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## Overview

Declaring a “development emergency,” a host of world leaders meeting in Davos, Switzerland, in January 2008 issued an MDG Call to Action to help the world get back on track to meet the Millennium Development Goals. Halfway to 2015, the international community needs to recommit to the development goals and redouble efforts to achieve them. International attention and a series of planned high-level meetings in connection with the MDG midpoint make 2008 a crucial year to build stronger and broader momentum toward the MDGs—to make the midpoint a turning point for the development goals.

While many developing countries are making impressive progress toward the MDGs, many others are falling behind. On current trends, a majority of countries will fall short of most MDGs. Yet, the MDGs remain achievable for most countries if stronger efforts are made both by the countries themselves and their development partners—in the spirit of mutual accountability for these goals agreed at Monterrey, Mexico, in 2002.<sup>1</sup> Assessment at the MDG halfway point shows a clear, urgent need to accelerate progress and make it more inclusive. The planned high-level international meetings in 2008 provide an opportunity to agree on priorities, including setting possible interim milestones

toward the goals to focus the action and measure progress.

Building on the outcome of the Bali climate change conference, 2008 is also an important year to make progress on the climate change agenda. MDG 7 underscores the strong links between development and environmental sustainability. Ensuring environmental sustainability is important for achieving the other MDGs and sustaining long-term growth and development. Climate change and loss and degradation of natural resources have the potential to severely reverse hard-earned development gains of the past and constrain prospects for the future. Developing countries will suffer the most and are the least able to adapt. As World Bank President Robert B. Zoellick observed at the Bali conference, “Climate change is a development, economic, and investment challenge, not just an environmental issue. . . . Addressing climate change is a critical pillar of the development agenda.”<sup>2</sup>

This report addresses the interrelated challenges of development and environmental sustainability. It assesses progress and priorities in the agenda to achieve the MDGs. It assesses the challenge of environmental sustainability and its implications for developing countries, and monitors progress at national and global levels to address the

challenge. Based on its assessment, the report sets out an integrated agenda for development that is inclusive and sustainable.

### MDGs at Midpoint: Significant Progress, Yet Formidable Challenges

#### *Poverty reduction: strong but uneven progress.*

First the good news. The world is on course to achieve the first target under MDG 1—halving extreme poverty between 1990 and 2015. This success owes much to a remarkable surge in economic growth. The world economy and the developing countries have rarely grown faster over a sustained period. Growth in developing countries has averaged over 7 percent in the past five years. The number of extreme poor—those living under \$1 a day—in the developing world declined by 278 million between 1990 and 2004, and by a stunning 150 million in the last five years of that period. The sizable reduction in the absolute number of poor people is all the more remarkable as it was achieved notwithstanding a rise in the population of the developing world by about 1 billion between 1990 and 2004. The decline in poverty has been the largest in regions with the strongest growth. East Asia, the fastest growing region, has already reached the poverty-reduction MDG. Other regions have also shared in the rise in economic growth and reduction of poverty.

Yet progress has been uneven, with many countries lagging behind, especially in Africa. While the MDG 1 poverty-reduction target will be met at the global level, Sub-Saharan Africa is likely to fall well short. There has been a very encouraging pickup in growth in the region. Some 18 countries with better-managed economies have grown at an average rate of about 5.5 percent over the past 10 years. But roughly as many countries in the region, some 20 in number, many affected by conflict, have remained trapped in low growth, averaging only about 2 percent. Even among the faster growers, only a few, mainly resource-rich countries, have managed to achieve growth in the 7–8 percent range that

is needed to make serious dents into poverty and reach the poverty-reduction target under MDG 1. In Africa as well as in other regions, progress in poverty reduction has been slowest in fragile states. Indeed, in aggregate, the incidence of extreme poverty *rose* in this group of countries. Fragile states, wracked by conflict and hampered by weak governance and capacities, account for about 19 percent of the population of low-income countries but more than one-third of their poor people. Globally, around 1 billion people continue to live in extreme poverty. Excluding China, extreme poverty between 1990 and 2004 declined by a much smaller 32 million.

#### *Human development goals: more serious shortfalls.*

Notable progress has been made on human development-related MDGs, but the risks of falling short are far greater for these goals than for the income poverty MDG. Again, the good news first. Halfway to 2015, about 40 million more children are in school; gender disparity in primary and secondary schools has declined by 60 percent; 3 million more children survive every year; 2 million lives are saved every year by immunization; and 2 million people now receive AIDS treatment. Yet, about 75 million children of primary school age are still not in school; 10,000 women die every week from treatable complications of pregnancy and birth; more than 190,000 children under five die of disease every week; over 33 million people are infected with HIV, with more than 2 million dying every year from AIDS; more than 1 million people die of malaria, a preventable disease, every year, including 1 child every 30 seconds; and about half of the developing world lacks basic sanitation.

Despite progress, on current trends most human development MDGs are unlikely to be met at the global level. While some regions will meet some of these goals, Sub-Saharan Africa and, in some cases, South Asia are likely to fall seriously short. Prospects are gravest in health, with large shortfalls likely at the global level and in several regions in reducing child and maternal mortality by

two-thirds and three-quarters, respectively, and halving the proportion of those without access to basic sanitation (there is greater progress on the related goal of halving the proportion of those without access to safe water). While much progress has been made in reducing child malnutrition, shortfalls are likely in reaching the goal of halving its incidence, especially in Sub-Saharan Africa and South Asia. The HIV prevalence rate has shown some decline in Africa but has risen in some other regions, albeit from much smaller levels than in Africa. Mortality from malaria remains high but lack of data makes it difficult to monitor incidence over time.

Prospects are better in education. The world is likely to miss the goal of universal primary school completion, though it will come close. However, sizable shortfalls are likely in Sub-Saharan Africa and South Asia. The goal of eliminating gender disparity in primary and secondary education seems attainable by 2015, although Sub-Saharan Africa is likely to fall short. Prospects for achieving gender parity in tertiary education and other gender-related targets are less promising. The regional shortfalls in Sub-Saharan Africa and South Asia in part reflect the lower base they started from.

**Overall outlook: daunting challenges, but grounds for hope.** In sum, while many countries have made impressive progress, most countries are currently off track to meet most of the MDGs, with fragile states falling behind most seriously. At a regional level, Sub-Saharan Africa lags on all MDGs, including MDG 1 for poverty reduction. South Asia lags on most human development goals, although it will likely meet the poverty reduction MDG.

With the world already at the halfway point, recovering lost ground on some of the MDGs seems daunting. Indeed, it is a huge challenge. But rapid progress is possible. The success of better-performing regions and countries inspires and gives reasons for hope. One such example is Vietnam's achievement in reducing poverty from around 58 percent in 1993 to 16 percent in 2006. Even in many

lagging countries, including in Africa, progress is being made. The strengthening of economic growth in a number of African countries is especially significant. Some African countries recently have achieved impressive results: for example, Ghana, Mozambique, Tanzania, and Uganda in accelerating growth and reducing poverty; Malawi in achieving particular success in boosting agricultural productivity; Ghana, Kenya, Tanzania, and Uganda in increasing primary school enrollment; Niger, Togo, and Zambia in combating malaria; Senegal and Uganda in increasing access to water and sanitation; Niger in promoting reforestation; and Rwanda in achieving an impressive recovery from conflict. This progress needs to be quickened and broadened—across MDGs, across countries, and across populations within countries.

### **Development and Environmental Sustainability: Integrally Linked**

Urgency of action to accelerate and broaden progress toward the development goals is paralleled by urgency of action to combat climate change that threatens the well-being of all countries but particularly that of poor countries and poor people. Development and environmental sustainability are fundamentally complementary objectives (although in the short term they may appear as trade-offs). Environmental sustainability is essential for continued economic growth and reduction of poverty. It also exerts positive impacts on human development goals—health, nutrition, and education outcomes. Economic growth and development in poor countries in turn can contribute to environmental sustainability by improving their access to modern energy and cleaner and more efficient technologies and by reducing reliance on activities, such as cutting forests, that are detrimental to the environment. Deforestation contributes about one-fifth of total greenhouse gas (GHG) emissions. At present, 1.6 billion people, about a third of the developing world's population, are

without access to modern energy, forced to rely on more carbon-emitting biomass and fossil-fuel energy. Economic development also expands the resources and capacities of poor countries to adapt to environmental impacts.

*Sound natural resource management essential.* For developing countries, most of whom have a high dependence on natural resources, carefully managing those resources and the environment is especially important for the sustainability of growth and development outcomes. On average, natural capital constitutes more than 40 percent of the national wealth of low-income countries (close to 60 percent if the more advanced emerging market countries are excluded from this group), compared with only 5 percent in high-income countries. Issues of sustainable use of natural resources are typically raised in relation to subsoil assets, notably oil, but extend to other resources such as forests and water. An area of forest equivalent to the size of Panama or Sierra Leone is lost every year to land use changes, with most of the loss concentrated in Latin America and Sub-Saharan Africa. Per capita freshwater availability could fall below critical levels in the near future in many countries in the Middle East and South Asia. Pollution threatens the quality of air and water. The major urban air pollutant affecting human health is particulate matter whose concentrations in low-income countries are on average nearly three times higher than in high-income countries. How these resources are managed will be critical to longer-term sustainability of growth.

*Climate change: poor countries most affected.* Heavier dependence on natural resources and agriculture and lack of development also render poor countries more vulnerable to the impact of climate change and less able to adapt. These include impacts on agriculture and human health, and the effects of sea level rise and extreme weather events.

Estimates of the impact of global warming through 2080 based on nonmitigation

scenarios show developing countries in Sub-Saharan Africa, South Asia, and parts of Latin America, which are home to 1 billion of the world's poorest people, suffering the largest losses in agricultural output, ranging from 15–60 percent. Environmental risk factors play a role in 80 percent of diseases globally, and the economic burden of environmental health hazards has been estimated at 1.5–4 percent of GDP. The cost of climate change in disability-adjusted life years was estimated at 5.5 million annually in 2000, an estimate that will only rise if climate change is not checked. Children of the developing world bear the brunt of the health impact of climate change through increased incidence of diseases such as diarrhea, malaria, and respiratory infections. More than 200 million people in developing countries live in potential impact zones where they would become refugees from coastal flooding at a three-meter sea level rise. Even at a one-meter sea level rise, a number of countries would be significantly affected: for example, without adaptation efforts, more than 10 percent of Vietnam's population would be affected, and the country would lose 10 percent of its GDP and 29 percent of its wetlands. During the 1990s, 200 million people per year, on average, were affected by climate-related disasters in developing countries, compared with about 1 million in developed countries.

### **Inclusive and Sustainable Development: A Six-Point Agenda**

What is the agenda implied by this assessment? Progress toward the MDGs must be quickened and broadened to include the many countries that are lagging behind. To ensure the sustainability of this progress, the environmental challenges must be addressed in a manner that is supportive of developing countries' growth and development. To meet these challenges, the report sets out a six-point agenda for inclusive and sustainable development (box 0.1).

## BOX 0.1 MDGs and the environment

### A six-point agenda for inclusive and sustainable development

- *Sustain and broaden the growth momentum*
  - Strong and inclusive growth must be at the center of the strategy to achieve the MDGs.
  - Concerted efforts are needed to spur growth in lagging countries in Africa and fragile states; a dynamic agricultural sector is crucial for strong and inclusive growth in many poor countries.
  - Sound macroeconomic policies, a conducive private investment climate (regulatory environment, infrastructure), and good governance are essential for growth.
  - Risks to developing-country growth arising from recent financial market turbulence and rises in oil and food prices need careful monitoring and appropriate responses.
- *Achieve better results in human development*
  - Key programs in health and education must be stepped up—for example, the Fast-Track Initiative in education, eradication of malaria, and health systems strengthening.
  - Increased public spending alone is not the answer; quality and equity of spending are equally important.
  - A stronger focus is needed to combat malnutrition, especially among children, and to underpin better human development outcomes.
  - Policies and interventions must factor in the strong links between health and education outcomes, nutrition, and environmental factors—water and sanitation, pollution, and climate change.
- *Integrate development and environmental sustainability*
  - Environmental sustainability must be integrated into core development work, maximizing synergies.
  - For natural resource-dependent countries, sound resource management is critical for sustainable growth.
  - Developing countries will suffer most from climate change and are least able to adapt; for them the best way to adapt is to develop.
  - Transition to climate-resilient and low-carbon growth will require financing and technology transfer to developing countries. Such support should not divert resources from other development programs.
- *Scale up aid and increase its effectiveness*
  - Donors must expedite aid delivery in line with commitments. Sizable shortfalls loom if current ODA trends persist, which will particularly hurt poor countries and fragile states that offer promising scale-up opportunities.
  - The changing aid architecture promises more resources and innovation but also poses new challenges for aid effectiveness and coherence. The Accra High Level Forum provides a timely opportunity to address the new, dynamic dimensions of the aid agenda.
  - Increased private flows to developing countries create opportunities to catalyze and leverage more private capital in support of development, including through innovative public-private partnerships.
  - Both borrowers and creditors need to pay attention to debt sustainability to prevent a reaccumulation of unsustainable debts following debt relief.
- *Harness trade for strong, inclusive, and sustainable growth*
  - Countries must aim for a successful Doha outcome in 2008. High food prices provide a window of opportunity to move on agricultural trade reform.
  - Aid for trade to strengthen trade logistics, supported by services liberalization, is important for poor countries' competitiveness and ability to benefit from trade opportunities.
  - Trade policy can facilitate transfer of environmentally friendly technologies by removing barriers to trade in environmental products and services.
- *Leverage IFI support for inclusive and sustainable development*
  - The declining relative financing role of the international financial institutions (IFIs) does not imply less relevance. Their impact through leverage remains key in achieving collective action on development (MDGs and related outcomes) and the increasingly important global and regional public goods such as combating climate change.
  - Adaptation of operational strategies initiated by several IFIs in response to increasing client differentiation and global change is important and timely.

## 1. Sustaining and Broadening the Growth Momentum

Strong and inclusive growth is central to achieving the MDGs and related development outcomes. It reduces poverty directly and expands resources and capacities for achieving the other MDGs related to human development and environmental sustainability.

### Implications of Global Economic Developments

*Financial turbulence, global slowdown.* An immediate priority is to contain the international financial market turbulence and limit its impact on developing country growth. Thus far the effects on developing countries have been relatively contained, thanks to improved macroeconomic policies and stronger fundamentals. Global GDP growth in 2008 is projected to slow to 3.7 percent from 4.9 percent in 2007, with growth in developing countries slowing by about a percentage point but still remaining relatively strong at 6.7 percent.

Nonetheless, the persistence of financial market turbulence and its knock-on effects on growth pose downside risks to this outlook. Also, private capital flows, which have become much more important as a source of external financing in developing countries, could reverse. Countries with large current account deficits and asset bubbles are particularly vulnerable, especially in emerging Europe, and bear close monitoring. Given current uncertainties and country differences, there is no single policy prescription for developing countries in addressing the implications of the financial market turmoil. Vulnerabilities and the appropriate policy responses must be assessed on a country-by-country basis. Prudent policies that allow automatic stabilizers to operate may be preferable to policy activism for many countries. Renewed attention to fundamentals—prudent external debt management, fiscal discipline, and flexible exchange rate policies—can cushion shocks and facilitate adjustment in vulnerable countries.

*Rise in oil and food prices.* Another, and related, immediate concern is the implications

of the sharp rise in the prices of oil and food. Both supply constraints and rapid growth in demand have contributed to the rise in prices—including, in the case of food prices, the increasing use of food crops for biofuels. Thus far the macroeconomic impact on importing countries in general has been relatively limited, offset by rising prices of other commodity exports and higher capital inflows. But the situation of net oil and food importers could worsen if oil and food prices rise further or if the favorable offsetting developments reverse. Poor people in developing countries spend as much as a half of their income on food. The urban poor are the most directly affected. Possible policy responses range from energy demand management and targeted safety nets for affected poor in the short term to longer-term measures to increase energy production and promote agricultural growth. To cushion the impact of price shocks on the poor, reliance should be placed on targeted safety net programs, avoiding recourse to price controls and trade restrictions that are distortive, ineffective, and ultimately unsustainable. If needed, the International Monetary Fund (IMF) and the World Bank could provide financial support through the Exogenous Shocks Facility or IDA (International Development Association) financing.

### Policies and Institutions for Strong and Inclusive Growth

Looking to the medium term, a key challenge is to spur stronger growth in lagging countries that have not shared in the surge in growth witnessed in much of the developing world over the past several years. Specific policy priorities and sequencing of actions to promote growth necessarily vary by country. Across developing countries there is considerable diversity in economic circumstances. The specifics of the policy agenda for growth at the country level must be defined as part of individual country development strategies. Looking across countries, three broad areas emerge as being essential to robust growth: sound macroeconomic policies; a conducive private

investment climate, including a business-friendly regulatory environment and access to key infrastructure; and good governance. Policies in all three areas have been improving in developing countries but progress has been uneven, which is mirrored in the improving but uneven growth performance across countries in recent years. Deeper and more consistent progress on reforms in these key areas will be needed to achieve sustained and more broadly based growth.

*The growth agenda in Africa.* Sub-Saharan Africa perhaps illustrates the diversity of countries' growth performance most strikingly. About 20 countries, accounting for a third of the region's population, continue to record very low rates of economic growth that imply stagnant or even declining per capita incomes. Many of these are fragile states affected by conflict. Their policy agenda comprises a mix of security enhancement, political reform and consolidation, capacity building, and actions to build private sector opportunities. They need international aid, but they also need to strengthen basic governmental capacity to ensure its effective use.

Another group of African countries accounting also for roughly a third of the region's population has improved growth performance in recent years to an average of 5–6 percent, with some achieving higher growth. This group includes countries such as Ghana, Mozambique, Rwanda, Tanzania, and Uganda, which a decade ago appeared to have rather grim prospects. Their main challenge is to build on reforms to strengthen the foundations for strong, sustained, and broad-based growth. Solidifying macroeconomic stability, further improving the climate for private investment through regulatory and institutional reform and strengthened physical infrastructure, and deepening regional and global links are key elements of their growth agenda. These countries demonstrate capacity to utilize scaled-up external assistance effectively to further their growth prospects.

In many countries in Africa, and in low-income countries more generally, a dynamic

agricultural sector is crucial for strong and inclusive growth and will help to mitigate the upward pressures on food prices that became visible in 2007. An estimated 900 million rural people in the developing world live on less than \$1 a day; most of them are engaged in agriculture in some form. A recent World Bank study estimated that GDP growth originating in agriculture is about four times more effective in reducing poverty than GDP growth originating outside the sector.<sup>3</sup> An African Green Revolution would provide a strong foundation for growth and poverty reduction in the region.

*Managing natural resource revenues.* Some African countries that are rich in natural resources, and that together account for most of the remaining one-third of the region's population, have achieved average growth rates as high as 9 percent, fueled by the boom in resource prices. Their main challenge lies in managing and transforming their natural resource wealth into long-term sustainable growth. This calls for good governance to support extracting and managing the resource wealth efficiently and transparently and transforming resource revenues into productive investments that help diversify the economic base. Explicit resource rent policies are often needed: the chain from rent capture to the management and use of resource rents can determine whether rich resource stocks are a source of development finance or a contributor to the "resource curse." Countries should be encouraged to participate in the Extractive Industries Transparency Initiative (EITI), which is making headway, with 24 implementing countries (of which 17 are in Sub-Saharan Africa) including 7 with national EITI reports out and a system in place for validating performance.

*Rise in income inequalities: Is globalization to blame?* Besides disparities in growth performance across developing countries, there has been an increase in income inequality within many countries. That increase has been more pronounced in countries with higher growth rates. A recent IMF study ana-

lyzing the impact of globalization on inequality found that the major factor contributing to the rise in inequality has not been globalization, but rather technological progress, which has reduced demand for low-skill workers and increased opportunities and rewards for higher-skill workers. Financial globalization has contributed too, but its effect has been more than offset by the equalizing effect of trade liberalization. Broadening access to education and financial services would help counter the disqualifying effects of technological progress and financial globalization.<sup>4</sup> Also important is an investment climate that expands opportunities by providing a level playing field to firms. In poor countries, boosting agriculture is crucial for inclusive growth, as noted above.

## 2. Achieving Better Results in Human Development

Progress toward the human development MDGs must be expedited if serious shortfalls are to be avoided. A major scaling up of efforts is needed in education and health, and especially in health, where on current trends shortfalls are likely to be the most serious. This will require commitment of more resources, including donor support, to programs in these sectors—for example, the Fast-Track Initiative in education, health systems strengthening, and combating malaria. But more spending alone is not the answer. The quality and equity of spending are equally important. More attention needs to be paid to early childhood interventions, such as improved nutrition, that can establish a stronger foundation for better human development outcomes later in life. Policies and programs must also factor in the strong links that exist between health and education outcomes and environmental risk factors, such as lack of access to clean water and basic sanitation, pollution, and climate change.

*Raising quality of health services.* Complementing the focus on quality in education in the 2007 *Global Monitoring Report*,

this report assesses the quality of programs and services in health and the role of quality in achieving the desired health outcomes. Addressing the issue of quality in public health care can make a significant contribution toward reducing child mortality, improving maternal health, checking the spread of major diseases, and reducing malnutrition. Health care quality is highly uneven, both across and within countries, whether measured by the breadth of medical facility and treatment coverage, health care provider competence and motivation, or medical outcomes. Thanks to expanded health programs, access to health care is improving, but poor outcome measures in many instances suggest low or falling quality as access rises. Research shows that rising per capita income is positively related to health care quality, but rising public health spending alone is not. Effectiveness of spending and service delivery matters. Improved governance is critical for raising quality, including attention to the competency of providers, incentives to improve performance, and accountability mechanisms to ensure better outcomes. Sound expenditure management, better information (real-time data, oversight, including checking the extensive prevalence of absenteeism, and monitoring and auditing), and a focus on results are essential to more effective service delivery. Strategies to make effective use of the private sector and to strengthen the voice of clients at the point of service delivery and within communities also contribute to better quality services.

*Achieving more equitable outcomes.* In addition to quality issues, progress toward the MDGs is undermined by inequity in health and education spending and outcomes. Health and education spending is often skewed toward higher-income households. Analysis of the incidence of public health and education spending shows the top income quintile benefiting substantially more than the bottom quintile in practically all developing regions—by a factor of more than two in South Asia and Sub-Saharan

Africa. Inequity in outcomes is illustrated by the fact that in Latin America a child born in the poorest quintile is almost three times as likely to die before the age of five as a child born in the richest quintile, almost six times as likely to be malnourished, and only two-thirds as likely to receive medical treatment for a simple complaint such as a fever. Low service quality exacerbates inequity as the poor are much more likely to receive sub-standard services and could be discouraged from using the services altogether—even if these are free. Achieving gender parity in service access and outcomes has been a relative success, but large disparities persist for poorer segments of the population, those in rural areas, and minority groups. Better targeted and tailored programs are needed to reach the underserved and marginalized groups. Where feasible, conditional cash transfer (CCT) programs can help.

**Tackling malnutrition.** Malnutrition, especially among children, directly affects the incidence of disease and the probability of mortality. Malnutrition is the underlying cause of at least 3.5 million deaths annually and accounts for 35 percent of the disease burden of children under age five. Better nutrition in early years influences children's subsequent educational performance and their prospects for finishing school. Malnutrition during pregnancy increases the risk of a mother's death at delivery and accounts for more than 20 percent of maternal mortality. Combating malnutrition, part of MDG 1, is thus important also to the achievement of MDGs 2, 4, and 5. While much progress has been made in reducing child malnutrition in the developing world, it remains widespread in many countries, especially in Sub-Saharan Africa and South Asia where severe to moderate stunting affects as many as 35 percent of children under five. South Asia has the highest incidence of child malnutrition; the child malnutrition rate in India is double the African average.

Food security is important for combating malnutrition, but factors such as the

mother's education and family income are equally, if not more, important. Through reducing the risk of diseases such as diarrhea, access to clean water and basic sanitation also matters. Technical interventions to combat malnutrition already exist. They need to be expanded to scale and placed in a wider multisectoral context. Donor programs to combat nutrition typically have been dominated by food aid and supply-led technical assistance. An integrated, multi-sectoral approach is needed that recognizes the multiple factors involved and exploits related synergies, emphasizes education for mothers, explores innovative delivery mechanisms such as school feeding programs with locally purchased food and CCTs, and engages communities and the private sector. The recent sharp rise in world food prices only increases the urgency of action.

**Addressing environmental health risks.**

Principal environmental risk factors for health include water and sanitation (diarrhea and malaria), indoor and urban outdoor air pollution (respiratory infections), and climate change (tropical vector-borne diseases such as malaria). About a quarter of all deaths in the developing world are principally attributable to environmental risk factors. Unsafe drinking water and poor sanitation and hygiene account for around 90 percent of diarrhea cases worldwide. More than 40 percent of the global burden of malaria can be prevented through improved environmental management. An estimated 1.5 million deaths annually caused by respiratory infections are attributable to environmental pollution.

In addressing the environmental risk factors, a key priority is to improve access to clean water and basic sanitation and to promote better hygiene, a vital complement to water and sanitation expansion in poor countries. It is estimated that meeting the water and sanitation MDG will require annual investment on the order of \$30 billion, roughly double the current level.<sup>5</sup> But it is not only a matter of public investment in

new systems. Better operation and maintenance of existing systems, and use of tariffs to help finance that while protecting the poor, are essential, as is the exploitation of opportunities for private participation. Institutional strengthening of sector agencies will be necessary, as will coordination across sectors given the strong linkages to health. Responses to environmental health risks arising from pollution and climate change are part of the broader agenda of mitigation and adaptation addressed below.

### 3. Integrating Development and Environmental Sustainability

Environmental sustainability must be integrated into core development work, maximizing synergies. Countries have over the years increasingly incorporated into their growth and development strategies important aspects of environmental management, including energy access and efficiency, control of pollution, improvement of water and sanitation systems, forest resource and land use management, and preservation of fisheries and biodiversity. Building on this progress, the growing threat of global warming now necessitates an increased emphasis on integration of climate change prevention in development strategies—not to curtail development but to sustain it by permitting continued economic growth through reductions in carbon intensity and by strengthening capacity to adapt to climate risks.

Early action to control GHG emissions will significantly reduce mitigation and adaptation costs. Even if efforts to stabilize GHG emission are successful, some degree of warming and related impacts will continue to occur into the next decades. An effective response to climate change must combine both mitigation and adaptation.

*Moving forward on mitigation.* The international community must work toward a timely agreement on a post-Kyoto framework for mitigation. Stabilization of GHG concentrations within levels that keep the

effects of climate change manageable will require a significant reduction of carbon emissions by developed countries along with a curbing of growth in emissions by developing countries with eventual stabilization in the longer term. This accords with the principle of “common but differentiated responsibilities and respective capabilities” that recognizes developing countries’ lower historical contribution to GHG concentrations and much lower energy use and carbon emissions per capita. However, even if total carbon emissions of developing countries are allowed to rise for some time, efforts must be made to reduce the carbon intensity of GDP (emissions per unit of GDP). Key elements of a mitigation framework include:

- pricing of carbon to provide market-based incentives to mitigate
- development and diffusion of cleaner and more energy efficient technologies and of renewable energy sources
- financing and technology transfer to support transition to low-carbon growth in developing countries
- reducing deforestation.

Low-cost, high-impact opportunities should be fully exploited, such as investing in “no-regrets” options for improving energy efficiency—investments that are based on existing technologies or approaches and would pay for themselves if subsidies to energy consumption and production were removed.

*Strengthening adaptation: vital for developing countries.* Adaptation is particularly important for developing countries as they will suffer the most from climate change and are able to adapt the least. For them, the best way to adapt is to develop, which will strengthen adaptation options and capacities by diversifying their economies and expanding the resources they need to adapt—by strengthening infrastructure, developing health systems and curbing climate-sensitive diseases such as malaria and diarrhea. Programs to reduce vulnerability and “climate

proofing” of investments can have immediate payoffs, such as implementing early warning systems for heat waves, floods, and droughts; building dams to accommodate increased runoff; and making roads and bridges climate proof. As vulnerability to climate impacts varies widely across developing countries, adaptation programs must be country specific.

*Financing mitigation and adaptation.* The Secretariat of the UN Framework Convention on Climate Change has estimated that by 2030, annual financial flows to developing countries will need to be on the order of \$100 billion to finance mitigation and \$28 billion to \$67 billion for adaptation. While over 80 percent of these flows are expected to come from the private sector, with carbon markets playing an increasingly important role, public sector financing also will be essential to create the enabling environment for private financing. Assistance for mitigation and adaptation should be additional to current levels of official development assistance so that resources are not diverted from other development programs.

*Institutional strengthening.* Environmental management and its integration with the development agenda will also require institutional strengthening in developing countries. This includes both capacity building for related institutions and improvement of key policies such as property rights to natural resources. While progress is being made, institutions for environmental management in developing countries are particularly weak. Progress has been strongest in Eastern Europe and Central Asia whereas South Asia and Sub-Saharan Africa have lagged behind. Progress on environmental policies in many cases is undermined by weak institutional capacities for enforcement.

#### 4. Scaling Up Aid and Increasing its Effectiveness

Developing countries must make stronger efforts to mobilize more domestic resources

to accelerate progress toward the MDGs—moving vigorously to spur economic growth, strengthening revenue administration, and improving the efficiency of spending. They must also build on reforms to mobilize private investment—domestic and foreign. Still, for most low-income countries, official development assistance (ODA) remains a major source of development finance. In Sub-Saharan Africa, home to most of these countries, official flows account for about two-thirds of all capital inflows. Even with stronger efforts to mobilize more domestic resources and attract more private capital inflows, these countries will need a substantial increase in ODA to improve their prospects for achieving the MDGs. In middle-income countries aid plays a much smaller but still important role, by catalyzing reforms, supporting efforts to tackle concentrations of poverty, helping to counter negative shocks, and assisting with global or regional public goods such as climate change.

*Increasing aid to exploit scale-up opportunities.* The time to deliver on aid commitments to support the effort to achieve the MDGs is now. Donors must expedite aid delivery. If current ODA trends persist, sizable shortfalls loom, which would particularly hurt poor countries and fragile states that offer promising opportunities to scale up development results. Many countries have improved their policies and capacities and are able to utilize increased aid productively. But donor response has tended to fall short. Both aid recipients and donors need to deliver on their commitments if the MDGs are to be achieved.

The latest aid numbers give cause for concern. The rise in ODA appears to have stalled. After rising during 2002–05, total net ODA from Development Assistance Committee (DAC) donors fell by 5 percent in real terms in 2006, and preliminary indications are that it declined by a further 8.4 percent in real terms in 2007. At \$103.7 billion in 2007, DAC net ODA was about \$15 billion higher than its 2004 (pre-Glencoe) level, but much larger and sustained

increases in aid will be needed to reach the target of a \$50 billion increase in real terms by 2010 that was set at the 2005 Group of Eight summit in Gleneagles, United Kingdom (which would raise total net ODA to \$130 billion in constant 2004 dollars). Aid to Sub-Saharan Africa shows broadly the same pattern: it has risen but at well short of the rate that would achieve the targeted doubling of aid by 2010. Moreover, the bulk (about 70 percent) of the increase in ODA post-Gleneagles has been in the form of debt relief. Core development aid—program and project aid—has shown relatively little increase. Debt relief has significantly reduced the debt burden of beneficiary countries and expanded the fiscal space for development spending. As debt relief operations wind down, core development aid will need to rise quite sharply to reach the Gleneagles target for total ODA. However, preliminary evidence from DAC's 2007 forward survey of donors' aid intentions suggests that, overall, these are not yet sufficiently ambitious to meet the targets set for 2010.

While traditional donors remain the dominant source of development aid, the aid landscape is changing rapidly. New sources of aid have emerged, both from new official bilateral donors, including some developing-country donors such as China and India, and from private donors, who are playing an increasing role in aid. New modalities of aid include global vertical funds focused on specific objectives, such as the Global Fund to Fight AIDS, Tuberculosis, and Malaria and the Global Alliance for Vaccination and Immunization, and innovative financing modalities, such as the International Finance Facility for Immunization, Advance Market Commitments, and the solidarity levy on airline tickets. These new sources and modalities of aid, whose role in the overall aid architecture is likely to increase, are expanding the potential aid envelope and creating new opportunities for experimentation and innovation in development finance. They also pose new challenges for aid effectiveness and coherence, to maximize their development impact.

*Ensuring aid effectiveness in a changing aid architecture.* Overall, there is some encouraging progress in the implementation of the Paris Declaration on Aid Effectiveness. Progress on aid alignment and harmonization has been notable though uneven. The predictability of aid is improving. However, much of that improved predictability relates to the near term. Medium-term predictability, important for countries' planning and implementation of development strategies and programs, remains low. Longer time horizons for aid commitments and clearer rules for qualification and disbursement are needed. Even as gains are made on the Paris aid alignment and harmonization agenda, new challenges have arisen as the aid architecture has become more complex with more donors, the potential for increased fragmentation of aid, and increased earmarking through vertical approaches.

The increased complexity of the aid architecture enhances the role of strong country-led strategies as a critical element in aid effectiveness. Empowered by clear, coherent national development strategies that are linked to budgetary frameworks and underpinned by stronger country systems and capacities, countries themselves will be best positioned to engage with a plurality of aid sources and ensure coherence of aid with their development priorities. A challenge for the Paris agenda is the integration of the new sources and modalities of aid in the aid alignment and harmonization framework. The Accra High Level Forum in September 2008 provides a timely opportunity to address the new, dynamic dimensions of the aid agenda.

*Health sector financing.* The health sector epitomizes the challenges to aid effectiveness in the new aid architecture. New donors and aid channels—global vertical funds, earmarked funds from bilateral sources, private donors—have brought much needed attention and financing. Aid to health has increased sharply, more than doubling between 2000 and 2006. But the multiplic-

ity of donors and aid channels and a vertical focus on specific communicable diseases have also made aid effectiveness and coherence more challenging. Issues of alignment with country strategies and priorities are illustrated by the fact that in seven African countries support from vertical funds for fighting HIV/AIDS ranges from one-third to one-half of total spending on health. Donor funding for HIV/AIDS exceeded that for malaria by 40 percent in Ghana and 160 percent in Rwanda, even though in both countries malaria is the leading cause of morbidity and mortality. Issues of efficiency of use are illustrated by the fact that roughly one-half of health aid is off budget and by mismatches between rapid increases in earmarked funds and absorptive capacity. In Ethiopia health systems strengthening has recently received only about 15 percent of donor financing for health, compared with 60 percent for HIV/AIDS.

Such consequences, however, are not inevitable. The key is to better align and integrate vertical and earmarked funds with country strategies and systems and improve donor coordination and complementarity. The strengthening of health systems—human resources, financial management and procurement, information, the governance framework—needs greater attention in donor support. This is important to bolster country capacities to plan and implement effective and integrated health programs—for communicable diseases but also for other programs such as mother and child health that are interrelated. The need for greater coordination and integration is recognized by recent initiatives such as the International Health Partnership that brings together traditional and new donors and the selection of health as a special focus sector in monitoring the application of the Paris principles.

**Securing debt sustainability.** While debt relief provided under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI)

has improved the debt indicators, long-term debt sustainability remains a challenge for several post completion–point countries. Prudent debt management as part of a sound macroeconomic framework and reforms to build resilience to exogenous shocks will help prevent debt burdens from becoming unsustainable again. Creditors need to take debt sustainability considerations into account in their lending decisions. The Bank-Fund Debt Sustainability Framework is a tool that can be used by borrowers and creditors alike to assess and manage risks.

## 5. Harnessing Trade for Strong, Inclusive, and Sustainable Growth

Strong expansion in world trade has been a powerful force boosting global economic growth. Worldwide merchandise exports grew 14 percent in value in 2007, well above the average 9 percent growth recorded in the previous 10 years, with developing-country exports rising still faster at 17 percent. Research shows that economic growth has been faster in countries that have liberalized their trade more. Trade restrictiveness has been on a declining trend in developing countries in this decade, with middle-income countries seeing the largest declines.

**Unleashing trade.** A successful Doha Round is crucial for sustaining strong trade growth and making the sharing of its benefits more inclusive—even more so now as protectionist pressures may intensify with the prospective slowing of the global economy. A key bottleneck holding up progress has been the lack of agreement on agricultural trade liberalization. The current high prices for food provide a window of opportunity that World Trade Organization (WTO) members should use to break the impasse on reforming agricultural trade policies in high-income countries. The highly restrictive and distortive agricultural support policies maintained by these countries hurt both their consumers and producers in developing countries, including some of the poorest countries.

The linkage to agricultural growth in poor countries makes reform of these policies especially important for achievement of the MDGs. The Doha outcome must aim for a major reduction of barriers to agricultural trade. The bulk of the potential benefits from Doha are dependent on that.

Significant trade policy commitments by developing countries also are essential for realizing the potential of trade for development, including tapping the considerable scope for expanded trade among them. Developing countries have higher average levels of trade restrictiveness than high-income countries but more neutral trade policy regimes between agriculture and manufacturing. The traditional policy of taxing agriculture in many developing countries has become much less prevalent. Since the mid-1980s, gross subsidy equivalents of support to farmers in high-income countries have remained high, at about \$200 billion a year, but have moved in developing countries from a negative amount (implying effective taxation) of about \$100 billion a year to positive amounts, signifying small to moderate positive support (except in Africa where the trade policy regime on balance continues to tax farmers). Doha offers an opportunity to developing countries to lock in the current relatively neutral cross-sectoral trade policy stance and to reap the efficiency gains of further lowering applied levels of protection.

*Promoting inclusiveness in exploitation of trade opportunities.* Enabling firms to exploit opportunities created by trade liberalization and expanded market access requires complementary behind-the-border policies to improve competitiveness and supply response capacities. Of particular importance are services policies. The quality and cost of services such as transportation, telecommunications, and finance are major determinants of competitiveness. Research shows that countries with better trade logistics are more successful in integrating into global markets. Poor countries' competitive-

ness typically is hampered by weaker trade logistics. Many developing countries have sought to improve the quality of key logistical services by opening them to foreign competition. However, services trade regimes in most developing countries remain relatively restrictive. Most services liberalization so far has been undertaken unilaterally. The Doha Round provides an opportunity to use the WTO as a mechanism to further services liberalization.

Aid for trade needs to be scaled up substantially to help countries address the behind-the-border constraints on their capacity to exploit trade opportunities. It is particularly important for the least developed countries (LDCs), most of which are in Africa, for whom lack of trade capacity and competitiveness arising from poor logistics such as trade-related infrastructure and customs services, rather than market access, is often the binding constraint. Progress has been made recently on aid for trade, as illustrated by the initiative to enhance the Integrated Framework for trade-related assistance for LDCs and the willingness of donors to make commitments to the associated trust fund to support its operations. Aid for trade rose 10 percent in 2006 to reach an estimated total of about \$23 billion, with well over half of it directed to economic infrastructure. Only half of the total flowed to low-income countries, and only about a quarter to LDCs.

*Facilitating transfer of environmentally friendly technologies.* Trade policy and aid for trade also have a role to play in fighting global warming and supporting sustainable development by promoting the transfer and adoption of environmentally friendly technologies. Trade barriers confronting environmental goods and services, such as products that generate energy in more environmentally friendly ways or use energy more efficiently, tend to be highest in low-income countries, paralleling the overall pattern of trade restrictiveness. From an environmental perspective, the best trade

policy is one that encourages the use of the most efficient environmental goods and services. Removing policies that restrain trade in such products, and assisting producers in developing countries to benefit rather than lose from initiatives such as carbon labeling, can help harness the potential of trade to support strong and inclusive growth and improve environmental outcomes. Complementing trade policy, streamlining of intellectual property rights and investment rules can further aid in the transfer and assimilation of environmentally more efficient technologies, which can help with both the mitigation and adaptation aspects of the fight against climate change.

## 6. Leveraging IFI Support for Inclusive and Sustainable Development

How should international financial institutions (IFIs)—multilateral development banks (MDBs) and the IMF—strengthen and sharpen support for the foregoing agenda for inclusive and sustainable development? Net financial flows to developing countries from IFIs relative to other sources of financing have been declining. In 2007 the IFIs had a share in net ODA of only 8 percent. Net nonconcessional flows turned slightly positive in 2007 after four years of large negative flows. But the IFIs' declining relative financing role does not imply less relevance. The true measure of their impact must consider the development leverage they achieve beyond their narrow financing role. Their impact through leverage remains key in achieving collective action on the MDGs and related development outcomes and on the increasingly important global and regional public goods. Shareholder recognition of this broader impact through leverage is reflected in record pledges made in the past year for IDA15 and AfDF (African Development Fund) XI.

*Responding to change: new strategic frameworks.* IFIs face a challenging context of rapid change brought about by globaliza-

tion, an evolving international financial architecture, and increasingly differentiated client needs across low-income countries, fragile states, and middle-income countries. They must adapt their strategies to this change. While a process of adaptation has been under way for some time, all IFIs over the course of the past year initiated major strategic reviews and introduced important shifts. These strategic shifts have three common themes:

- First is a shift in client and business focus to promote inclusive and sustainable globalization. One aspect of this shift has been a sharpened focus on low-income countries and fragile states, and also on major concentrations of poverty within middle-income countries, to connect the “bottom billion” to the global economy. Another is a strengthening of private sector operations, as private sector supply response is essential to reap the full benefits of globalization. Common to these shifts is a sharper differentiation of products and services across clients.
- Second is an orientation toward knowledge services as a critical means of achieving development leverage and as the glue that binds development partners—by building country absorptive capacities, strengthening country strategies, underpinning aid effectiveness, disseminating best practice, and developing a shared knowledge base. There is demand for knowledge services from both low- and middle-income countries, but innovation is required to increase flexibility and responsiveness. Middle-income countries also offer practical experiences that the IFIs can increasingly tap for dissemination to low-income countries.
- Third is an increased emphasis on global and regional public goods, through direct interventions and by creating an enabling environment to leverage private sector. These public goods span global macroeconomic and financial stability,

international financial architecture, trade, control of communicable diseases, global environmental commons, regional economic integration, and global and regional knowledge goods. The increased focus on global and regional public goods poses a challenge for IFIs whose business model has in large part been structured around country platforms.

Success in carrying out these strategic shifts will be crucial to the IFIs' ability to increase impact by leveraging their assets and activities. Progress in ongoing efforts to adapt governance structures—members' quotas, voice, participation—also will be important for continued effectiveness.

*Ensuring strong operational outcomes in a context of change.* Amid this process of strategic change, MDBs posted an overall strong performance in their financial operations during 2007. Their gross disbursements reached a record \$49 billion. Concessional flows and nonconcessional flows to nonsovereign entities have been the most dynamic elements. Gross concessional flows rose by 11 percent to over \$12 billion, with flows to Africa showing the fastest increase. MDB support to Sub-Saharan Africa has more than doubled since 2000. Implementation capacity (including fiduciary) constitutes the key bottleneck in scaling up concessional finance. MDB nonconcessional flows to nonsovereign entities rose to over \$13 billion in 2007, a quadrupling since 2000. Half of these flows are accounted for by the International Finance Corporation (IFC) and the other half by private sector arms of other MDBs. Encouragingly, nonsovereign flows to Africa have also more than doubled since 2000. An important IBRD-IFC innovation in 2007 was the establishment of a Global Emerging Markets Local Currency Bond Fund (GEMLOC). Guarantees, cofinancing, and trust fund operations have also expanded (guarantees from IDA and the International

Bank for Reconstruction and Development have an average leverage ratio of almost 10 to 1). On the other hand, nonconcessional lending to sovereigns, about \$23 billion in 2007, has been generally flat, with large fluctuations depending on circumstances in individual countries.

Challenges to effective engagement are especially complex in fragile states. The needs in these countries are huge, as they are farthest away from reaching the MDGs, but they present difficult political and governance contexts for effective delivery of development finance and services. Nonetheless, MDB financial flows to fragile states rose by about 55 percent in the five-year period 2002–07, reaching \$2.4 billion. As some of these states move from peace-building to state-building, demand for MDB support will rise further. Developing and implementing effective operational strategies for fragile states is a key element of the IFIs' contribution to the agenda for inclusive and sustainable development.

Strong country-led development strategies (poverty reduction strategies or equivalent strategic frameworks) are central to development effectiveness, even more so in a changing aid architecture characterized by a plurality of aid sources and modalities. Strengthening country strategies is an important focus of IFI knowledge services and capacity building. In 2007, 13 percent of low-income countries were deemed to have well-developed operational frameworks while another 67 percent had taken significant action to develop such frameworks (comparable figures for 2005 were 8 percent and 56 percent, respectively). These figures show progress but also a continuing challenge. Both the IMF and the MDBs are engaged in efforts to strengthen analytic support and policy advice, tailor it better to different client needs, and enhance its impact.

The IFIs are making progress on alignment and harmonization in the framework of the Paris Declaration, but monitoring

surveys show room for improvement on several dimensions: use of country systems and implementation frameworks; efficient modalities for joint operations and programmatic and sectorwide approaches; and predictability of support. Harmonization in the context of the changing aid architecture, with the emergence of new players such as vertical funds that committed around \$3.5 billion last year, poses new challenges. In 2007 the report of an External Review Committee (Malan report) identified areas for strengthening collaboration between the IMF and the World Bank, including in crisis management, work on fiscal and financial sector issues, and technical assistance.<sup>6</sup> Implementation of the committee's recommendations is proceeding under a Joint Management Action Plan drawn up during the year.

**Better tracking results.** IFIs are making progress in strengthening the results orientation of their operations and supporting partner countries' capacity to manage for results. A range of internal and external monitoring and evaluation methodologies have been developed to track IFI performance and results. Findings from these exercises over the past year show mixed results. Improvements have been made in implementation of key programs such as the development outcomes targeted in the IDA14 Results Measurement System, and the World Bank's Africa Action Plan and Infrastructure Action Plan. MDBs' Comparative Assessment System (COMPAS) indicators show progress on several dimensions of the results agenda, such as results orientation of country assistance strategies and processes related to projects and program design and implementation. But the indicators also point to the need for stronger efforts to link resource allocation, incentives, and institutional learning to results. Findings from IFI independent evaluations conducted over the past year included the need to further streamline conditionality,

correct underinvestment in regional public goods, achieve further progress in decentralization, and improve the development impact of private sector projects. Overall, results tracking methodologies need to develop a stronger focus on real results on the ground, such as the MDGs, rather than processes. Also, stronger, concerted support is needed to build country development data capacity.

**Rising to the environmental challenge.** Programs supporting environmental sustainability exemplify the IFIs' increasing engagement in the provision of global public goods. Over the years, the IFIs have considerably expanded their environmental activities—in energy, pollution control, water, land, biodiversity, environmental institutions. These activities have accounted for 12–15 percent of their lending in recent years. Going forward, a major priority will be responding to the increasing challenge of climate change. The IFIs have a crucial role to perform in supporting global collective action to combat climate change. They are actively developing new strategies to scale up work in this area. An example is the Clean Energy Investment Framework. Key elements of their engagement will include:

- Integrating climate action into core development work
- Providing innovative and concessional financing, such as the Global Environment Facility and carbon finance
- Expanding the role of markets, such as the Carbon Partnership Facility and Forest Carbon Partnership Facility
- Facilitating new technology development and diffusion
- Creating an enabling environment to tap the private sector—engaging the IFC and other MDB private sector arms
- Expanding research on mitigation and adaptation, such as low-carbon country growth studies.

## Notes

1. The MDGs flowed from the Millennium Declaration adopted by 189 countries at the UN Millennium Summit, held in New York in 2000. The Monterrey mutual accountability compact (also known as the Monterrey Consensus) emerged from the UN Conference on Financing for Development, held in Monterrey, Mexico, in 2002.

2. Robert B. Zoellick, speech at the United Nations Climate Change Conference in Bali, Indonesia, December 12, 2007.

3. World Bank. 2008, *World Development Report, 2008: Agriculture for Development*. Washington, DC: World Bank.

4. IMF. 2007. *World Economic Outlook: Globalization and Inequality*. Washington, DC: IMF.

5. This estimate does not include costs of all related water infrastructure, such as wastewater treatment.

6. IMF and World Bank. 2007. *Report of the External Review Committee on Bank-Fund Collaboration*. OM2007-0014, Washington, DC.