated a significant increase in public spending, that was not achieved in many developing countries, particularly after the global financial crisis. This important increase in public spending will have to occur, either to address the unfinished business of the MDGs or to achieve similarly ambitious development goals. Should this be the case, it is important to keep in mind the potential macroeconomic trade-offs involved. This can be illustrated using an economy-wide modelling simulation analysis for 27 developing countries, which employs a scenario that assumes countries were able to scale up public spending to meet the MDGs by 2015.

Consider a baseline scenario that projects, up to 2015, a continuation of the pace of economic growth and public spending priorities and budget financing policies seen in the period 2005-2010. Under this scenario there is substantial progress towards achieving the MDGs, but the majority of countries included in the analysis do not fully meet, by 2015, a set of targets for primary school completion, reduction of child and maternal mortality, and expanded coverage of drinking water and sanitation (figure II.3.1).

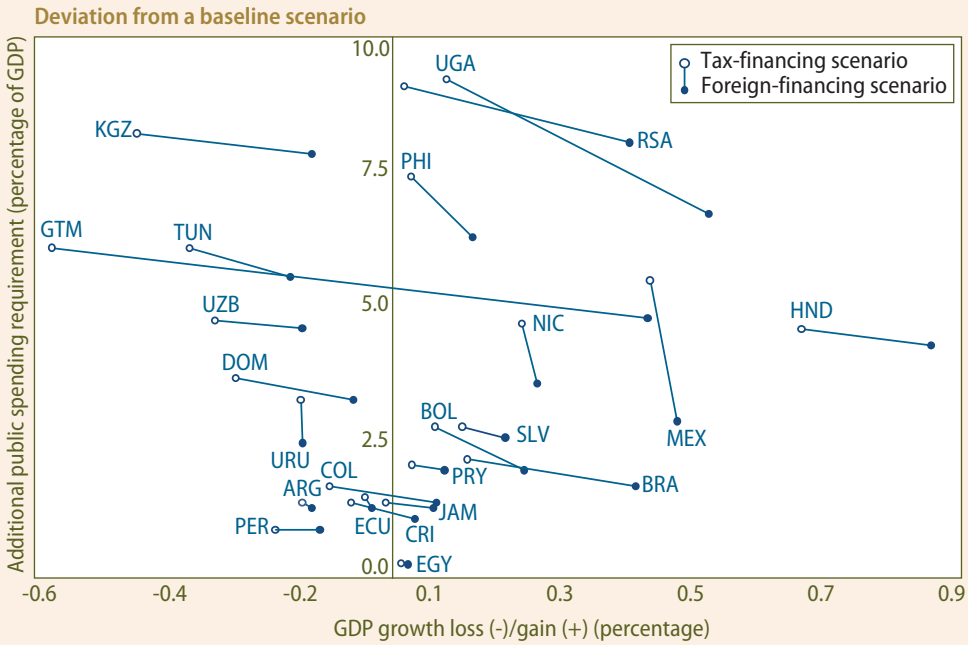
Because of the shortfalls, alternative scenarios are considered where countries scale up their public spending, using alternative financing sources in each scenario, in order to fully meet the targets by 2015. In ten cases, for example, the additional public spending required is about 5 to almost 10 percentage points of gross domestic product (GDP) per year, irrespective of the financing source, equivalent to 15 to 48 per cent of total public spending per year depending on the country. The vertical axis of the figure shows the additional public investment that would presumably have been required as a percentage of GDP (during 2010-2015) to meet the MDGs.

Different ways of financing such additional spending requirements have different implications for economic growth, which can be adverse in the short term, especially because the larger investments in education and health would not be expected to bear fruit so quickly, and therefore cannot immediately show positive overall impact on labour productivity (and growth). Financing the spending through domestic sources, such as direct taxation, tends to yield a *less* positive impact on GDP growth than does a strategy of using a foreign source of financing—assuming that the cost of external financing does not increase over time, otherwise it could introduce an element of instability. Figure II.3.1 shows that, for each country, the observation for foreign financing is to the right of direct taxation along the horizontal axis, implying a less negative impact on GDP growth. This simulation result is due to the fact that increased direct taxation depresses private disposable incomes and thereby aggregate domestic demand. The crowding out of private consumption and investment thus depresses GDP growth, which is reflected in a reduction of private demand for, as well as provisioning of, social services. This feedback effect requires Governments to invest even more to compensate for the loss of private spending in social sectors in order to ensure that MDG targets are met, thereby incurring more additional public spending. The figure shows that for each country the additional public spending in the scenario using foreign financing is *below* that of increased direct taxation (the vertical axis).

Yet there are trade-offs associated with foreign financing to be considered too. It is well known that an inflow of foreign currency may lead to real exchange-rate appreciation, harming the tradable sector. This will be the case particularly when the amounts are spent on non-tradable social services, as would be required to meet development goals. The appreciation of the real exchange rate may lead to resource allocation away from dynamic export industries that will negatively affect GDP growth in the absence of an adequate policy response. The figure shows that GDP growth in the scenario of foreign financing would be lower than in the baseline for a number of countries.

Box II.3 (*continued*)

Figure II.3.1
Public spending and GDP growth under two alternative MDG financing scenarios, 2010–2015



Source: UN/DESA, based on 27 country analyses conducted by national researchers and government experts with technical support from UN/DESA and the World Bank, documented in Sánchez and Vos, eds., 2013; Sánchez and others, eds., 2010.

Note: Under the MDG financing scenarios, public spending rises until defining a path towards meeting a set of five targets by 2015. Additional public spending requirement and GDP growth loss/gain refer to the difference between the estimate of, respectively, public spending and GDP growth under each of the MDG financing scenarios and the estimate for the same variables under a baseline scenario.

Another challenge is whether countries can effectively realize access to alternative sources of finance and whether it is economically feasible to use it. First of all, domestic financing through taxation may not be an easy option, because existing tax burdens on those parts of the economy which are in the tax net are already considered high in many developing countries. Second, the foreign financing route is also becoming problematic. On the one hand, if this financing comes in the form of loans, then it increases the debt burden. In addition, the countries may expose themselves to currency mismatches or the effects of devaluation when borrowing in a different currency, which could exacerbate debt burdens. On the other hand, a slow recovery after the global financial crisis in developed countries is making prospects of aid and concessional financing for developing countries increasingly limited and uncertain. A feasible financing strategy would likely involve a combination of sources.

growth that is required to create fiscal space and maintain solid development standards. This is necessary because better education and health outcomes are unlikely to have a positive impact on overall labour productivity (and growth) in the short run. This process takes time, as children need to go through more than one educational cycle before they become economically active. Similarly, improved child and maternal health care today can lead to healthier students and workers only after several years have passed. Hence, financing strategies for development goals may also pose important inter-temporal macroeconomic trade-offs. Moreover, some economies may not be equipped to absorb the increased stock of better-educated workers resulting from investment in education, which is also important to keep in mind going forward. In fact, there have been mismatches between education and the labour market in many developing countries, which, due to insufficient creation

of skilled jobs, have resulted in youth unemployment and underemployment. Addressing such mismatches requires changes that will have to come from within the education sector (see chap. III). At the same time, broader economic policies that strengthen productive and decent employment and productivity growth will be necessary.

Planning within a budgeting framework

Integrated planning and budgeting frameworks are essential for achieving policy coherence

The use of planning frameworks that are well integrated with budgeting frameworks is essential for reducing spending gaps that leave development objectives unattained, minimizing macroeconomic trade-offs of financing development, and, more broadly, achieving policy coherence. It was noted in chapter I that, while poverty reduction strategy papers (PRSPs) and National Development Strategies (NDSs) in some cases enabled the incorporation of the MDGs into national development planning, they did not necessarily guarantee a requisite fiscal envelope for the implementation of development goals. This would have required coherence and alignment between development priorities—for example, as laid out in PRSPs or NDSs, and a resource allocation or budgetary framework, as laid out in needs assessments or MTEFs. Coherence and alignment between these frameworks would in turn have required that most of the sectors identified in NDSs, PRSPs, and MTEFs had addressed the MDGs in some form or the other, not least by identifying policies and programmes that would drive progress towards the goals.

MTEFs predate the MDG process, but they received renewed attention in the context of the formulation of PRSPs in the early 2000s. At the same time, the adoption of the MDGs in the early 2000s, and the universal quest for larger fiscal envelopes to realize the goals and improve fiscal efficiency and effectiveness, acted as new impetus for countries to transition to MTEFs. The number of countries that adopted an MTEF increased from 11 in 1990 to 132 by the end of 2008 (World Bank, 2013a). It was argued that poverty reduction strategies required increased allocative and technical efficiencies in public expenditures. A Government may achieve these efficiencies by integrating policy objectives in the budgetary process, by establishing clear links between fiscal inputs and expected development outcomes, as well as through costing and multi-year financing (and possibly sequencing) of various fiscal outlays. MTEFs, when properly executed, could be an ideal tool for incorporating NDSs and PRSPs into a coherent, multi-year public expenditure framework.

However, a lack of coherence between national development planning processes and existing budgetary or resource allocation frameworks is perhaps one of the critical factors that have prevented a more adequate adaptation of MDG goals and targets to local conditions and priorities. Fukuda-Parr (2008) points to a number of PRSP countries where Governments, with the support of the United Nations Millennium Project, estimated the investment needed to meet MDG targets in education, health, and water and sanitation. Despite the existence of these cost estimates, none of the countries' PRSPs referred to them. These estimates were not fully incorporated into the countries' planning and budgeting for three main reasons: (i) resources could not be mobilized; (ii) the reliability of the estimates themselves was not exempt from criticism; and (iii) the potential macroeconomic impact on public expenditure ceilings and aid dependence raised concerns.

There are relatively successful stories, nonetheless. For example, to further facilitate mainstreaming the MDGs into its Tenth Five Year Plan, Bhutan aligned national budgetary outlays with resource requirements for meeting the MDGs. This was done

through a detailed costing exercise—as reported in the Bhutan Millennium Development Goals Needs Assessment and Costing (2006-2015) Report in 2006.[7] This exercise was based on the United Nations Millennium Project model. Another example is Nigeria, where Medium-Term Sector Strategies (MTSSs) were developed to guide the preparation and implementation of an MTEF. In 2006, this framework earmarked about 57 per cent of total capital expenditure for MDG-related sectors (Nigeria's Millennium Development Goals Report for 2010).[8]

While there appear to be positive effects of resource allocation or budgetary frameworks on allocative efficiency, the effects on technical efficiency are more uncertain. Cross-country panel data estimation by Vlaicu and others (2014) show that MTEFs improve allocative efficiency, measured as the volatility of health expenditures to total expenditures, with reduced volatility in health expenditures and an increase in aggregate health expenditures. The effect is larger as the country goes from an MTEF to a Medium-Term Budget Framework (MTBF). However, their results on technical efficiency—how MTEFs affect programme level outputs and outcomes such as life expectancy or infant mortality—are, at best, mixed. It is therefore far from clear that adoption of MTEFs in a large number of developing countries directly contributed to making progress towards the achievement of MDGs. This is largely because it has been difficult for most developing countries to operate fiscal policy with full completion of all the stages involved in an MTEF—hence the MDG spending gaps pointed out earlier.

It has also been observed that MTEFs alone were not delivering improved public expenditure management in countries in which other key aspects of budget management—notably budget execution and reporting—remained weak (Le Houerou and Taliercio, 2002). Furthermore, if actual budget disbursement remained unpredictable—as it did in many developing countries—MTEFs merely became a conceptual framework and stakeholders lacked confidence in their medium-term projections. Moreover, MTEFs often failed to improve spending efficiencies without ensuring accountability of the budget actors—ministers, parliamentarians and public officials. It was also a challenge to ensure accountability as the bulk of aid financing remained outside the purview of MTEFs, making programme budgeting extremely difficult for countries dependent on foreign aid. Similarly, MTEF efforts to achieve transparency in the allocation of resources to specific activities often became futile in situations where overall sector policies remained unclear, inconsistent or unrealistic (Oxford Policy Management, 2000).

Economic policy pathways going forward

Economic conditions at the time of MDG adoption were amenable to implementing important policies that impacted MDG achievement…

The initial conditions at the onset of the 2030 Agenda for Sustainable Development implementation period will differ considerably from the conditions that unfolded early into the new millennium when the MDG agenda was adopted and began to be implemented. The period from 2000 to 2008 was characterized by broadly sustained economic growth and macroeconomic stability in both developed and developing countries, supported by the dynamism of emerging economies, rising commodity prices, increasing trade, FDI, ODA and remittances, and by generally positive world market conditions. As a consequence, policy space expanded based on improvements in government revenues, decreases in fiscal

7 For more details, see Bhutan, Planning Commission (2007).

8 For more details, see Nigeria (2010).

balances, lower overall debt and generally improved macroeconomic fundamentals (with some exceptions in both developing and developed countries). These circumstances were important both for spending significantly more for pursuing policies geared towards achieving development goals, including the MDGs, and also for building the policy space that would subsequently be needed to deal with the global financial crisis and the ensuing recovery. Private spending in education, health and water and sanitation have benefited from this favourable context in many countries. The impact of remittances on extreme poverty and other MDGs stands out.

As a result of the improving conditions before the crisis, policies for expanding investment, smoothing shocks and dealing with downturns were also put in place; for example, many countries built up foreign-exchange reserves and a number then bundled some of these funds in sovereign wealth funds. Appropriate use of commodity based funds for supplementary spending also helped to mitigate some of the shocks. In addition, some countries established fiscal rules to help reduce procyclicality of government spending. Properly executed budgeting frameworks also helped to improve policy coherence and limit macroeconomic trade-offs in a handful of countries. Macroprudential tools have also proved useful in limiting exposure to external volatility. These have allowed many countries to enact countercyclical fiscal policies to weather the global financial crisis. For example, lower debt levels during the pre-crisis period allowed some countries to enact stimulus policies and temporarily run higher deficits to offset the effects of the crisis. This meant that, while policy space was more constrained during the crisis, the effects on the population and for the achievement of the MDGs were not as drastic as they potentially could have been.

… while initial economic conditions prior to SDG implementation are considerably more challenging

The initial conditions for implementation of the 2030 Agenda for Sustainable Development are considerably less promising when compared with those of the period 2000-2015, even if the effects of the global financial crisis are considered. The world economy today is characterized by a slow economic recovery precisely because of the crisis, which has limited fiscal space in many developed and developing countries as well as private spending. The economic recovery in developed economies continues to be relatively sluggish, and most developing countries are not expected to post the same dynamic growth rates they experienced before the crisis. Trade growth continues to be well below pre-crisis levels and there are limited prospects for improvement as trade integration appears to have slowed and new trade agreements are not expected to result in significant upticks in trade growth. Inward FDI to developing countries has continued to expand although at a less rapid pace than prior to the crisis (United Nations Conference on Trade and Development, 2015). Commodity prices are generally lower—with some, such as crude oil and iron ore, down considerably—and are not expected to return to previous peaks in the near future. Slowing growth in China has contributed to dampening growth prospects in other developing countries that export raw materials or intermediate goods to China. Overall investment is down across many countries, which is likely to continue to constrain growth in the future. At the same time that policy space is more constrained, many developing countries did not make the most of the economic bonanza of 2000 to 2008 and created critical spending gaps for achieving the MDGs that are visible today. Remittances experienced a slight drop after the crisis, but then steadily resumed their climb; however, it remains to be seen if the trend is sustainable, considering that a number of countries are expected to face slowing economic growth in 2015 (World Bank, 2015c).

Addressing the unfinished business of the MDGs going forward and further implementing the more challenging new aspects of the 2030 Agenda for Sustainable Development will necessitate more robust economic growth to boost private and public spending in key social sectors. In those cases where developing countries present important spending gaps, financing these gaps may result in macroeconomic hardships with unfavourable repercussions for economic growth. Policy coherence will be needed to allocate the resources in the most efficient way possible under a more constrained economic environment. General lessons from the period of MDG implementation include the following:

First, the experience of the 2000-2015 period points to the general need to ensure that Governments and policymakers take advantage of periods of robust growth. Not only are periods of robust growth necessary to produce progress towards the achievement of development goals but they are also critical to establishing the necessary conditions for dealing with external shocks and avoiding setbacks in development progress.

Second, in a broader sense, it will be necessary for countries to pursue adequate policies for macroeconomic stability compatible with long-term development, particularly during times of robust growth. As observed over the period since the MDGs were adopted, macroeconomic stability and investments for development will help to ensure both stable growth during prosperous times as well as more stable growth during downturns.

Third, countries need to continue improving the fundamental bases for weathering economic shocks. This includes ensuring adequate levels of foreign reserves and limiting external debt levels within manageable parameters. Furthermore, social safety net programmes and other countercyclical measures will need to be established and in place prior to shocks so that they can act as automatic stabilizers.

Fourth, in order to reduce procyclicality in general, countries will need to introduce the appropriate policies, including fiscal rules, medium-term expenditure frameworks, and stabilization funds. These will tend to function best when introduced during periods of higher growth so that they can lay the necessary groundwork and build up the requisite buffers to stabilize growth during downturns.

Fifth, pursuing development goals after 2015 will demand the investment of significant public resources, especially in the least developed countries. Financing strategies will have to be devised and carefully assessed to avoid undesirable impacts on private investments or real exchange-rate appreciation.

Sixth, developing countries will also have to work with a policy budgeting framework, with adequate linkages among policies, outcomes and outputs, to minimize the possibility of emerging spending gaps and leaving development goals unattained. This will be critical to guaranteeing policy coherence.

Seventh, economic growth will be required to make the financing associated with public spending more feasible. The challenge will not only be that growth be robust and stable in view of the financing gaps but, importantly, it should also be sustainable and inclusive. Economic policies will have to be pursued to strengthen productive and decent employment and productivity growth. These policies include infrastructure investments, credit policies and other support measures fostering investments in economic diversification towards technologies and activities that absorb larger amounts of skilled labour and reduce the vulnerability to external shocks.

Eighth, national economic policies will further need the support of an enabling external environment, especially in the form of a stronger recovery of export demand and a stable international financial system. This will require continued strengthening of international policy coordination.