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Promoting Pro-Poor Growth

POLICY GUIDANCE FOR DONORS



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Promoting Pro-Poor Growth

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Foreword

Promoting pro-poor growth – enabling a pace and pattern of growth that enhances the ability of poor women and men to participate in, contribute to and benefit from growth – will be critical in achieving a sustainable trajectory out of poverty and meeting the Millennium Development Goals, especially the target of halving the proportion of people living on less than one dollar a day. Developing and sharing good practice in advancing this agenda has been the focus of the Development Assistance Committee (DAC) through its Network on Poverty Reduction (POVNET) since 2003.

The DAC Guidelines on Poverty Reduction, *published in 2001, show that poverty has multiple and interlinked causes and dimensions: economic, human, political, socio-cultural, protective/security. The work of POVNET since then has given priority to addressing strategies and policies in areas that contribute to pro-poor economic growth, with particular attention to private sector development, agriculture and infrastructure. POVNET has sought to build consensus on the key underpinnings of pro-poor growth and to explore recent thinking on risk and vulnerability and ex ante poverty impact assessment.*

This compendium summarises the conclusions and recommendations coming out of POVNET's work on growth and poverty reduction. The key messages are as follows:

- *Rapid and sustained poverty reduction requires pro-poor growth, as described above.*
- *Policies to tackle the multiple dimensions of poverty, including the cross-cutting dimensions of gender and environment, are mutually reinforcing and should go hand-in-hand.*
- *Empowering the poor is essential for bringing about the policies and investments needed to promote pro-poor growth and address the multiple dimensions of poverty.*

For donors, the pro-poor growth agenda is not business as usual and more of the same will not be sufficient. This compendium provides specific guidance to donors on how to make their support to pro-poor growth more effective in the areas of private sector development, agriculture and infrastructure.



Richard Manning
DAC Chair



James T. Smith
POVNET Chair

In order to achieve its aims the OECD has set up a number of specialised committees. One of these is the ***Development Assistance Committee****, whose members have agreed to secure an expansion of aggregate volume of resources made available to developing countries and to improve their effectiveness. To this end, members periodically review together both the amount and the nature of their contributions to aid programmes, bilateral and multilateral, and consult each other on all other relevant aspects of their development assistance policies.*

The members of the Development Assistance Committee are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States and the Commission of the European Communities.

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Acronyms

ACP	Africa, Caribbean and Pacific countries
ADB	Asian Development Bank
AdI*	*Aguas del Illimani*
AFD*	French Development Agency – *Agence Française de Développement*
AKFED	Aga Khan Fund for Economic Development
AU	Africa Union
BDS	Business development service
BLT	Build-lease-transfer
BMZ*	German Ministry for Economic Co-operation and Development *Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung*
BOT	Build-operate-transfer
BOOT	Build-own-operate-transfer
CAADP	Comprehensive African Agriculture Development Programme
CARICOM	Carribbean Community
CEDAW	Convention of the Elimination of All Forms of Discrimination against Women
CEPA*	*Comision Ejecutiva Portuaria Autonoma*
CGAP	Consultative Group to Assist the Poor
CIDA	Canadian International Development Agency
COMESA	Common Market for Eastern and Southern Africa
CSO	Civil society organisation
CUTS	Consumer Unity and Trust Society
DAC	Development Assistance Committee
DCI	Development Cooperation Ireland
DFI	Development financial institution
DTF	Devolution Trust Fund
DFID	UK Department for International Development
EPA	Economic Partnership Agreement
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign direct investment
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
GIC	Growth incidence curve
GTZ*	German Agency for Technical Co-operation *Deutsche Gesellschaft für Technische Zusammenarbeit GmbH*
ICN	International Competition Network
ICT	Information and communication technology
IDA	International Development Association
IFAD	International Fund for Agricultural Development

IFC	International Finance Corporation
IGE	Intergovernmental Group of Experts on Competition Law and Policy
IICA	Inter-American Institute for Cooperation on Agriculture
IMF	International Monetary Fund
IT	Information Technology
IWRM	Integrated water resource management
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
KfW*	German Bank for Development – *Kreditanstalt für Wiederaufbau*
MDG	Millennium Development Goal
MERCOSUR*	*Mercado Común del Sur*
MFI	Microfinance institution
MTEF	Medium-term expenditure framework
SME	Medium, small-sized enterprise
MSME	Micro, small and medium-sized enterprise
NEPAD	New Partnership for Africa's Development
NGO	Non-governmental organisation
NORAD*	Norwegian Agency for Development Co-operation
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PIA	Poverty Impact Assessment
PIDG	Private Infrastructure Development Group
PIP	Public investment programme
POVNET	DAC Network on Poverty Reduction
PPD	Public-private dialogue
PPP	Public private-sector partnership
PRS	Poverty reduction strategy
PRSP	Poverty reduction strategy paper
PSD	Private Sector Development
PSIA	Poverty and Social Impact Analysis
PSO	Private sector organisation
RADEEF*	*Régie Autonome de Distribution et d'Électricité de Fès*
REDI	Recent Economic Developments in Infrastructure
Seco*	Swiss State Secretariat for Economic Affairs
Sida*	Swedish International Development Cooperation Agency
SME	Small and medium-sized enterprises
SWAp	Sector-wide approach
TAF	Local Capacity Building Technical Assistance Facility
UEMOA*	West African Economic and Monetary Union *Union Économique et Monétaire Ouest Africaine*
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
USAID	United States Agency for International Development
WTO	World Trade Organization
WFP	World Food Programme

* Denotes acronym in original language.

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Pro-poor Growth: Policy Statement

The 2001 DAC Guidelines on *Poverty Reduction* show that poverty has multiple and interlinked causes and dimensions: economic, human, political, socio-cultural, protective/security. This policy statement focuses on one dimension of that bigger picture – reducing economic poverty through pro-poor growth. In doing so, it looks at the relationship between the economic and other dimensions of poverty and how policies for pro-poor growth and other policy areas need to interact so that, collectively, they can make major and sustainable inroads into poverty reduction.

Three key messages from this work are that:

- Rapid and sustained poverty reduction requires pro-poor growth, *i.e.* a pace and pattern of growth that enhances the ability of poor women and men to participate in, contribute to and benefit from growth. Policies therefore need to promote both the pace of economic growth and its pattern, *i.e.* the extent to which the poor participate in growth as both agents and beneficiaries, as these are interlinked and both are critical for long-term growth and sustained poverty reduction.
- Policies to tackle the multiple dimensions of poverty, including the cross-cutting dimensions of gender and environment, are mutually reinforcing and should go hand-in-hand. Progress in one dimension will be accelerated by progress in others. In tackling poverty, perceptions of policy dichotomies have been misplaced. Policy trade-offs do exist but can be better managed.
- Empowering the poor is essential for bringing about the policies and investments needed to promote pro-poor growth and address the multiple dimensions of poverty. To achieve this, the state and its policy making processes need to be open, transparent and accountable to the interests of the poor. Policies and resources need to help expand the economic activities of the poor.

When implementing the policy guidance on how donors can support and facilitate pro-poor growth, they must bear in mind that the poor are not a homogenous group, that country contexts vary considerably, and that policy implementation must be based on a sound understanding of who the poor are and how they earn their livelihoods. Promoting pro-poor growth requires policy choices to be guided by assessments of their expected impact on the income and assets of the poor.

Rapid and sustained poverty reduction requires pro-poor growth, i.e. a pace and pattern of growth that enhances the ability of poor women and men to participate in, contribute to and benefit from growth.

i) **Both the pace and the pattern of growth are critical for long-term and sustainable poverty reduction.** Economic growth is an essential requirement and, frequently, the major contributing factor in reducing economic poverty. For growth to be rapid and

sustained, it should be broad-based across sectors and regions and inclusive of the large part of the workforce that poor women and men make up. Pattern and pace are thus interlinked and need to be addressed together. Policies for sustaining growth such as those aiming at macroeconomic stability, institutional quality, democratic and effective governance and a favourable investment climate should promote the engagement of the poor in economic growth by increasing their incentives, opportunities and capabilities for employment and entrepreneurship.

ii) **A pro-poor pattern of growth makes growth more effective in reducing poverty.** Developing countries with similar rates of economic growth have experienced quite different levels of economic poverty reduction, due to initial conditions and whether growth occurs in areas and sectors where the poor live and are economically active. Policies need to create the conditions and remove the obstacles to the participation of the poor in the growth process, *e.g.* by increasing access to land, labour and capital markets and by investing in basic social services, social protection and infrastructure. As the poor often depend heavily on natural resources for their livelihoods, policies to promote environmental sustainability should also be integral to promoting pro-poor growth.

iii) **Inequality matters.** Inequality of assets and opportunity hinders the ability of poor people to participate in and contribute to growth. High and rising levels of income inequality lower the poverty reduction impact of a given rate of growth and can reduce the political stability and social cohesion needed for sustainable growth. Gender is a particularly important dimension of inequality. Women face particular barriers concerning assets, access and participation in the growth process, with serious implications for the ability of growth to be pro-poor. The growth experience shows that rising inequality is not an inevitable consequence of the growth process, as long as there is a mix of policies that addresses both growth and distributional objectives, strengthens empowerment and deals with gender and other biases (*e.g.* race, caste, disability, religion).

iv) **The vulnerability of the poor to risk and the lack of social protection reduce the pace of growth and the extent to which it is pro-poor.** The poor often avoid higher risk opportunities with potentially higher payoffs because of their vulnerability. In addition, the journey out of poverty is not one way and many return to it because man-made and natural shocks erode the very assets that the poor need to escape poverty. Policies that tackle risk and vulnerability, through prevention, mitigation and coping strategies, improve both the pattern and pace of growth and can be a cost effective investment in pro-poor growth.

v) **Policies need to tackle the causes of market failure and improve market access.** Well functioning markets are important for pro-poor growth. Market failure hurts the poor disproportionately and the poor may be disadvantaged by the terms on which they participate in markets. Programmes are needed to ensure that markets that matter for their livelihoods work better for the poor. Such programmes need to be carefully designed to avoid replacing market failure with government failure. Policies to tackle market failure should be accompanied by measures aimed at increasing economic capabilities of the poor.

In tackling poverty, perceptions of policy dichotomies have been misplaced. Policy trade-offs do exist but can be better managed.

i) **Policies to tackle the multiple dimensions of poverty should go hand-in-hand**. Poverty is multidimensional. Pro-poor growth will be strengthened by progress on the non-economic dimensions of poverty. More effective policies require a better understanding of these interdependencies. Perceptions of dichotomies (*e.g.* economic *versus* social policies) can be misplaced. The pace and pattern of growth have multiple determinants and consequences and each dimension nourishes (or holds back) the other. Progress on the income poverty Millennium Development Goal (MDG) facilitates progress on other MDGs and *vice versa*.

ii) **Policy trade-offs still exist, but can be better managed.** Policies which promote only one dimension of poverty reduction while undermining others should be avoided. Whenever possible, policies need to be complementary rather than compensatory. Sequencing of policies and investments can help manage trade-offs. Policy choices should be based on understanding the binding constraints through analysis of the growth, poverty and inequality experience and the results of poverty impact assessments. The ability of institutions to handle trade-offs is important for achieving pro-poor outcomes.

For pro-poor growth policies to emerge, the poor need to be informed and empowered to participate in a policy-making process that is accountable to their interests.

i) **The poor need to participate in and influence the policy reform process that goes with poverty reduction strategies (PRSs).** Approaches are needed to increase the voice and influence of poor women and men in order that policy making is evidence-based, rather than determined by narrow vested interests.

ii) **A well-functioning state is important for responding to the interests of the poor**. Effective pro-poor growth strategies need policy and institutional change for which the state, in all its dimensions, is made more accountable to the interests of the poor. The state needs to provide the opportunity for structured public-private dialogue at various levels, including with civil society and private sector actors who are frequently marginalised. The state needs to provide the required incentives, enabling environments and policy and planning frameworks to be more accountable to the voices of the poor.

iii) **Pro-poor reform is likely to require changes to the current political settlement among the diverse interests of different segments of society.** This entails a better understanding of the political economy, power relations and drivers of change, and supporting formal, transparent decision making, strengthening the demand for pro-poor change and building capacity of the state to respond to demand.

For donors, the pro-poor growth agenda is not business as usual and more of the same will not be sufficient.

i) **Donors should focus on supporting in-country policy processes.** Policies for pro-poor growth can only be achieved through country-level processes that are inclusive of the poor and based on country-level analyses. Donors should support the emergence and development of processes that are formal, transparent and take account of the interests of the poor, and conduct their policy dialogue through them. Donors should support measures to empower the poor in these policy processes and build the country-level capacity to undertake analyses, including poverty impact assessments.

ii) **Donor support needs to be flexible and responsive to country situations**. The type of support provided needs to take account of the level of development, the policy environment and the extent to which there is a well-functioning state. Donors need to adapt their approach to fragile and failed states and more research is required to inform this process.

iii) **A pro-poor lens on areas important for pro-poor growth, such as private sector development, agriculture, infrastructure and risk and vulnerability, requires a rethinking of donor agendas.** The importance of these areas for the pace and pattern of growth has been underestimated. New approaches to strengthen the contributions of private sector development, agriculture and infrastructure have been developed by the DAC. Work on risk and vulnerability/social protection/human security is ongoing.

iv) **Donors need to enhance their organisational capacities to effectively support country-led, pro-poor growth.** Donors need to provide appropriate support and incentives to field staff, build multi-donor and multidisciplinary teams at the field level, and empower them to negotiate, co-ordinate and implement programmes. Recent progress to establish such teams in several partner countries should be replicated.

PART I

Key Policy Messages

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PART I

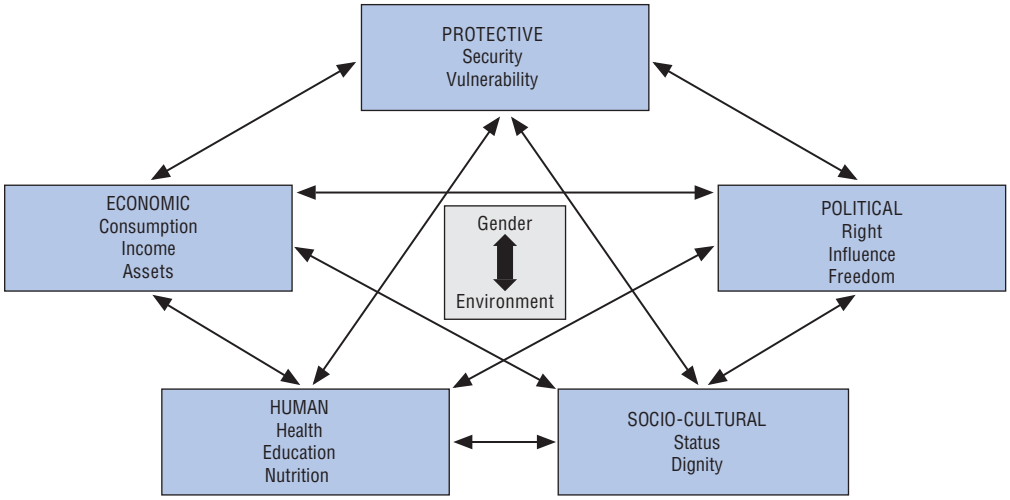
Chapter 1

Introduction

The multiple dimensions of poverty

The 2001 DAC Guidelines on *Poverty Reduction* show that the forms of deprivation that poverty takes, economic, human, political, socio-cultural and protective (security), are interlinked, and that gender equity and environmental sustainability cut across all the dimensions of poverty (Figure 1.1).

Figure 1.1. **The multi-dimensional poverty framework**



Part I of this report focuses on one dimension of poverty – how to reduce economic poverty through pro-poor growth. As poverty is a set of interlinked forms of deprivation, it also addresses how progress on economic poverty may contribute to and be facilitated by progress on the other dimensions of poverty.

What is pro-poor growth and why is it important?

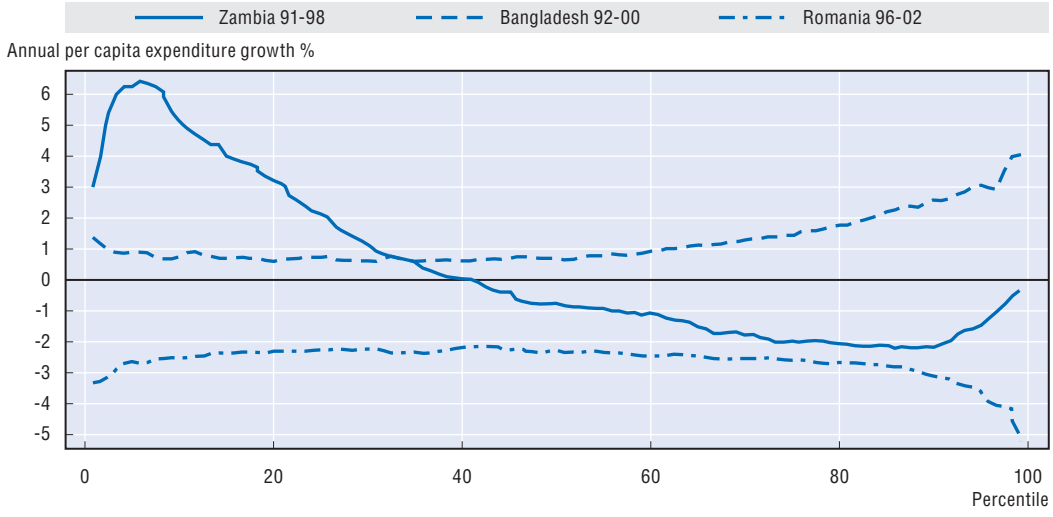
Reducing economic poverty is vital for over 3 billion people, roughly half the human race, with incomes less than USD 2 per day and who are challenged to meet their basic needs – and even more crucial for the 1 billion people with incomes less than USD 1 per day, who struggle for survival. The experience of many developing countries in achieving economic growth and reducing poverty has been far from satisfactory. Large numbers of poor women and men have been able to escape economic poverty in countries such as China and India that have sustained high rates of growth. But in most developing countries, growth has been low and has not enabled the poor to lift themselves out of economic poverty. In terms of regions, sub-Saharan Africa is in danger of not meeting the poverty reduction target of MDG 1 and Latin America has, in recent years, experienced little reduction in income poverty. Even where, on the whole, growth and poverty reduction

have been satisfactory, the evidence shows that a significant proportion of poor people have been marginalised in the growth process and have not been able to escape poverty.

Pro-poor growth focuses attention on the extent to which poor women and men are able to participate in, contribute to and benefit from growth, as measured by changes in the incomes of the households in which they live and the assets they and their children acquire to earn higher incomes in the future.* When may growth be termed pro-poor? There are different views on this issue. For some, what matters is whether the incomes of the poor are rising *relative* to the incomes of the non-poor and hence inequality is falling. The merit of this perspective is that it focuses attention on whether the poor are benefiting more or less proportionately from growth and whether inequality, a key determinant of the extent to which growth reduces poverty, is increasing or falling. For others, what matters most is the *absolute* rate at which the incomes of the poor are rising. For example, are the incomes of the poor rising fast enough to reduce the number of people living below the international poverty line in accordance with MDG 1:1?

The relative and absolute concepts of pro-poor growth are both relevant, and complement each other in the analysis of growth processes from a pro-poor perspective. In fact, the tools needed to analyse how the poor are participating in and benefiting from growth may be used with either definition. This may be illustrated by growth incidence curves (GICs), which plot how the incomes (or expenditure) of households at different levels of income have changed over a given time period (Figure 1.2) revealing both absolute and relative changes in incomes (Klasen, 2005a). Figure 1.2 shows that in Zambia the poor benefited from growth in absolute and relative terms (even though growth was weak), whereas in Bangladesh better-off households benefited more than the poor.

Figure 1.2. **Selected growth incidence curves**



Source: McKay (2005).

* In practice, the focus has been on measuring changes in incomes (or expenditure) as data are more readily available.

The importance of context

Developing effective strategies to reduce poverty requires an understanding of who the poor are and how they earn their livelihoods. The poor are not a homogenous group with poverty incidence varying with gender, membership of social groups, regions in which they live, urban as opposed to rural households and so on. And poor men and women pursue a diversity of strategies to earn their livelihoods. For example, though some two-thirds of the world's poor live in rural areas, there are a wide range of "rural worlds" that offer different opportunities to earn livelihoods from agriculture and non-farm occupations. Strategies to increase pro-poor growth must take account of these differing opportunities to earn incomes. The country context is also crucial for developing effective strategies. The world's poor live in many different settings – in large, middle-income countries, having been marginalised by the growth process; in the low-income countries where growth has historically been low; and one-third of the world's poor live in "fragile states" where the state does not function effectively. These variations require adapting the strategies described below to suit the particular context.

A thorough understanding of the growth/inequality/poverty experience is essential for adapting strategies to the context. A wide range of tools may be used to analyse the growth/inequality/poverty experience, as shown in Box 1.1.

Box 1.1. **Tools for analysing the linkages between growth, inequality and income poverty**

Tools which may be used for this kind of analysis include the following:

i) disaggregating growth to identify macro-micro linkages [gross domestic product (GDP) growth in relation to household income growth] and identify the sources of growth in terms of sectors, types of expenditure (consumption, investment, etc.), and increases in factor inputs (labour, capital) and their productivity and so on;

ii) examining the spatial distribution of growth (*e.g.* regions, urban-rural), changes in employment patterns (*e.g.* participation rates for women and men, sectors of employment, formal *versus* informal employment, unemployment) and wages/incomes derived from them;

iii) disaggregating changes in poverty and inequality using GICs to understand distributional impacts, adapting them to understand poverty and inequality experiences of different types of households (*e.g.* female and male headed, members of different social groups, urban *versus* rural households, region of residence), decomposing the contribution growth and changes in the distribution of income make to the incomes of the poor, calculating the average growth in the incomes of the poor and comparing it with the non-poor and similar countries.

Source: McKay (2005).

The structure of Part I

Part I is structured as follows:

- **Chapter 2** sets out the policies required to promote pro-poor growth.
- **Chapter 3** examines the way pro-poor growth benefits from progress on the other dimensions of poverty.
- **Chapter 4** focuses on the policy making process to promote pro-poor growth and on the need for the poor to be informed and empowered to participate in this process.
- **Chapter 5** considers the role of donors in the pro-poor growth agenda.

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PART I

Chapter 2

Reducing Economic Poverty through Pro-poor Growth

Rapid and sustained reduction of economic poverty requires pro-poor growth: a pace and pattern of growth that enhances the ability of poor women and men to participate in, contribute to and benefit from growth.

Pace and pattern

The pace and pattern of growth are interlinked and need to be addressed together.

The 2001 DAC Guidelines on *Poverty Reduction* state that both the pace and pattern of growth, in terms of its sustainability, composition and equity, are important for effective reduction of economic poverty. POVNET's recent work has shown pace and pattern to be interlinked. Growth that is broad based across sectors is likely to be longer sustained than growth dependent on market conditions in one or two sectors and provides greater opportunity for the poor to participate in the growth process, thus promoting equity. In developing countries, poor women and men make up a substantial proportion of the workforce and if they are more able to participate in and contribute to the growth process, economic growth will be faster and more equitable. Moreover, unlike past approaches that sought to focus initially on the rate of growth with the hope of addressing its pattern and the distribution of its benefits later, it has become clear that the two need to be addressed together. Policies that impact on pace also address pattern and *vice versa* and so neither should be approached in isolation. An inclusive pattern of growth is crucial because the revenue systems of developing countries are often underdeveloped, thereby reducing the scope to use tax-based transfers to achieve equitable growth.

Sustaining growth

Sustained growth is essential for reducing economic poverty.

There is clear evidence to show that economic growth is an essential requirement and, frequently, the main contributing factor in reducing income poverty. Evidence across countries and time periods shows that long-term reduction in income poverty results first and foremost from growth. Studies of the experiences of 14 developing countries during the 1990s found that income poverty fell only when there was growth and, in general, the higher the growth the greater was the decline in income poverty (AFD *et al.*, 2005).

All countries experience short episodes of growth, either rapid or modest. These are not sufficient to provide the opportunities that poor people need to escape economic poverty. The key to reducing economic poverty lies in ensuring that a rapid rate of growth is sustained over the long term. This is what the countries of Asia such as China and India have accomplished recently and this has resulted in a substantial reduction in income poverty. Growth may start for a variety of reasons: discovery of natural resources, higher commodity prices, a better investment climate for the private sector and so on. In India, as little a change as government signalling a more positive sentiment toward business was sufficient to trigger growth (Rodrik, 2004). Sustaining growth, however, requires deepening the incentive to invest and increasing the use and productivity of capital and labour across the economy as a whole, through appropriate policies and institutions. Recently, growth rates have increased in Africa. The challenge now is to ensure that growth accelerates to levels required to achieve MDG 1 and is sustained by appropriate policies and institutions.[1]

Box 2.1. **Private sector development (PSD)**

The private sector is often referred to as the engine of growth and so, up to now, private sector development (PSD) has been mainly associated with increasing the pace of growth. The private sector also has a strong bearing on the pattern of growth, influencing whether growth is broad or narrowly based and more or less inclusive of the poor. Secure, safe and well paid jobs and productive self employment in agriculture and non-farm occupations in the private sector are important pathways out of income poverty.

The emerging pro-poor agenda for private sector development acknowledges that what matters is the degree to which growth provides opportunities for the poor, and the extent to which poor men and women benefit from them. At present, most developing countries are unable to create sufficient formal jobs to cope with the increase in the non-agricultural workforce. This forces hundreds of millions of the poor to earn their livelihoods informally. It is estimated that 72% of the non-agricultural workforce of Africa, 65% of Asia and 52% of Latin America earns its livelihood informally, representing one of the most important policy issues for PSD today (ILO, 2002). While informal occupations may be their only means of survival, many of the poor may be forced to engage in low value-added occupations, find employment in insecure jobs where core labour standards are not enforced and there are no provisions for social insurance, thus contributing little to growth and failing to provide the opportunity and security to escape income poverty. In addition, as a result of the disadvantages faced by informal businesses, the substantial assets held in the informal economy – in Tanzania, their estimated value is USD 29 billion* – that could be used to help spur economic growth fail to fulfil their productive potential. In practice, there is a continuum between formality and informality with many informal businesses paying taxes and formally registered businesses employing labour and serving markets informally. PSD policies to address informality may help to increase job creation in the formal economy, reduce barriers to and increase the incentive for formality and help to improve productivity in the informal economy through better access to credit and business support services.

* Speech by the President of Tanzania, Reforming the Business Environment, Cairo, 2005.

To sustain growth, policies and institutions need to increase the stability and predictability of doing business so that the risk-to-reward ratio for businesses and individuals improves, spurring entrepreneurship and investment. Social or political conflict, the lack of a functioning state and policy volatility, caused by frequent political change, undermine growth. Restoring peace and the legitimacy of the state are therefore essential pre-conditions for pro-poor growth in fragile states. Factors that contribute to sustaining growth include – macroeconomic stability; institutions that provide clear rules that are enforced predictably, good governance that will reduce corruption and rent seeking; a favourable investment climate which includes secure property rights and efficient markets that allow the productive assets of land, labour and capital to flow to areas where the returns are highest and increases access to these resources, including for the poor.

Whilst macroeconomic stability is essential for pro-poor growth, helping to sustain growth and ensuring that the incomes of the poor are not damaged by inflation or economic crises, it needs to be achieved through a flexible approach. Rigid adherence to targets that do not take account of the phase, in the economic cycle (expanding or contracting), or the potentially high returns to social investment, may undermine growth unnecessarily (World Bank, 2005a). Moreover, they should take account of the effect on poor people so that, if public expenditure needs to be cut back to reduce fiscal deficits in

pursuit of macro stability, the burden should not be borne by the poor. Governments have often found it politically expedient to placate powerful vested interests by maintaining spending on services and investments that matter to them whilst cutting back expenditures that matter for the poor because they lack a strong political voice.

Moreover, it is now recognised that, in themselves, policies associated with faster growth are not panaceas and may need complementary policies to bring about sustained, pro-poor growth. Harnessing the international economic linkages of trade and investment can help to sustain rapid growth but this is more likely to contribute to sustained pro-poor growth if the way the international trading system works is more equitable and trade policy is accompanied by complementary polices to build domestic capacity and competitiveness, enable productive assets to be redeployed, reduce the cost and risk of trading and help the poor to adjust to or better cope with the new situation.

An effective regulatory framework with sound governance that ensures environmental sustainability is vital for sustaining growth, not least because a high proportion of developing countries are dependent on natural resources and because a high proportion of agriculture in Africa takes place on fragile lands. Policies that promote environmental sustainability underpin pro-poor growth by ensuring that natural resources are not exploited unsustainably (Chapter 3).

Exploitation of natural resources is frequently accompanied by a "resource curse" (Sachs *et al.*, 1995). Over reliance on exports of natural resources may undermine pro-poor growth in several ways: the exchange rate appreciates which damages (tradable) sectors of the economy, such as agriculture, and inequality increases as does the risk of corruption and conflict. This is why many of the resource cursed countries are also fragile states. As Botswana has proven, with effective policies to stabilise foreign exchange earnings, prudent public expenditure policies that target the poor and investments to promote broad-based growth, the discovery of natural resources can be the basis of pro-poor growth rather than the curse it has proved for many countries.

Given the diversity of types of economy, resource availability, levels of development and variations in policy and institutions, it is not possible to arrive at a formula of policies and institutions that can be applied universally (World Bank, 2005a). Context is crucial. However, the fundamentals for sustaining growth remain the same across countries. What is required is a sound analysis of the country's growth/inequality/poverty experience and policy and institutional framework to identify the binding constraints that need to be addressed to sustain pro-poor growth.

Pro-poor growth pattern

Economic growth is likely to be faster, longer sustained and more effective in reducing economic poverty when associated with a pro-poor growth pattern.

The effect growth has on poverty varies tremendously. Evidence shows that a 1% increase in *per capita* incomes may reduce income poverty by as much as 4% or by less than 1%, depending on the country and time period (Ravallion, 2004). In part, this is due to initial conditions, particularly levels of inequality in incomes and assets. In addition, the effect growth has on reducing income poverty will depend upon the extent to which the pattern of growth enhances the ability of poor people to participate in, contribute to and benefit from growth. If the pattern of growth is broad based and inclusive with respect to the sectors from which poor women and men earn their livelihoods, the regions in which they live, creates jobs

that they may fill, and increases access to productive assets and markets for goods and services they produce, it is likely that their incomes will rise more rapidly and they will be able to acquire the assets they need to continue to increase incomes in the future. If, on the other hand, the poor are stuck in regions and sectors that are marginalised from the growth process, then very rapid rates of *per capita* growth will do little to reduce poverty: in China, since 2000, income poverty has not declined despite double digit rates of growth nationally as the poor live in rural areas of marginalised regions in the west.

Box 2.2. **Infrastructure**

The infrastructure gap is huge. Globally, more than 1 billion people have no access to roads, 1.2 billion do not have safe drinking water, 2.3 billion lack reliable energy, 2.4 billion have no sanitation facilities and 4 billion no modern communication services. In the absence of accessible transport, energy and water, the poor pay heavily in time, money and health. When road surfaces are severely corrugated, electricity blackouts frequent, water services dysfunctional and telecommunications absent, countries and regions have great difficulty to achieve pro-poor economic growth. There is strong evidence that good and equitable access to infrastructure services not only promotes **faster growth** but also **growth patterns** beneficial to poor people.

Reliable and affordable infrastructure reduces the production and transaction costs of doing business. It also helps to connect up poor people to the growth process by improving their access and mobility. One mechanism is by connecting remote areas to growth poles and, in this way, correcting regional imbalances and helping poor people break out of poverty traps. There is evidence that increased access to infrastructure contributes to lower inequality (Calderon, 2004). Furthermore, access to infrastructure services contributes to the achievement of several MDGs, *e.g.* by its positive impacts on primary education coverage and on reduction of malnutrition and child mortality (where clean water and safe sanitation are crucial factors). In many countries, infrastructure suffered from severe cuts in public spending during the 1990s. The hope that private investors could fill a major part of the financing gap did not materialise. Between 1997 and 2003, bilateral donor support to infrastructure decreased from roughly 35% to 15% of total bilateral ODA.* Investment in new infrastructure and maintenance has been neglected. Governments and donors are now giving increased attention to infrastructure though much more needs to be done.

* See Part IV "Infrastructure".

Policies are needed to ensure that the poor are not marginalised from the growth process. Addressing lagging regions in which the poor are concentrated is not easy because faster developing regions tend to capture economies of scale and concentration. Nevertheless, context-specific solutions that include improved institutions and governance, a better investment climate with increased access to credit and services to increase productivity, improving transport links with growth poles and investing in the region's infrastructure may help kick start faster growth. Greater investment in health, education, infrastructure and agriculture targeted at the poor, combined with encouraging labour mobility to other regions, may pay dividends in ensuring that the poor benefit from growth (World Bank, 2005b).

The performance of agriculture is critically important for a pro-poor pattern of growth. When agriculture lags other sectors, growth tends to be less pro-poor (AFD, 2005). Where growth was initiated by increased agricultural productivity, growth has been pro-poor, as experienced in most countries of the Far East. Rising agricultural productivity contributed not only to growth and the incomes of the poor directly, it also helped with the transformation of the economy, enabling manufacturing and services to expand. The growth of agricultural (land) productivity should contribute to faster growth of the incomes of the poor, particularly if combined with the growth of productivity in non-farm activities to ensure that rural incomes rise rapidly (Datt, 1998).

The world over, the proportion of the non-agricultural workforce earning its living informally is increasing as employment in the formal sector has not kept pace with its growth. Where productivity in informal occupations is higher than agriculture and provides adequate incomes for the poor, as experienced in Vietnam (Bernabé, 2005), growing informality may not detract from a pro-poor pattern of growth. In Africa, however, productivity and incomes from informal activities are low with the majority of the

Box 2.3. **Agriculture**

Agriculture plays an important role in ensuring pro-poor growth. The green revolution in Asia succeeded in lifting millions out of poverty. The average real income of small farmers in south India rose by 90% and that of landless labourers by 125% between 1973 and 1994 as a result of the Green Revolution (World Bank, 2000). Agricultural productivity plays a particularly important role in improving existing livelihoods, meeting consumption needs and providing the basis for new livelihoods. A 10% increase in crop yields may lead to a reduction of between 6% and 10% of people living on less than USD 1 per day (Irz *et al.*, 2001). For every 1% of growth in agricultural GDP, the positive impact on the poorest has been shown to be greater than that from similar growth in manufacturing or services (Gallup *et al.*, 1997). Such impacts are usually best realised where there is an equitable distribution of assets, particularly land (de Janvry *et al.*, 1996), where there is access to markets for the poor and where there are good rural-urban links. Investment in agricultural research provides some of the highest returns to public spending yet funding by governments and donors has declined over the past decade.

Agriculture in Africa has not been able to contribute to pro-poor growth as effectively as in Asia. Since 1990, food availability has fallen 3% *per capita* in Africa whereas it has increased 30% in Asia. African agriculture faces particular challenges. These include the wide range of crops and livestock combinations across diverse ecological zones that increases the demands on research and extension; the lack of a suitable investment climate and domestic savings for investment; poor institutional quality; vulnerability in the absence of social protection that may undermine risk taking; low access to markets exacerbated by a weak road system; new and more demanding technical barriers to trade in accessing OECD markets, etc. These challenges are not insuperable, at least in the regions that are suitable for increasing agricultural productivity. They require a combination of concerted investment in improving access to markets and productivity enhancing technology, improving policies and institutional quality and a more favourable investment climate in agriculture addressing the needs of both commercial and small farmers. Like infrastructure, governments and donors need to re-examine and increase their commitment to the development of agriculture through more effective ways of providing support outlined in Chapter 4.

self-employed engaged in "survival businesses" unable to escape poverty. To a large extent, this is also the case in Latin America. Addressing informality requires a combination of removing barriers to formalisation, increasing the positive incentives of becoming formal by reducing rent seeking by corrupt officials and improved access to markets and finance, and ensuring higher rates of investment and job creation in the formal sector.

Addressing inequality

High inequality undermines the pace and pattern of growth and its effectiveness in reducing economic poverty.

In developing countries, the distribution of productive assets and the opportunity to participate in and benefit from growth are most unequal, resulting in a high level of inequality in the distribution of incomes. Inequality in the distribution of assets reduces the ability of poor people to increase their incomes and contribute to growth. Men and women work harder and invest more on land they own or over which they have secure use, as evidenced in China and Vietnam. Investment in land and natural resources by poor people and market-based approaches to land redistribution will increase pro-poor growth. Greater equality of opportunity contributes to higher growth. When markets fail, a frequent situation in developing countries, the allocation of resources and opportunities for wealth creation are determined by wealth and power, disadvantaging poor men and women who may have made more productive use of them, thus undermining growth. Increasing inequality in opportunity, assets and incomes also runs the danger that mounting dissatisfaction and a sense of injustice combine to undermine the political and social stability that is vital for sustaining growth.

Growth, inequality of incomes and poverty are interlinked and are sometimes described as three sides of a triangle. With a high level of income inequality to begin with, growth needs to be faster and longer sustained to achieve the same level of poverty reduction. If income inequality increases, it will reduce the effect growth would have had on raising the incomes of the poor. In Ethiopia, between 1981 and 1995, growth should have resulted in a 31% reduction of income poverty, if the poor had benefited from growth equitably. Instead, increased inequality undermined the potential benefits from growth on the incomes of the poor and resulted in income poverty rising by 6% (Bourguignon, 2004).

Evidence shows that, contrary to earlier views, rising inequality is not inevitable in the early stages of development.[2] Growth reduces income inequality as frequently as it increases it (Ravallion, 2004). Where inequality is high or rising, there will be a need to examine the pattern of growth and ensure that poor women and men are not being marginalised in the growth process. High levels of income inequality in Latin America and rising income inequality in sub-Saharan Africa are thus a cause of major concern that require policy responses from governments and donors.

A very wide range of policies are required to address inequality starting with those required to bring about a pro-poor pattern of growth, and including measures to address risk and vulnerability. Evidence shows that investment in early childhood development will promote equality of opportunity, and hence pro-poor growth. Efficient public spending on the basic social services of health, education and infrastructure that reach the poor is vital for pro-poor growth. The current situation is that, in many countries, public spending is not efficient and benefits the non-poor disproportionately (Wilhelm *et al.*, 2005). Gender biases, social stigma associated with caste, disability, HIV/AIDS and membership of social or religious

groups, result in individuals failing to achieve their latent potential. These inequities undermine growth and are all the more damaging for poor people's efforts to escape poverty because they are perpetrated over generations. Enforcement of laws that most countries have adopted to address discrimination on social grounds, needs to be improved.

Gender is a particularly important dimension of inequality. This is illustrated by the difficulties that women face when participating in economic activities because of their role as carers, as well as discrimination in accessing assets such as land, and negative social attitudes. Policies that increase women's participation in the workforce and the returns to that participation are major contributors to pro-poor growth. Greater access to infrastructure, reproductive health services and child care, a decline in fertility rates caused by changes in attitudes or access to contraception, higher female life expectancy and improved social attitudes to women's involvement in economic activity all help to increase women's participation in the workforce. Greater access for girls and women to education at all levels and equitable employment policies help to increase returns to women's participation in the workforce (Klasen, 2005b).

Addressing risk and vulnerability

Risk and vulnerability limit poor people's participation in the growth process. The establishment of effective risk mitigation instruments and credible social protection should be an essential element of pro-poor growth strategies.

Along with greater human security (Chapter 3), increasing the economic security of the poor pays the double dividend of helping to sustain faster growth and bringing about a pro-poor pattern of growth. Taking advantage of opportunities requires taking risk – producing new crops, entrepreneurship, moving to new areas and jobs all involve risk. With their meagre incomes, the poor are especially vulnerable to the potential consequences of risk taking and are hence reluctant to take on additional risk. Prevention, mitigating or coping strategies that reduce vulnerability to risk, such as increasing the reliability of agricultural incomes, deepening insurance markets through public-private arrangements so that they reach the poor and ensuring credible social protection, are thus important for pro-poor growth. Policies that provide greater incentive to combine pro-poor growth with sustainable use of natural resources often contribute to addressing the vulnerability of the poor.

Escaping poverty is not a one-way journey. Many poor women and men fall back into it. Shocks caused by natural disasters or man-made crises may cause economic contraction and huge numbers of people can fall back into poverty. Economic, political and social stability help to avoid man-made shocks and so contribute to growth and more effective reduction of economic poverty. Of course, it is not possible to eliminate risk either at the macro level or amongst households. It is important therefore to have in place reliable social protection instruments that may be deployed rapidly to cope with natural disasters and man-made shocks, to avoid extreme deprivation for the poor and the loss of their human, financial and social capital in a desperate attempt to cope. If the poor are forced to sell or deplete the very assets that they need to earn better incomes, they will be less likely to escape poverty in future, resulting in "poverty traps". Policies that prevent extreme deprivation, such as labour schemes to build infrastructure can be useful in this regard. Where poverty traps exist, "smart" cash transfers that are conditional on the poor building assets by accessing health and education for their children should help, such as Mexico's Progresa/Oportunidades (Farrington *et al.*, 2005). Addressing barriers for the disabled to find productive employment may also pay high

dividends as small changes in levels of accessibility may allow sizeable parts of the workforce to live productive lives. Providing safety nets such as contributory or non-contributory pensions (South Africa) or cash transfers (Zambia) will help to prevent extreme deprivation amongst the elderly, chronically infirm or extreme poor.

Policies to tackle the causes of market failure and improve market access

Markets connect poor men and women to the growth process. Market failures and disadvantages in the terms on which the poor participate in markets prevent pro-poor outcomes.

Market failures are common in developing countries and when they occur, outcomes undermine pro-poor growth. The causes of market failure are manifold: inappropriate policies and institutions, unequal access to market information, concentration of market power, high cost of transactions and co-ordination failures or failing to take account of wider impacts such as on the environment. Even if markets do not fail, the poor may be disadvantaged when participating in them though discriminatory formal or informal institutions and higher costs of accessing markets.

When markets have failed or market outcomes have not been pro-poor, governments have often intervened directly, providing goods and services themselves. In many cases this has led to market failures being replaced by government failures with the poor still remaining disadvantaged. Deregulation has, in some cases, helped to improve market access and functioning for the poor. But in agricultural and rural markets where old market failures have resurfaced, the poor remain particularly disadvantaged by high transaction and co-ordination costs, poor access to information and lack of market power. New approaches, which combine tackling market failures with improving market access, are needed to make markets work better for the poor. These approaches need to include investment in the economic capabilities of the poor.

Participation in markets influences the ability of poor women and men to improve their livelihoods and contribute to growth. Well-functioning markets for productive assets that increase access for the poor have a vital role to play in generating pro-poor growth. This has numerous dimensions. Financial sector deepening is associated with higher rates of pro-poor growth (Beck *et al.*, 2004), especially when accompanied by increased access of the poor to financial services. Greater access to and security over land and other property

Box 2.4. **Financial markets**

Financial markets that are characterised by limited competition and/or adverse incentives for private lending often exclude poor people. For this reason, governments, development agencies and others have promoted microfinance schemes and these have been of great benefit to poor women and men. Nevertheless, it has become evident that isolated microfinance projects are not a long-term solution. To bridge the gap between microfinance and traditional financial markets and to expand more generally the access of poor people to sustainable financial services, inclusive financial systems are needed which provide appropriate products and services for all types of clients. To achieve this, a supporting infrastructure (refinancing institutions, associations, credit bureaus, rating agencies, etc.) as well as a conducive macroeconomic and policy environment, are required.

for the poor and well-functioning labour markets that increase formal job creation, enable labour mobility and meet core labour standards are all needed.

On top of this, targeted assistance may be necessary in order to reach those who, even where the playing field for market access is levelled, still cannot make use of market opportunities because of lack of assets such as knowledge and skills, capital, land or certain basic needs. But such assistance needs to be "smart", to avoid distortions, to address the binding constraints and to reach the intended target group, and it should be temporary. Examples of such assistance include cash for work, voucher systems for research and business development services and output based payment systems for infrastructure services.

Key implementation issues

- Is income poverty decreasing in line with MDG 1:1? Is information available on the average rate of growth of the incomes of the poor? How does it compare to the overall rate of economic growth? Is there disaggregated data on income poverty and income growth with regard to gender, region, urban-rural, type of occupation and ethnicity?
- What is the level of income inequality and how has it been changing with economic growth? What can be done to reduce asset inequality and bring about greater equality of opportunity? What can be done to address unemployment, informality, poverty traps, lagging regions, etc.?
- Is growth broad-based and inclusive of the poor? Are poor women and men marginalised from economic processes? What barriers need to be removed for women, people with disability, ethnic or other minorities to participate in and benefit from the growth process? How efficient is public spending on basic social services and is it reaching the poor?
- What are the key policies and institutions that need to be improved to achieve sustained pro-poor growth (competitiveness, investment climate, legal system, property rights, public services, infrastructure, etc.)? Are direct and indirect impacts on poor women and men taken into account in the design of such policy reforms?
- How widespread is market failure and to what extent does it hurt the poor disproportionately? Are there special constraints for the poor in agricultural markets, land markets, rural credit markets, urban labour markets, etc.? What is the government response to market failure?
- Are there policies and instruments in place for poor people to manage their health risks, increase reliability of agricultural incomes, pool their livelihood risks, deepen insurance markets, reduce man-made shocks, cope with shocks and help poor men and women escape poverty traps? Are there safety nets for the elderly, infirm and extreme poor? What is the evidence regarding impacts of social protection instruments on pro-poor growth (considering costs as well as benefits)?

Notes

1. Whilst rates of economic growth in Africa have increased with several countries now recording 4-5% growth, the rates are less than the 6%-8% p.a. estimated to be required to achieve MDG 1.
2. This refers to the Kuznets curve which postulates that inequality is likely to increase in the early stages of development but fall as *per capita* incomes start to reach developed country levels.

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PART I

Chapter 3

Addressing the Multiple Dimensions of Poverty

Poverty is multidimensional and pro-poor growth will be strengthened by progress on other dimensions of poverty. In tackling poverty, perceptions of policy dichotomies have been misplaced. Policy trade-offs do exist but can be better managed.

Inter-linkages between the different dimensions of poverty

Pro-poor growth will be strengthened by progress on other dimensions of poverty. Policies to tackle the multiple dimensions of poverty should go hand-in-hand.

As set out in the DAC Guidelines on *Poverty Reduction*, the multiple deprivations that poverty takes are inter-linked. Understanding the inter-linkages should help to develop more effective pro-poor growth strategies and to integrate these better into national poverty reduction strategies, ensuring that policies to address the multiple dimensions of poverty go hand-in-hand. Pro-poor growth will be strengthened by progress on other dimensions of poverty than the economic one. Focusing on economic development alone, as some have attempted in past, is unlikely to prove as effective in addressing economic poverty as strategies that address the multiple dimensions of poverty. The paragraphs below provide the evidence for this, and show, for example, how failures to tackle social and cultural discrimination may keep millions in both economic and socio-cultural poverty even in middle-income countries. Moreover, they draw attention to the growing recognition that, without political empowerment of the poor, policies to address pro-poor growth are unlikely to be implemented in the first place.

Reducing economic poverty through pro-poor growth should contribute to progress on the human dimension of poverty. For instance, higher incomes should enable the poor to spend more on health and education for their households so that they and their children may live healthier, more productive lives. And higher levels of economic prosperity should provide the resources the state needs to spend more on health and education. However, it cannot be assumed that higher levels of income will automatically produce better human development outcomes. Without effective policies to address them, the human capabilities of poor men and women may remain underdeveloped despite increased incomes, as shown by increasing infant mortality in recent years in Senegal and by the lack of progress on health indicators amongst the poor in Bolivia (Klasen, 2005a). As noted earlier, public expenditure on health and education may not be pro-poor. The consequence is likely to be that the lack of development of human capabilities amongst poor men and women reduces the rate of growth and the extent to which growth is pro-poor. Not only will countries fail to achieve MDG 1 but they will fail also to deliver against the MDGs for health and education. Africa faces a particular challenge in combating the HIV/AIDS pandemic which is reversing gains in life expectancy made over decades. HIV/AIDS is undermining growth through reducing the productivity of the workforce and is diverting scarce public resources away from making progress on other health issues and increasing access to education. The pandemic is now threatening countries such as India and China with huge populations. Effective policies, backed by adequate resources, are required to check the spread of the pandemic and to provide health care for the millions who are or will be affected.

The socio-cultural dimension of poverty focuses on status and dignity. A high proportion of the world's economic poor are members of social groups that are denied status and dignity in countries that have had success in economic development:

indigenous people and those of Afro-American descent in Latin America, the so-called scheduled castes of India and ethnic minorities of successful East Asian countries such as China and Vietnam. These countries prove how an absence of effective policies to address social or cultural discrimination can leave millions in economic poverty despite higher *per capita* incomes. The inability of these men and women to fulfil their latent potential slows growth and makes it less pro-poor. In sub-Saharan Africa, with its myriad of tribal and ethnic groups and a high incidence of poverty amongst female-headed households, discrimination on the basis of social groups and gender is rife, often spilling over into social conflict, undermining pro-poor growth and contributing to the failure of the state. From a wider perspective, people experiencing such loss of status and dignity are frequently denied their basic human rights. Many countries have appropriate legislation in place to address social discrimination and guarantee human freedoms. However, powerful elites, unaffected by its consequences and uninformed of its effects, have chosen not to enforce these laws effectively. Progress on addressing the social dimension should reduce both socio-cultural and economic poverty.

The wider concept of human security encompasses two dimensions of individual freedoms: the freedom from fear of conflict and natural disasters and the freedom from want in the form of hunger and lack of basic social services. It calls for policies to address the risk of war and conflict and of man-made and natural disasters, protect civil liberties and address hunger and want. Such policies are needed to create the conditions necessary for addressing economic security. The experiences of Rwanda and Sierra Leone show how increasing human security may start the process of laying the foundations for pro-poor growth. More research and thinking is required on how to bring about greater human security through reducing conflict.

Chapter 2 addresses the role women played in bringing about pro-poor growth. As recognised in the DAC Guidelines on *Poverty Reduction*, gender equity is a cross-cutting issue covering all dimensions of poverty. The first six MDGs are directly affected by the level of gender equity. Bringing about gender equity thus extends beyond bringing about the beneficial participation of women in the workforce. It is based on securing "all the human rights and fundamental freedoms in the political, economic, social, cultural, civil or any other field" for women, as set out under the "Convention on the Elimination of All Forms of Discrimination against Women" (CEDAW). Progress on gender equity in developing countries remains slow and requires greater commitment from governments and donors.

Environmental sustainability also cuts across all dimensions of poverty. The state of the environment and the productivity of natural resources affect both the pace and pattern of growth. Poverty assessments show that poor rural households are particularly dependent on natural resources for their livelihoods. In Malawi, a 1% increase in biomass scarcity can reduce average rural household welfare by 1%. Poor households are particularly affected, experiencing a 2% decline in welfare. In Nepal, the presence of community forestry in a village increases household welfare by approximately 6%.* Environmental sustainability is thus important for economic and human development as environmental "costs" at the global, national and local levels bear heaviest upon the poor. They are crucial for living conditions world wide, with climate change and environmental

* Examples provided by the Environmentally and Socially Sustainable Development Network (ESSD) of the World Bank.

pollution being major issues that require concerted efforts on behalf of all governments. Environmental degradation is not the inevitable cost of economic development. Rather than trying to mitigate the environmental impact of policies and projects, developing countries and their donor partners should use tools such as Strategic Environmental Assessments to help make informed choices. Central to such an approach is effective governance and fiscal policies that change incentives in favour of environmental sustainability and growth. One way of dealing with land degradation is by increasing the availability and affordability of agricultural inputs, such as fertilisers, in combination with risk mitigation instruments (insurance), allowing farmers to make better use of them. Pro-poor growth would be greatly strengthened by investments in improving environmental quality backed up by effective regulatory frameworks and governance.

The political dimension of poverty may mean that the poor become marginalised in the political process, and hence have little influence over the policy-making process. Where the inequality in political power between the poor and non-poor becomes marked, there is a danger that key institutions of the state may be captured by rich, powerful elites and used to bring about policies and institutions that promote their narrow vested interest, rather than promote widespread economic prosperity through pro-poor growth. Policy and institutional reforms required for pro-poor growth and wider poverty reduction are more likely to be implemented if poor women and men are empowered to participate actively in the political process and, through their representatives, able to influence the policy making process. Reducing the multiple dimensions of poverty is thus enabled by political empowerment, as further discussed in Chapter 4.

Traditional dichotomies

Traditional dichotomies between pro-growth and pro-poor policies have been misplaced.

Traditionally, pro-growth and pro-poor policies to empower poor people socially and politically have often been regarded as separate, unconnected and often competing strands of development. The former has been emphasised by economists who have pointed to the dramatic reduction in income poverty achieved by countries that have sustained high rates of growth as evidence that growth is the decisive influence in reducing economic poverty. The latter has been stressed by social and political scientists concerned with human freedoms and the rights of the poor. A pro-poor growth lens shows both these persuasive schools of thought to be complementary in reducing poverty and an effective poverty reduction strategy needs to encompass both these perspectives.

Countries like Brazil and Egypt that enjoyed high rates of growth in the 1970s, but did not invest in human capabilities, were unable to sustain growth because the productivity of the workforce failed to increase, thus reducing growth. Equally, without growth, it is unlikely that investing in the capabilities of the poor will be translated into reduced income poverty because the poor will not have the opportunity to use their new capabilities to earn higher incomes, as evidence by the experience of Jamaica (UNDP, 1996). Routes out of poverty vary. Countries such as India were able to increase growth with slow improvements in human development. Others, such as China, invested heavily in human development before bringing about rapid, sustained growth. What is clear, however, is that no country can maintain growth unless that growth is accompanied by major gains in human development. And, as noted above, policies to address social discrimination and increase human security are important for pro-poor growth.

Potential trade-offs

Policy trade-offs exist, but need to and can be better managed. Policies need to be sequenced to address the binding constraints. The ability of institutions to handle trade-offs is important for achieving pro-poor outcomes.

One of the main reasons why traditional dichotomies have persisted for so long has been the perception that there are strong trade-offs between pro-growth and pro-poor policies. Some held the view that the public spending required to increase human development and security could only be afforded through high rates of taxation which would stifle growth. Others held the view that there was a choice between investment to promote growth and that needed to bring about a pro-poor pattern of growth. For example, investing in infrastructure to enhance growth in cities and towns that were expanding rapidly was seen as an alternative to investing in infrastructure to enhance the ability of poor people in rural areas to participate in the growth process.

Obviously, in the short run and at the extremes, there are trade-offs. In the short run, hard choices may need to be made on whether to focus initially on economic as opposed to social development and between pace and a pro-poor pattern of growth. But the pro-poor growth lens shows these trade-offs to be exaggerated. For example, in the short term, if the choice made is to invest in bringing about greater participation of women in the workforce and developing human capabilities through improved access to health and education, it will lead to higher growth in the medium term, thus increasing the tax base to fund additional investment in the future. Equally, investment in infrastructure to promote trade, investment and employment will generate income and tax revenues to support household expenditure and public investment in health and education in the medium term.

Priorities for the short term may be set by examining the growth/inequality/poverty experience and progress in achieving other MDGs to find the binding constraints to pro-poor growth and poverty reduction. POVNET has developed a simple, practical approach to carry out *ex ante* poverty impact assessments (PIAs) that can help to inform policy choices and investment design (Box 3.1). It focuses on identifying transmission channels and the potential impacts of the intervention on different groups.

In fact, there is a large policy space in which it is possible to pursue complementary policies that address both pro-growth and pro-poor objectives. Thus, the development of micro finance institutions that are part of the mainstream financial sector will help to increase credit to the private sector and to the poor, addressing both pro-growth and pro-poor objectives. Financial deepening of this type addresses not only economic poverty but is associated with gains in human development indicators such as reducing infant mortality (Beck *et al.*, 2004). Investment in providing and maintaining infrastructure which is accessible by the poor should help to increase pro-poor growth and reduce several other dimensions of poverty: provision of electricity for the productive use of the poor, for instance could improve labour productivity, increase household income by allowing women to spend more time on economic activities and household duties including care for children and health. As concerns environmental degradation, fiscal incentives for the sustainable use of natural resources and pricing policies that will lead to greater access to water and sanitation for the poor on a financially and fiscally sustainable basis help to ensure that environmental gains are accompanied by increased, not reduced, pro-poor or pro-growth expenditures (OECD, 2005a).

Box 3.1. **Analysing the impact of development interventions**

Poverty and social impact analysis (PSIA) has been developed by a number of donors to help understand the distributional consequences of policies on the welfare of people, particularly those who are poor and vulnerable. PSIA draws on a range of multi-disciplinary tools for this analysis and encourages an inclusive, transparent and accountable process. It can be used before, during or after an intervention. This is proving to be an effective approach, but tends to be costly and time consuming making it inappropriate for intensive use across a wide range of development interventions (projects, programmes and policies). POVNET has developed a simple, more practical approach that can help to inform policy and investment choices and design. This draws on the PSIA framework, the MDGs and other important welfare measures. This framework for *ex ante* poverty impact assessments (PIAs) focuses on:

i) Existing information, assessing gaps, and whether there is need for more detailed data and analysis.

ii) Aligning with national development/poverty reduction strategies.

iii) Identifying the transmission channels through which interventions will impact on stakeholders.

iv) Understanding impacts on the capabilities of different groups, in particular the most vulnerable.

v) Examining the potential contribution to the MDGs and other high priority agendas, such as pro-poor growth.

Key implementation issues

- In what way do national poverty reduction strategies reflect understanding of poverty and the inter-linkages between the multiple dimensions of poverty? How can government (regional/local) planning take better account of the linkages between the economic and non-economic dimensions?
- Are policies for reducing the human, social and security dimensions of poverty helping to bring about pro-poor growth?
- What is the experience with complementary policies that are both pro-growth and pro-poor, *e.g.* investment in health and education, micro finance, investment in infrastructure for the poor, etc.?
- How effective are laws to prevent discrimination on the basis of gender, social and cultural differences and what could be done to improve the situation?
- In what way is the role of environmental sustainability in pro-poor growth and living conditions reflected in policies?
- Are policy choices and investment priorities informed by prior analysis of their potential impacts on the various dimensions of poverty?
- How are potential trade-offs dealt with between pro-growth and pro-poor policies? Are opportunities for sequencing policy reforms and co-ordinating investments in social and economic areas fully exploited?

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PART I

Chapter 4

Political Empowerment and the Policy Making Process

For pro-poor growth policies to emerge, the poor need to be informed and empowered to influence a policy making process that is accountable to their interests.

Political empowerment and participation

The poor need to participate in and influence the policy reform process that goes with poverty reduction strategies. Approaches are needed to increase the voice and influence of poor women and men in order that policy making is accountable to the actual needs of the poor.

To bring about pro-poor growth, it is important to make the policies described in Chapters 2 and 3 the basis of national development or poverty reduction strategies which are supported widely within the state, the private sector and civil society. Addressing this issue represents a major challenge. In many developing countries, inequalities in political power and influence can be huge and if powerful elites so choose, they may pay lip service to or ignore the interests of the poor. At the extreme, in fragile or failed states, control of the state may be captured by a few, powerful interest groups who may impose policies and make investment choices that serve their interests rather than those of the poor. Even with a relatively well functioning state, the voice of the poor may be weak, policy making processes opaque, informal or not amenable to being influenced by evidence-based dialogue and there may be little accountability of policy makers to the poor.

Actions are needed to bring about a stronger, better informed voice for poor people with whom they, and those who represent their interests, may influence policy makers. This may require the strengthening of the capacity of organisations who represent the interests of the poor (farmers, small business and women's organisations, trade unions, politicians, Non-Governmental Organisations (NGOs), media, etc.) to analyse the growth/inequality/poverty experience and identify the key policy and institutional reforms required to promote pro-poor growth. The analysis may be used to convince other actors and organisations in the public and private sectors and civil society so that they may better align their demand for policy change more closely to the interests of the poor. Further, initiatives are required to make the various policy making processes of the state more formal, transparent and evidence-based, so that they may be influenced by the representatives of the poor. In this way, the focus of policy making may shift from the claims of competing vested interests, which frequently disadvantage the poor, to more evidence-based dialogue. A stronger voice and better policy making processes should also help increase the accountability of the state to those representing the interests of poor women and men.

The role of the state and public-private dialogue

A well-functioning state is essential for responding to the interests of the poor. The state needs to provide the opportunity for the representatives of the poor to influence policy making processes and make policy makers more accountable to the poor.

The likelihood that the policy and institutional reforms required to promote pro-poor growth will be implemented will be increased if the state is functioning effectively. Where the checks and balances that the organs of the state (legislature, judiciary, etc.) are meant to exercise on government break down, the danger of capture of the state by vested interest

increases. If the state is unable to make different parts of society (*e.g.* government, private sector, civil society) respect the rule of law and provide effective governance on behalf of all its citizens, it is likely that respect for the institutions of the state will be diminished. That would encourage vested interests within each group to flout the authority of the state in pursuit of their own goals. In these circumstances, the greater political power of these vested interest groups would make policies to promote pro-poor growth highly unlikely. At the extreme, the inevitable consequence of such developments is partial or complete failure of the state, frequently accompanied by political or social conflict, conditions which make pro-poor growth nearly impossible.

The state also plays a crucial role in determining whether policies for pro-poor growth are implemented through the structure and characteristics of the policy making processes it adopts and the extent to which it makes policy makers accountable to the interests of the poor. Centralised, autocratic decision making by national government may reduce the influence that those who represent the interests of the poor have on the policy making process and diminish accountability to the interests of poor people. Whilst macro policies should be made centrally, there are a wide range of economic policies that affect the investment climate (cost of doing business, infrastructure, etc.) and social policies (health, education, social protection and inclusion, etc.) that may be more suited to the context and pro-poor if policy making is decentralised. However, decentralising policy making, by itself, may not be sufficient. Without sufficient participation of the intended beneficiaries (including poor women and men), there is a danger that powerful vested interests locally may capture the policy making process and decentralisation enable greater rent seeking and corruption. Decentralisation needs to be supported by human and financial resources and accompanied by building capacity to improve governance locally.

Moreover, the likelihood of policies being implemented that promote pro-poor growth should increase if they are developed and implemented through broad-based dialogue and participation involving the different parts of society and including the interests of the poor, rather than the autocratic decisions made by government alone. What is crucial in this kind of process is that not only the voices of a few large formal actors in the private sector are heard but also a much wider spectrum of people, including small farmers, micro-entrepreneurs in the formal and informal private sector and so on. Civil society has an important complementary role to play by articulating the interests of women, disadvantaged groups and society more generally in economic and social reform processes. Furthermore, if public-private dialogue only takes place at the national level, many opportunities at the local level may be lost.

It is important to note, though, that greater dialogue, by itself, is not a panacea (Pinaud, 2006). Dialogue needs to serve a purpose and lead to policy outcomes. Interest groups in society, particularly those representing the interests of the poor, need to be better informed and organised in order to participate effectively in public-private dialogue and to articulate and defend their interests more widely. Where the boundary between the "public" and the "private" is fluid (as in much of Africa), the quality of the dialogue depends on the structure of the participating institutions. Merely assembling government representatives, high-level civil servants and the most powerful/influential private sector people around a table will not suffice to create an atmosphere of trust in which the broad direction of economic policy can be jointly expounded and may lead to consultation fatigue. The organisational and process dimensions of the dialogue can turn out to be key to its success. For example, it is important to assess which issues are likely to generate

greatest interest, analyse in advance the political economy in order to determine whether such a dialogue is both feasible and timely and to communicate policy options. The dialogue should be linked to a specific policy reform process with declared objectives such as the formulation of a local or regional plan, green/white paper on an issue, national poverty reduction strategy etc. Local organisational capacity to conduct meaningful dialogue is key to ensuring policy outcomes in favour of pro-poor growth.

Box 4.1. **Dialogue as a means to pro-poor policy reform**

An interesting example of successful interplay between market development and dialogue is the emergence during the last few years of a flourishing commercial radio market in Uganda. In 2004, 19 commercial radio stations were broadcasting to 7 million regular listeners. This has given many small local businesses, run by female as well as male entrepreneurs, an opportunity to participate in debates on how to improve and bring about reforms of the local business climate.

Source: The Donor Committee for Entreprise Development Web site (*www.businessenvironment.org*); Using Radio to Address Policy Constraints in Uganda and Ghana, 2004.

Effective governance plays a crucial role in delivering policy outcomes. Experience from countries which have carried out successful governance reforms show that these are often linked to the processes of economic and social development, whereby virtuous circles are established between governance reforms and pro-poor growth. There can be different triggers to setting such circles in motion. Sometimes a crisis (political, financial, natural) or change in the political leadership can be the starting point for concrete steps to improve governance as well as sending positive signals to the private sector. Carrying out surveys of the business climate that show the importance of improved governance may help to trigger a process, during which public and private sector and civil society organisations are strengthened and they come to hold each other to account as partners in development.

The wider political settlement

Pro-poor reform is likely to require changes to the current political settlement between the diverse interests of different segments of society.

Policies and institutions represent the current political settlement between diverse interest groups that make up the state, the private sector and civil society. Hence, policy and institutional reforms needed to promote pro-poor growth are likely to involve changes to the current political settlement. As all change involves winners and losers, the likelihood of successfully promoting pro-poor change will be greatly enhanced by an understanding of the political economy of change: mapping stakeholder interests and understanding who is likely to win and lose from change. It may be necessary to arrive at technical solutions that minimise the adverse consequences of change or support other pro-poor reforms that may be in the interest of those who stand to lose from change. Otherwise, if those who are likely to lose from change are powerful enough, they will resist and hence block pro-poor change.

In such analysis, it is important to identify the potential constituencies in favour of and opposed to change. In so doing, it is important to recognise that those in favour of and opposed to pro-poor policy reform may vary from issue to issue. For example, farmers and

large exporters may be on opposite sides in terms of priorities for public expenditure but on the same side in ensuring a competitive exchange rate. Further, it is useful to identify change agents, those who are able to influence policy makers and public opinion and support them in delivering pro-poor policy change. An understanding of the historical context, decision making structures (formal and informal) and the types of evidence and arguments that are most likely to influence decision makers, will also help in promoting policy reform in favour of pro-poor growth (DFID, 2005).

Successful policy and institutional change in favour of pro-poor growth depends upon effective demand for change. Frequently, those who represent the interests of the poor do not have the capability to undertake evidence-based research or articulate policy change in ways that will minimise resistance to change. In these instances, building capacity amongst those who are advocating such change (*e.g.* rural NGOs, farmers' organisations, etc.) should prove helpful. There are instances where the state is unable to respond effectively to the demand for change because of technical or resource limitations. In such instances, assistance in building the capacity of the state to respond effectively to change should prove helpful (OECD, 2006). To meet the demand for change and the capacity of the state to respond, this kind of capacity building should be directed not only to central but also to regional and local levels. Where policy and investment choices exist and conflicting views threaten to block progress, *ex ante* poverty impact assessments may help to understand better the relative merits of the choices and to provide solutions that mitigate the impact on those who stand to lose from change.

Instead of the view taken in the past that increasing growth that would benefit the poor depended upon the wholesale adoption of a set of policies that were universally applicable, evidence has shown that introducing policy and institutional change is a continuous process that involves innovation and lesson learning (World Bank, 2005b). This process requires the progressive forging of a "social contract" in favour of pro-poor growth between the different parts of society (*i.e.* the state, the private sector and civil society). The contract will be strengthened by political empowerment of the poor, a state open to influence and accountable to the private sector and civil society, including those who represent the interests of the poor, and by processes that will help to bring about a pro-poor political settlement in the wider polity.

Poverty reduction strategies

Poverty reduction strategies need to be nationally owned, better integrate the pro-poor growth component and contribute to greater accountability of the state to the interests of the poor.

Effective poverty reduction strategies, be they national development strategies or formal Poverty Reduction Strategy Papers (PRSPs), provide an important opportunity to strengthen the voice of the poor, influence the state's policy and the wider political settlement. As policy reform involves winners and losers, the need to overcome possible resistance to change means that strategies should be nationally owned and have broad-based support. In the early phases, PRSPs were regarded mainly as a means to obtain Heavily indebted poor countries (HIPC) debt relief and hence there was limited national ownership (IMF *et al.*, 2005). Further, these PRSPs focused on social development with a cursory glance at the need to accelerate pro-poor growth. The policies required to increase growth to the unprecedented levels projected were not set out, nor were the mechanisms for enhancing the extent to which the poor would be able to participate in, contribute to and benefit from growth.

Poverty reduction strategies need to be based on realistic views of growth prospects based on domestic and external environments as well as a thorough analysis of the inter-dependencies between growth, inequality and poverty in the country (Box 1.1). Binding constraints to accelerating pro-poor growth need to be identified, attention given to both its economic and social determinants and the linkages between the multiple dimensions of poverty addressed to ensure a holistic approach to reducing poverty. Poverty reduction strategies should become the instruments of strengthening the social contract between the different segments of society. This can be fostered by encouraging greater participation and dialogue in their preparation and ensuring that representatives of the interests of the poor are involved in monitoring implementation, thereby helping to increase the accountability of the state to the interests of the poor.

Key implementation issues

- In which areas important for pro-poor growth is the state not functioning effectively? Does it ensure respect for the rule of law and effective governance over the activities of government, the private sector and civil society?
- Are economic reform programmes accepted and owned by the country's political stakeholders? What are the drivers of economic change and what is the role of private sector actors, civil society and media in relation to economic reform?
- Are mechanisms in place for poor women and men to influence the policy making process? How can the voice of the poor be strengthened so that they are better able to influence the policy-making process?
- Is there a sound understanding of stakeholder interests and of who is likely to win and lose from specific policy changes? Is it possible to identify and support change agents who can champion pro-poor change?
- To what extent is analysis of constraints and opportunities conducted at the local level and decision making on reform and investment decentralised? Is institutional capacity for this at the local level sufficiently developed or supported?
- Do poverty reduction strategies reflect a sound understanding of the linkages between growth, inequality and poverty reduction? How can the process of preparing PRSs strengthen the social contract in favour of pro-poor growth?

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PART I

Chapter 5

The Role of Donors

The pro-poor growth agenda has important implications for the way donors support partner countries. It is not a "business as usual" agenda, and "more of the same" will not be sufficient.

Donors in the pro-poor growth agenda

The pro-poor growth agenda, focusing on policy and institutional change, recognises the importance of country contexts in identifying the binding constraints to pro-poor growth. This shows the practice of some donors of pushing agendas based on their experience elsewhere, or priorities developed by their governments and head offices, to be inappropriate as neither may be suited to the country context. And, the perennial debate within donor organisations, of whether to support growth or to develop the capabilities of the poor, is shown to be misplaced as the pro-poor growth agenda highlights the importance of breaking down traditional dichotomies between economic and social development.

Moreover, the pro-poor growth agenda recognises that helping to bring about pro-poor policy and institutional change is predicated upon strengthening the voice of poor women and men and supporting champions of pro-poor change to increase their influence over the policy making process. Pro-poor change cannot be imposed from the outside. The practice of providing "our solutions to their problems" is unproductive. Implementing policies to promote pro-poor growth involves a continuous process of strengthening the engagement between policy makers and the representatives of the private sector and civil society, especially those who represent the interests of the poor and promoting evidence-based, transparent decision making, as well as innovation and lesson learning to arrive at policies suited to the local context.

The implications of the above are that donors need to reappraise the way they relate to partner countries and the modalities they use to provide assistance. Carrying on business as usual and scaling up aid to do more of the same will not suffice.

Supporting in-country policy making processes

Donors should focus on supporting in-country processes that are inclusive of the poor. Donors should support the emergence and development of policy making processes that are formal, transparent and accountable to the interests of the poor, and conduct their policy dialogue through them.

As set out in the Paris Declaration on Aid Effectiveness (OECD, 2005b), effective aid requires the mutual commitment that partner countries exercise leadership in developing and implementing national development strategies through broad-based consultative processes and that donors respect country leadership and help strengthen their capacity to exercise it. In promoting the pro-poor growth agenda, donors should focus on assisting partner countries to develop and implement nationally owned poverty reduction strategies suited to the local context through processes that strengthen the social contract in favour of pro-poor growth.

Donors may help support the policy making process at various levels and by building capacity to: *i)* identify the binding constraints to pro-poor growth; *ii)* undertake broad-based dialogue; *iii)* innovate to find context-specific solutions; *iv)* make informed and evidence-based policy choices such as by carrying out *ex ante* poverty impact assessments;

and *v)* manage for development results and ensure accountability. Donors may help to ensure that poverty reduction strategies better integrate pro-poor growth with progress on other dimensions of poverty.

Support for these policy processes should form the basis of policy dialogue between donors and partner country governments. The outcomes of the policy making process and the policy dialogue should, in turn, be reflected in donors' country assistance strategies and the design of programmes, helping to make them better aligned and more relevant to country-led processes.

The basis of engagement

Donor support needs to be long term, flexible and responsive to country situations.

The pro-poor growth agenda is, by its nature, long term. Helping partner countries implement policies and institutions needed to promote pro-poor growth is a continuous process, informed by the growth/inequality/poverty experience. To promote pro-poor growth, donors must therefore be prepared to engage with partner countries on a long-term basis and to provide aid predictably. Short-term assistance is unlikely to be productive, unless it complements and is well co-ordinated with more long-term development interventions.

As recognised in the Paris Declaration, donor harmonisation is essential for improving the quality as well as quantity of aid. A well thought through, co-ordinated response by donors to poverty reduction strategies and other policy reform processes should help to ensure effective donor support. Each donor is likely to have core competency in particular areas addressed by the strategy or reform process and may therefore focus on supporting parts that they have the greatest value added to contribute, consistent with co-ordination and local ownership principles.

The aims of the assistance provided and the modality for delivering aid will need to reflect country situations. In addition to the level of development of the country and hence its access to resources, donor assistance will need to take account of the extent to which there is a functioning state and a social contract that is pro-poor. Clearly, middle-income countries do not need large, budgetary assistance. For these countries, addressing pro-poor growth is likely to focus on the pattern of growth: job creation, lagging regions, informality, discrimination on ethnic and gender grounds, etc., to better connect the poor to the growth process. In low-income countries with functioning states, budgetary support, with appropriate engagement over the implementation of poverty reduction strategies and pro-poor policy reform and support to capacity building where needed, may be appropriate.

In recognition of the need to innovate, the unpredictable nature of policy change and changing priorities, donors will need to be flexible in providing assistance. Earmarking aid for specific purposes without reference to the context well in advance of its use may not be helpful. It may well fail to address the binding constraint or prove inappropriate by the unpredictable nature of policy change. It is better to provide programmatic aid that will allow flexibility in supporting specific initiatives, as and when they become appropriate. The programmes should be informed by engagement in the policy reform process, address the broad, strategic direction of policy and institutional change and identify the types of investment and assistance that may be needed and enable individual projects to be undertaken flexibly whilst ensuring that they contribute coherently to desired programme outcomes. In promoting pro-poor growth, donors need to work with partners within the state, the private sector and civil society. Some areas of assistance may be suitable for

sector-wide approaches (SWAps) of the type now common in health and education. In others (private sector development, agriculture) there will also be a need to work directly with representatives of the private sector and civil society.

Given the aim of reducing poverty, what priority should donors give to different types of interventions? Should donors – on one hand – provide support at a general level of institutional change, capacity building or infrastructure or – on the other hand – go for interventions that are directly focused on poor people, *e.g.* targeted support to community-based organisations representing the poor?

A pro-poor growth lens shows that these different options should not be looked upon as mutually exclusive, but rather as complementary. Without the necessary policy and institutional reform, targeted support, no matter how well designed and implemented and irrespective of whether its subject is economic or social development, is unlikely to bring about sustained gains for the poor. On the other hand, focusing on the enabling environment alone ignores, for example, that small enterprises often don't have the capacities needed to exploit new market opportunities, or that women and particular social groups and the poor generally may start with disadvantages in economic capabilities, suffer discrimination and lack political voice to influence policy outcomes. Selecting combinations of interventions that are most efficient must be judged on a case-by-case basis depending upon the specific situation. To improve aid effectiveness it is also important to find optimal combinations which take account of comparative advantages within donor agencies in terms of staff capacity and financial resources.

Fragile and failed states

Donors need to stay engaged in states where respect for the rule of law and governance are weak.

With the aim of helping those who have helped themselves and to make aid more effective, there has been a move among some donors to shift resources to countries that have well-functioning states and a basic commitment to promoting pro-poor growth. Whilst this is understandable, with the objective of achieving the MDGs, it is not advisable to abandon millions of poor women and men that live in fragile or failed states and leave them with little hope for the future. Some 30% of the world's poor people live in such states. It is in these states that the incidence of poverty is likely to be highest and where aid may play a vital role as a catalyst for change. In Sierra Leone, during the civil war, poverty incidence exceeded 80%. The restoration of peace and the building of a functioning state, with the support of donors, have led to a substantial reduction in poverty.

However, the approach to these states will need to be adapted to their special circumstances. Many of these countries experience social or political conflict and, for them, the restoration of peace must be the first priority. Even if there is no outright conflict, national strategies are unlikely to be based on broad consultation and, even if they are, the state is unlikely to be able to effectively implement policies needed for pro-poor growth. Under these circumstances, donor assistance should focus on finding opportunities to strengthen policy dialogue, improving policy making processes, developing capacities of those proposing policies that will promote pro-poor growth, building capabilities of organs of the state to exercise oversight over government and strengthening institutions. Resources can be directed to the development of human capabilities and the construction of basic infrastructure (Moreno Torres, 2004).

The programme of assistance will need to be accompanied by engagement with the state to strengthen in-country processes that will restore its legitimacy and help the state improve its administrative and regulatory functions. Peer review mechanisms, such as those available under NEPAD or other country groupings, can be helpful in this regard. The incentive of greater international acceptance that would enable countries to participate in international institutions and draw on greater international assistance can help to serve as a catalyst for change, as proved recently by the ending of the north-south civil war in Sudan.

Rethinking agendas and approaches

A pro-poor growth lens reveals the need to rethink agendas and approaches in areas important to pro-poor growth, such as private sector development (PSD), infrastructure, agriculture and risk and vulnerability.

There is clear evidence that during the last decade some donors have tended to neglect the needs of sectors important to the strengthening of productive capabilities important for pro-poor growth. Over the past two years, POVNET's task teams working on PSD, infrastructure and agriculture have found that the pro-poor growth lens requires donors to rethink agendas and approaches to these areas that have a major impact on pro-poor growth (Box 5.1). Instead of stand-alone areas for donor assistance, they need to form an integral part of poverty reduction strategies that focus on pro-poor growth. There are substantial synergies between these areas and, together, they impact on both the pace and pattern of growth. A fuller description of the contribution of these areas to pro-poor growth and implications for donors' strategies is presented in each Parts of this report.

Private sector development contributes to pro-poor growth by helping to bring about sustained and inclusive growth that provides opportunities for the poor. Rather than attempting to assist types of firms (*e.g.* certain size groups, activities, sectors) alone, the PSD agenda needs to focus on how policies combine to provide incentives that shape private sector activity that brings about pro-poor outcomes in markets that matter for the livelihoods of the poor. To help donors increase the leverage of private sector development on reducing poverty, POVNET prepared guidance on six important topics:

- Removing barriers to formalisation. Donors can support efforts by developing countries to reduce such obstacles as regulatory and administrative barriers, fees and financial requirements, corruption in public administration, socio-cultural attitudes and lack of key business services.
- Implementing competition policy. Donors should provide technical assistance and capacity building targeted at supporting the formulation of competition policy and strengthening institutions responsible for enforcing competition law.
- Promoting the supply-side response: Business development services and financial assistance. Donors should adopt more market based and sustainable approaches to providing support to firms and focus on the causes of problems, promote a level playing field, avoid or minimise subsidies and have a clear exit strategy.
- The financial sector's contribution to pro-poor growth. Donors should encourage developing countries to improve the capabilities of supervisory and regulatory authorities, strengthen financial intermediaries, support prudent mobilisation of savings and remittances and help bridge the gap between banks and microfinance institutions so that greater access to financial services is mainstreamed in the development of the financial sector.

- Enhancing women's market access. Donors should support policies that address structural and social barriers to women's participation in labour, financial, goods and services markets.
- Constructing inclusive public-private dialogue. Donors should support, in a time-bound and strategic way, the establishment and operation of dialogue processes at national, sub-national and local levels. Helping poor entrepreneurs to participate and promote their interests is key.

Infrastructure contributes to both growth rates and growth patterns and to both income and non-income dimensions of poverty. The agenda for infrastructure needs to change from promoting growth to promoting pro-poor growth, meeting the needs of different groups and from projects in isolation to projects/programmes as part of networks that harness synergies between different types of infrastructure. POVNET has developed four guiding principles for developing infrastructure to promote pro-poor growth:

- Promoting country-led frameworks as a basis for co-ordinated donor support.
- Enhancing infrastructure's impact on pro-poor growth by focusing on bottlenecks, meeting the needs of different groups with appropriate services and tariff levels and benefiting from synergies between different types of infrastructure.
- Improving management of infrastructure by prioritising maintenance and rehabilitation, building management capacity, reducing corruption and better management of environmental impacts.
- Increased and better use of financial resources by greater efficiency and cost recovery, improving private participation and more predictable public funding and donor assistance.

Agriculture is crucially important for ensuring a pro-poor pattern of growth. Sound investments in agriculture and policy reform are cost-effective investments in pro-poor growth. The agenda for agriculture to contribute to pro-poor growth is much broader than increasing sector output. It focuses on agriculture's role in helping to improve existing livelihoods, to serve as the catalyst for transforming livelihoods by providing new opportunities, on and off-farm, and to reduce risk and vulnerability. Priorities for action within a pro-poor growth agenda for agriculture include:

- Increasing access to markets and assets, improving access to productivity enhancing technology, especially for small producers and agribusinesses, and increasing investment in infrastructure (power, irrigation, roads).
- Increasing opportunity to earn non-farm incomes through policies that increase access to capital, facilitate the movement of labour, investment in transport and communications services and access to health and education.
- Addressing risk and vulnerability by focusing on prevention strategies (*e.g.* drought resistant crops, irrigation), mitigation strategies (*e.g.* secure savings and crop and price insurance instruments), as well as coping strategies (*e.g.* smart transfers and safety nets).
- Supporting the development of country-led national development strategies that include agriculture (including forestry and fisheries) and rural development as part of the pro-poor growth agenda and fostering partnerships on the ground between the state, the private sector, civil society and donors to bring about policies that will increase the contribution of agriculture to pro-poor growth.

Work is underway within POVNET to develop approaches to addressing risk and vulnerability, including instruments that increase social protection that are adapted to conditions in developing countries.

Box 5.1. **Promoting pro-poor growth: Examples of evolving agendas and policy responses**

Evolving agendas		Policy responses
From …	*To …*	
Private Sector Development		
Target firms and sectors directly.	Promote enabling environments for pro-poor growth, focusing on market outcomes.	Strengthen the enabling environment, ensuring an improved risk to reward ratio. Any direct firm level support should be non-market distorting.
Informal sector is marginal and temporary.	Informal sector is large, the way from informality to formality is a continuum.	Reduce disincentives to formalisation, facilitate risk taking.
Institutions and processes of institutional change were neglected.	Policy and institutional reforms.	Promote dialogue between the state, the private sector and civil society.
The private sector is one of many stand-alone sectors.	PSD is a central part of a national poverty reduction strategy (PRSs).	Link/merge PSD in wider PRSs focusing on both pace and pattern of growth.
Agriculture		
Focus on commodity production and increasing farm productivity.	Focus on household productivity through diversified production and off farm work.	Build household assets, reduce market-related barriers and expand access to local, national and international markets.
One work location.	Multiple work locations.	Support diversified livelihoods.
Smallholders are marginal.	Reduce risk and vulnerability to increase market participation.	Secure assets (land, water, finance) and mitigate shocks (new forms of insurance).
One size fits all technologies.	Technologies that respond to the very diverse needs of a wide range of small producers.	Target research and development investments to smallholders.
Agriculture is synonymous with the farm.	Agriculture contributes to growth and poverty reduction beginning at the field level all the way to the table.	Promote a holistic approach to rural poverty reduction in country PRSs.
Infrastructure		
Donor driven/project based.	Country-led/programme based.	Co-ordinate and align donor support to country led frameworks.
Infrastructure for growth.	Infrastructure for inclusive growth, involving and benefiting the poor.	Target the poor to improve their access, encourage their involvement and promote their employment, ensure affordability, *e.g.* by use of "smart subsidies".
Finance capital costs.	Greater focus on governance structures and the sustainability of infrastructure facilities; stronger focus on maintenance.	Emphasise cost recovery, improved public operator management and enhanced transparency to address corruption and environmental sustainability.
Private sector fills the gap.	Greater public sector role with support from donors with public private partnerships.	Make aid predictable, apply mix of financial instruments to leverage private sector investment and build capacity in capital and financial markets.

Building capacity in donor organisations

Donors need to enhance their organisational capacities to effectively support country-led, pro-poor growth.

The pro-poor growth agenda requires donors to change the way they are organised to provide assistance. Effective donor co-ordination is essential in addressing the broad

agenda for pro-poor growth. In some countries, such as Tanzania, donors are already sharing the analysis required to develop country strategies with each other and are co-ordinating their responses to nationally-owned poverty reduction strategies. Such practice will need to be replicated in all countries.

Success in promoting pro-poor growth will also depend upon the capabilities of field office staff to engage with partner countries over the long-term, informed by the political economy of change, structures for policy making and a sound understanding of how to influence the policy-making process. This may require donors to increase their understanding by undertaking assessments of power relations, governance and change processes (Dahl-Østergaard *et al.*, 2005). Field staff may require greater delegation of authority to engage effectively, should be empowered to take the risks involved in supporting policy change, and not penalised for taking on difficult, time-consuming and risky initiatives in the short term. Staff will need to be in the field for an extended period of time if they are to build the knowledge and network of contacts across the state, the private sector and civil society. This may require changing the incentives that staff are currently provided with in terms of career development.

Home office staff need to support field staff by helping to undertake analysis to identify the binding constraints to pro-poor growth and providing guidance on the engagement process. Donor staff need to improve their understanding of the transmission mechanisms through which development interventions contribute to pro-poor growth patterns and be able to analyse how interventions affect different stakeholders in relation to different capabilities (economic, human, political, socio-cultural, protective). Analytic tools such as poverty impact assessments can help in these respects. Skills such as understanding power relations and influencing change processes and expertise in developing infrastructure may need to be strengthened through training and recruitment. Additional training may need to be given to re-orient approaches to PSD, agriculture and infrastructure, and to enable staff to better integrate economic, social and political development perspectives, needs and opportunities.

The pro-poor growth agenda shows that the ways in which field and home offices work together need to be reconsidered. Traditional specialist skills-based departments need to break out of their "professional silos" to forge multi-disciplinary teams. The monitoring and evaluation of aid effectiveness in promoting pro-poor growth needs to move away from inputs (aid volumes) and outputs to processes, outcomes and impacts. Inputs and outputs may not reflect the progress achieved in bringing about pro-poor policy and institutional change. Home office staff have an important role to play in influencing other departments of their government to promote policy coherence so that policies in areas such as foreign investment, trade and immigration complement the efforts of the donor agency.

Key issues for donors

- How can donors support the development of nationally owned poverty reduction strategies and reform processes that address pro-poor growth and poverty reduction effectively?
- To what extent is donor assistance long term and adapted to the country situation? To what extent is aid sufficiently predictable and flexible in responding to changing partner country needs?

- Is engagement confined to the state or broad-based across the different segments of society? How can donors better apply market-based approaches in their support to private sector development in order to avoid distorting markets?
- Do donors and partner countries share the same views regarding the most appropriate mix of interventions (such as support for institutional change or support that is more directly targeted at poor peoples' needs) and on the comparative advantages of different donor organisations?
- What approaches are used to engage with fragile or failed states?
- In what ways have the agendas for important areas that impact pro-poor growth (*e.g.* private sector development, agriculture, infrastructure and risk and vulnerability) been reassessed in the light of the pro-poor growth agenda?
- What is needed to support field and home office staff in promoting pro-poor growth? Are field staff sufficiently empowered to engage with partner countries and take the risks inherent in promoting pro-poor policy change? Are there incentives to encourage staff to work in multi-disciplinary teams?

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Key Policy Messages

As the major contributor to economic growth and employment creation, the private sector has a central place in renewed efforts to reduce poverty and achieve the Millennium Development Goals (MDGs). Developing country governments have a strong interest in fostering a business environment that enables the private sector to flourish and fulfil its role as the main engine of growth.

It is important to recognise that the private sector consists of more than formal businesses. Individuals and households, from rich to poor, also operate as private economic actors when they consume goods and services, sell their labour, farm or produce goods and services. Reducing poverty requires greater efforts to address the needs and maximise the contribution of the many informal enterprises, family-run farms and self-employed men and women that conduct business in developing countries.

There is growing recognition that in pursuing a pro-poor agenda for private sector development what matters is the degree to which economic growth provides opportunities for the poor, and the extent to which poor men and women can take advantage of those opportunities. This emerging agenda is more holistic and broader than the previous agenda, which often focussed mainly on supporting enterprises considered important for the poor. Experience has shown some shortcomings with such interventions, which have sometimes created market distortions or not been sustainable as a result of attempts to "pick winners" or to use public sector agencies or donors to provide services.

Through the work of a Task Team on Private Sector Development, the OECD's Development Assistance Committee (DAC) has generated some policy guidance for donors aimed at increasing the impact of private sector development on poverty reduction. This guidance is based on an analytical framework report, "Accelerating Pro-Poor Growth through Support for Private Sector Development", as well as work on a series of important topics. These are: *i)* removing barriers to formalisation; *ii)* implementing competition policy; *iii)* promoting the supply-side response; *iv)* the financial sector's contribution to pro-poor growth; *v)* enhancing women's market access; and *vi)* constructing inclusive public-private dialogue.

For the private sector to deliver pro-poor growth, five interlinked and mutually reinforcing factors need to be in place: *i)* providing incentives for entrepreneurship and investment; *ii)* increasing productivity through competition and innovation; *iii)* harnessing international economic linkages through trade and investment; *iv)* improving market access and functioning; and *v)* reducing risk and vulnerability. These factors are brought about and influenced by policies and institutions, including "rules of the game" and mechanisms for their conception, application and enforcement.

Institutional and policy reforms are consequently at the heart of efforts to reduce poverty through private sector development. Such reforms are often difficult and time-consuming – involving interaction between the state, the private sector and civil society – and require a careful mix of contestation and negotiation to overcome resistance to change. Structured and inclusive dialogue processes can facilitate negotiation and encourage monitoring by the private sector to ensure that reforms are implemented. The formulation of national development plans, including poverty reduction strategies (PRS), provides an opportunity to institutionalise engagement between different parts of society and to follow through on the priorities set. Currently, many PRSs do not include benchmarks for private sector development, nor do they involve the private sector or civil society sufficiently in the design of interventions or the monitoring of outcomes.

To increase the impact of private sector development on poverty reduction, donors should help to bring about systemic change that alters the incentives for the private sector (the risk-to-reward ratio), including by encouraging the public sector to foster a more conducive enabling environment. This is done by increasing the capacity of governments at all levels to promote pro-poor market outcomes such as more jobs, better returns on goods sold, greater affordability of essential goods and services and reduced exposure to risks. Donors should also support "change agents" within the public and private sectors and civil society. Accelerating the development of markets the poor depend on should be a high priority.

Donors should revisit how they are supporting private sector development in developing countries. A "business-as-usual" approach will not be enough to generate the higher and more inclusive growth patterns needed to make substantial and sustainable inroads into reducing poverty. Based on recent work in the DAC, key policy messages can be highlighted in three domains:

General approaches to promoting development of the private sector

- *Encourage entrepreneurship and investment by lowering the risks and costs of doing business, including by removing barriers to formalisation.*
- *Identify and unlock the potential for economic development in sectors and regions where the poor are concentrated.*
- *Use market-based approaches as a way to address obstacles to market development – including support for the promotion of competitive markets and the development of financial markets – and avoid the risks of market distortion if providing direct support to firms.*

Approaches that donors can emphasise in their policy dialogue with developing countries

- *Mainstream strategies for private sector development into national development frameworks such as national development plans and poverty reduction strategies (PRS).*
- *Link and, to the extent possible, merge private sector development and governance programmes under a comprehensive strategy and advocate the use of key analytical tools, especially gender analysis tools.*
- *Facilitate structured, inclusive and effective public-private dialogue as a main element in institutional reform; organised at national, sub-national and local levels, as well as between these levels. Pay attention to risks and mitigate these by carefully sequencing reforms.*

Approaches that will help donors increase the leverage of their private sector development activities on reducing poverty

- *Integrate private sector development as a central theme of donors' strategies – be they at agency, country or regional levels.*
- *Improve and formalise effective donor co-ordination, alignment and harmonisation mechanisms.*
- *Consider organisational changes to facilitate greater internal co-ordination and build up and integrate analytical capacity in related areas including governance, gender and the environment.*

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Overview

The world over, the private sector is the major contributor to economic growth and employment creation. Promoting a more dynamic and vibrant private sector consequently has a central place in renewed efforts to reduce poverty in developing countries and achieve the MDGs. But there is a need to revisit how donors are supporting private sector development. A "business-as-usual" approach will simply not be enough to generate the higher and more inclusive growth patterns needed to make substantial and sustainable inroads into poverty reduction.

Governments have a strong interest in fostering a business environment that enables the private sector to flourish. In addition to formal businesses, individuals and households, from rich to poor, operate as private economic actors as well when they consume goods and services, sell their labour, farm or produce goods and services. For the private sector to expand in developing countries and fulfil its role as the main engine for growth, efforts must be made to address the needs and maximise the contribution of the many informal enterprises, family-run farms and self-employed men and women that conduct business there.

Expanding market access to all private sector actors and improving how markets function can lead to such results as more jobs, better returns on goods sold, greater affordability of essential goods and services and reduced exposure to risk. These outcomes influence the rate and pattern of economic growth. For growth to be "pro-poor", the rate has to be high and sustainable and the pattern broad and inclusive. Institutions[1] and policies shape market outcomes and so determine the degree to which they are pro-poor. What is less clear, and merits further investigation, is how best to overcome resistance to change and bring about the institutional and policy reforms that will lead to more pro-poor market outcomes.

There is increasing recognition of an emerging pro-poor private sector development agenda that acknowledges that what matters is the degree to which economic growth provides opportunities for the poor and the extent to which poor men and women can take advantage of these opportunities. Economic and social development are thus interlinked and should be addressed together. Donors may need to pay greater attention to growth and its determinants than they have in recent years.

Part II provides donors with guidance on increasing the impact of private sector development on poverty reduction. It introduces the analytical framework previously published as "Accelerating Pro-Poor Growth through Support for Private Sector Development"[2] and provides practical guidance on six of the many important issues

highlighted in the analytical framework.[3] The six issues that have been considered in detail, and on which Hot Topic papers are presented in Chapters 1 to 6, are:

i) **Removing barriers to formalisation,** which examines what has been learnt about addressing the main barriers to the formalisation of enterprises.

ii) **Implementing competition policy in developing countries,** which demonstrates the harm that can be caused to poor people and developing countries by inadequate competition.

iii) **Promoting the supply-side response: Business development services and financial assistance,** which discusses market-based approaches to providing financial and technical support to firms.

iv) **The financial sector's contribution to pro-poor growth,** which highlights the importance of extending the provision of financial services to the poor.

v) **Enhancing women's market access,** which considers access to labour, financial, goods and service markets from a gender perspective.

vi) **Constructing inclusive public-private dialogue,** which reviews this form of structured interaction that can help reduce resistance to change and lead to institutional and policy reforms.

The first part of this Overview describes the private sector's role in promoting pro-poor growth. The next part introduces the six Hot Topic papers. The final part presents the main policy implications for donors.

The role of private sector development in promoting pro-poor growth

Accelerating pro-poor private sector development

At a general level, growth requires macroeconomic stability maintained by low budget deficits, low inflation and a stable and transparent currency regime that yields competitive exchange rates. Peace and political and social stability are additional requirements because war, social conflict and crime prevent most private sector actors from exploiting their potential and contributing effectively to growth. A healthy and educated labour force also facilitates growth. But, in many developing countries, human capacity development is being undermined by the effects of HIV/AIDS and pandemic diseases.

More specifically, for the private sector to deliver pro-poor growth, a set of interlinked and mutually reinforcing factors needs to be in place to allow private sector actors, including the poor, to participate in and benefit from growth. These five factors, which are brought about and influenced by institutions and policies, are to:

i) **Provide incentives for entrepreneurship and investment.** Entrepreneurship and investment contribute to growth by increasing the productive capacity of the economy, creating jobs and introducing technologies. Rates of entrepreneurship and investment reflect the risks and costs of doing business. Risks are lower when economic policy making and implementation are transparent, property rights are secure and transferable, and contracts enforceable. Costs fall when starting, operating and closing a business is less bureaucratic and inexpensive, corruption is lower and private sector actors can access financial services and affordable infrastructure. High risks impact heavily on poor entrepreneurs because they cannot easily change sector or move somewhere else. The poor also only have a low level of savings and assets to fall back on. High costs of doing business can drive the poor into the informal economy. The way

market regulating, facilitating and promoting organisations work, formally and informally, determines the risks and costs of doing business. Institutional and policy reforms can thus lead to enhanced access for all private sector actors to well-functioning markets for capital, labour and natural resources.

ii) **Increase productivity through competition and innovation.** Competitive firms find better ways to produce and distribute goods and services, innovate, and drive lower productivity activities out of markets so as to allocate resources to more productive uses. Competition benefits farmers, entrepreneurs and consumers, from rich to poor, through lower prices, better quality and improved choice of inputs and products, as well as more indirectly, through its impact on productivity, investment and living standards. A clearly defined competition law and policy can help curb uncompetitive practices, including in sectors that the poor participate in or interact with (*e.g.* transportation, wholesale and retail trade and infrastructure services). Innovation is fostered through access to knowledge about technologies, management techniques and practices. Business linkages and clusters, often facilitated by business associations, help to disseminate knowledge and technologies. This enables specialisation and flexibility, improves the productivity of all private sector actors and increases returns on investment. The poor may, however, lack access to such networks. Reforms that expand access to business associations and clusters, especially those in which informal firms and workers participate, help poor men and women gain better access to the knowledge and technologies that will increase their productivity.

iii) **Harness international economic linkages.** International trade helps economies to focus on their comparative advantages and increases competition for domestic businesses. Greater trade integration can also stimulate foreign direct investment (FDI), which raises productive capacity but also tends to produce benefits through the transfer of knowledge and skills. In many developing countries, an expansion in infrastructure services may be required to improve the investment climate and harness international linkages more fully. Strengthening linkages between multinational enterprises and domestic firms contributes to productivity increases and, in those domestic sectors likely to involve the poor, can accelerate pro-poor growth. At the same time, deeper international integration creates risks for the poor as it can also result in contraction in traditional sectors in which the poor conduct business or are employed. It is therefore critical to anticipate and mitigate the possible impact of trade policies on the poor, with the local context determining priorities and the sequencing of change. By careful sequencing, to create opportunities for the poor, and the enhancement of access to skills training and capital and other resources, institutional and policy reforms can help the poor to diversify activities, change to new revenue earning activities or move geographically. Safety nets may nonetheless be required for those who stand to lose from greater international linkages.

iv) **Improve market access and functioning.** The critical mechanism through which the poor participate in, and benefit from, growth are the markets for the productive resources and goods and services that they rely on most for their livelihoods and consumption needs. But, in many developing countries, market failure is widespread and the poor cannot access markets on equal terms to the rest of the private sector. Women can encounter specific constraints in participating in markets. Institutions and policy reforms play a key role in improving the terms on which the poor can access markets. For instance, formalisation of businesses can generate more formal

employment as well as increase market power within value chains. A competitive banking system, with expanded access to private credit on terms and conditions more adapted to the needs of the poor, can help the poor move into higher value-added activities. Investments in and private provision of basic services and infrastructure, including through public-private partnerships, can help develop linked markets. Returns to the poor should increase through promotion of the use of technical standards, dissemination of technical and market information and provision of extension services through market-based approaches.

v) **Reduce risk and vulnerability.** The poor are particularly vulnerable to man-made shocks and natural disasters. When crises occur, the poor may consume or sell, at the same time as others, their livestock and other assets. The running down of assets, combined with disadvantages linked to gender, ethnicity, HIV/AIDS, sickness or old age, can result in the poor becoming caught in "poverty traps" from which it may be impossible to escape. In the absence of private insurance schemes and publicly provided safety nets, poor people tend to adopt livelihood strategies to manage and cope with the risks and vulnerabilities they face. While these strategies are understandable from a survival perspective, they may prevent poor people from fully participating in and benefiting from the opportunities that growth offers. Servicing the needs of the poor is unlikely to be a high priority for the insurance industry in developing countries but markets for risk insurance, for instance for drought and livestock, are grossly underdeveloped and this hinders pro-poor growth. Similarly, greater access to savings instruments could provide poor people with a buffer against adversity but could also lead to higher incomes, by enabling the poor to mitigate some risks.

Reforming institutions and policies to deliver pro-poor change

Institutions and policies result from the interaction of the state, the private sector and civil society. For example, governments exercise influence over the political economy of growth: who gets what and how. The private sector often focuses on how business-friendly institutions are; *i.e.* the incentives for entrepreneurship and investment. For many civil society organisations, the main concerns are the broader social and economic outcomes of growth. Institutions and policies develop as a result of compromises made by each party, depending on their respective strengths. Thus, the *status quo* reflects the current political settlement.

Reforming institutions and policies can involve difficult and time-consuming processes and require a careful mix of contestation and negotiation to overcome resistance to change. Structured and inclusive dialogue between the public and private sectors can facilitate such contestation and encourage monitoring by the private sector, which can help ensure that decisions made are implemented and can be modified if required. Three factors influence the impact that institutional and policy reforms may have on improving the enabling environment for pro-poor private sector development:

- The effectiveness of both private and public representative organisations and awareness at different levels (national, sub-national and local) of the real, practical and underlying issues that constrain pro-poor private sector development.
- The ability to transfer these issues to the appropriate decision making levels in both private and public sector organisations.
- The translation of constraints or issues into appropriate policies, plans and strategies to address and resolve them.

The poverty reduction strategy (PRS) process provides an opportunity to institutionalise engagement between different parts of society and to follow through on the implementation of the priorities set. However, PRSs do not always include benchmarks for private sector development, nor do they involve the private sector or civil society sufficiently in monitoring outcomes. To the extent possible, stakeholder engagement should bring in the views of beneficiaries, including the poor, to help influence the future course of action and thereby set in motion a process of improving institutions and policies.

The role of donors in promoting pro-poor private sector development

The emerging pro-poor private sector development agenda is more holistic, integrated and broader than the previous agenda, which often focussed on supporting private sector enterprises considered important for the livelihoods of the poor, particularly small enterprises and agribusinesses. Experience has shown some shortcomings with such interventions, including some that result in market distortion or poor sustainability through attempts to "pick winners" or to use public sector agencies or donors to provide services.

To increase the impact of private sector development on poverty reduction, donors should help to bring about systemic change that alters the incentives for the private sector (the risk-to-reward ratio), including by encouraging the public sector to foster a more conducive enabling environment. This is done by increasing the capacity of governments at all levels to promote pro-poor market outcomes and by supporting "change agents" within the public and private sectors and civil society. Systemic change is likely to involve a combination of institutional and policy changes aimed at accelerating the development of markets the poor need to improve their livelihoods.

Donors should regard private sector development as a major, if not central, part of the country assistance they provide. This may require development agencies to realign their approaches, introduce organisational changes and ensure that their incentive and evaluation systems do not work against staff pursuing longer-term, programmatic and possibly higher risk interventions with high potential impact. As in other domains, donors should co-ordinate their actions in order to promote complementarities and increase the combined impact of their interventions.

Main messages from Hot Topic papers

To provide more specific guidance to donors on increasing the leverage of private sector development on poverty reduction, the Development Assistance Committee's (DAC's) Network on Poverty Reduction considered six issues in greater depth (Chapters 1 to 6): *i)* removing barriers to formalisation; *ii)* implementing competition policy; *iii)* promoting the supply-side response; *iv)* improving the financial sector's contribution to pro-poor growth; *v)* enhancing women's market access; and *vi)* constructing inclusive public-private dialogue. These are Hot Topics because they are areas where there is a need for further reflection and better understanding, and where guidance can help donors achieve a larger pro-poor impact. The aim of the work is to provide some guidance in such strategic areas, rather than attempting to present comprehensive solutions.

This section introduces each Hot Topic paper by illustrating its relevance for pro-poor growth, outlining some of the challenges, debates and controversies and suggesting how donors can intervene.

Removing barriers to formalisation

The informal economy forms a large part of the economies of many developing countries and provides employment and income to many poor households, including those who lose or cannot find work in the formal economy. It includes a disproportionate number of women and people from disadvantaged groups. But informal economic activities are not a long-term solution to reducing poverty. Development of the formal private sector has the potential to create more stable jobs and to deliver sustainable growth and welfare. The benefits associated with formal enterprises and jobs include: better paid and higher quality jobs, increased investor confidence, a broader tax base, a reduction of the cash economy (with increased resources for intermediation by the formal financial sector) and a stronger social contract between citizens and their state.

The heterogeneity of the informal economy and varying donor emphases have created a variety of approaches to understanding and addressing the informal economy. Two potential conflicts have emerged: *i)* improving livelihoods within the informal economy while encouraging greater formalisation; and *ii)* improving employment conditions for informal economy workers while increasing the competitiveness of the local private sector.

By supporting efforts to reduce barriers in a number of domains, donors can help informal enterprises move along the continuum towards a greater degree of formality. These barriers include: regulatory and administrative hurdles, fees and financial requirements, corruption in public administration, socio-cultural attitudes, lack of key business services, and criminality. Initiating dialogue with participants in the informal economy is critical as it will help enable governments to understand the specific constraints that informal firms face and why there may be resistance to formalisation. While much is known about how barriers restrain private sector growth, there is little specific research on why firms do not formalise.

Implementing competition policy in developing countries

Competitive markets are not only more efficient in producing and distributing goods and services and in allocating resources, they are essential for markets to work better for the poor. Competitive markets are more likely to provide the poor with opportunities to be employed or to start their own business. The impact on developing countries of a lack of competition can also be significant. For example, research[4] suggests that 16 international cartels overcharged developing countries between USD 16 billion and USD 32 billion in 1997 and that prices fell by 20% to 40% following the break up of the cartel.

A competition policy and law may seem to be a luxury for developing countries short of finance and skilled people but the potential gains can be enormous. For small countries that are members of regional groups, a regional competition policy could enhance the impact of domestic laws. Also, there is no necessary conflict between a new competition law and existing industrial policy: well-designed competition and industrial policies can and should be complementary. Nevertheless, more empirical research on the effects of increasing the intensity of competition would be of value and could help decision making on how to sequence reforms that promote greater competition.

Donors can assist developing countries to adopt appropriate competition regimes. Technical assistance and capacity building should be targeted at formulating competition policy and strengthening the institutions responsible for enforcing the competition law.

Competition should be "mainstreamed" in all sectors in order to spread a culture of competition. In addition, to guide future actions, empirical research on the impact of competition policy and law in developing countries should be encouraged.

Promoting the supply-side response: Business development services and financial assistance

Improving the business environment in developing countries is not sufficient to spur sustainable, poverty reducing growth and needs to be accompanied by interventions to promote supply-side responses. Lack of access to various kinds of services is a critical constraint on the development of enterprises and improving firms' access to business development services is a core instrument for promoting income and employment generation for poor people. The same applies to financial services where a deepening of markets is an important element in many programmes aimed at stimulating pro-poor growth.

The key challenge for donors is to find the right balance between providing subsidised or even free goods and services, which can deliver short-term outcomes, and supporting more market-driven and sustainable approaches. While there is now a consensus among donors on the need to move towards more market-oriented approaches, opinions differ on how to do this in practice. For example, although there is recognition that market-based approaches have limitations, there are different assessments of the appropriate criteria for diagnosing such situations and of the measures to take when markets fail.

To avoid causing market distortions, donors should apply the following criteria when providing support to firms: focus on the causes of problems, promote a level playing field, avoid or minimise subsidies (which should be provided to end users), apply output-based aid principles and have a clear exit strategy. There may be situations when, in the short-term, market development approaches are not applicable, especially in post-conflict situations or after natural disasters, but donors should nonetheless expect to shift gradually to a market-based approach that aims to rebuild the supporting institutional environment for the private sector.

The financial sector's contribution to pro-poor growth

The financial sector can have a direct impact on poverty reduction in two ways. First, a well-developed financial sector can provide the poor with access to a larger array of financial services, such as payment instruments, saving facilities, credit and insurance. Second, a sound financial sector reassures private investors and creates opportunities for investments to provide basic services to the poor. There are also indirect benefits including maintaining economic stability, securing financial transactions, mobilising external and domestic savings and improving the efficient allocation of capital.

Donors have tended to adopt two approaches to developing sound financial markets. Some have given priority to actions related to the enabling environment and institutions for the development and deepening of the financial sector. Others consider that direct interventions cannot be discarded, provided precautions are taken to avoid market distortions, and have sponsored direct interventions as well, by providing credit lines to banks and microfinance institutions or funding guarantee schemes.

When designing strategies for financial sector development, donors should encourage and help developing country governments to collect data on access to financial services, improve the capabilities of supervisory and regulatory authorities, strengthen financial

intermediaries, support prudent mobilisation of savings and remittances, bridge the gap between banks and microfinance institutions and include financial sector issues in PRSP documents.

Enhancing women's market access

Gender-specific exclusions and inequalities – stemming mostly from biases, social norms, prohibitions and gender division of labour – disadvantage women and girls. As a result, lower investments are made in the human capital of women and girls and their access to labour, financial, goods and services markets is limited. This jeopardises any effort to spread the benefits of growth among the poorest and so severely hinders the effectiveness of institutional and policy reforms aimed at promoting pro-poor growth.

An entitlements approach focuses on increasing women's access to resources and inputs that enable women to enter markets, raise their productivity or scale up their existing activities (micro-credit is an example). Capabilities projects provide resources and services that increase women's ability to deploy their existing resources or enter new markets (training and workforce development projects are an example). Donors need to be flexible in helping partners design and implement interventions with an appropriate mix and sequence of approaches. These depend on various context and country-specific circumstances that need to be analysed and considered in each case.

At the policy level, donors should promote the emergence of a conducive enabling environment by supporting policies that remove or ameliorate structural barriers to women's participation in markets. Gender analysis tools should be applied when developing interventions for private sector development to ensure that women's roles as consumers, workers, entrepreneurs and social actors are taken into account.

Constructing inclusive public-private dialogue

Public-private dialogue brings different stakeholders together to identify policies and institutional reforms that can promote private sector development. Well-organised public-private dialogue can allow the poor to voice their needs and concerns and ensure that local-level issues are fed into higher-level policy process, including the preparation of national poverty reduction strategies.

Public-private dialogues can make an effective contribution to private sector development if they involve well-organised, capable and accountable private sector organisations and participants that are committed to the process and are able to contribute effectively. The inclusion of a third, neutral party may facilitate such processes.

Special efforts should be directed at helping poor entrepreneurs to participate in dialogue processes and promote their interests. To do so, donors can support the emergence and strengthening of private sector organisations at national, sub-national and local levels that represent the interests of micro and small entrepreneurs and of informal firms and workers. However, donors should stay clear of imposing their own agendas on dialogue processes or of creating situations where participants respond more to donors' priorities than to those of their own constituencies.

Policy implications for donors

Donors seeking to increase the leverage of private sector development on reducing poverty can pursue a range of issues as part of their policy dialogue with partner countries,

setting priorities and determining an appropriate sequence based on an analysis of the local context. Donors can also examine their own organisational arrangements and internal practices to determine whether some realignment may be needed to be better able to increase the impact of their private sector development activities on poverty reduction.

The analytical framework and Hot Topic papers point to a number of policy recommendations that donors may wish to take account of. Practice and experience to date show that the following general approaches tend to bring about more sustainable and pro-poor outcomes in private sector development:

i) **Encourage entrepreneurship and investment by lowering the risk and costs of doing business.** Low entry and exit barriers, predictable rules of exchange, secure and transferable property rights, enforceability of contracts and a lower level of corruption are conditions under which entrepreneurship and investment can produce better and more pro-poor outcomes.

ii) **Work to identify and unlock the potential for economic development in sectors and regions where the poor are concentrated.** Too often investment is lacking in regions and sectors that are too readily considered to be marginal or as having low potential, perhaps due to poor infrastructure or a lack of innovations that allow resources to be exploited in a more profitable or sustainable way. Focusing on such potential will increase the pro-poor impact of more general institutional and policy reforms and increase the prospects for poor people to grow out of poverty, including by finding new opportunities that are either outside or only partially linked to a sector or a region.

iii) **Remove barriers to formalisation.** The development of the formal private sector has more potential to deliver sustainable pro-poor growth as formal businesses have improved access to the resources that will enable their business to grow.

iv) **Advocate the use of market-based approaches as a way to address obstacles to market development and avoid the risks related to providing direct support to firms. In the design and delivery of business and financial services aimed at building up the economic capacities of the poor, focus on value chains and clusters.** Capacity building should follow an approach that helps the poor to help themselves, focuses on facilitating the development of markets in business services and commercial credit and targets value chains that provide opportunities for poor men and women. Sector-wide approaches and assistance with building up the power base of the poor in value chains and clusters have the potential to address issues and constraints at macro, meso and micro levels, resulting in systemic change.

v) **Promote competitive markets for poor consumers, with the support of a clearly defined competition law and policy.** A culture of competition, especially if supported by a competition law and policy, will facilitate well-functioning markets; and help include the poor in these markets and attract FDI more effectively. Competition will also lower the costs of doing business by stemming anti-competitive practices in the economy.

vi) **Strengthen the functioning of natural resource markets by improving legal, regulatory and administrative frameworks.** Ensuring secure and transferable ownership rights to land and work premises, in rural and urban areas, and expand access to other natural resources (such as forests, marine and inland fisheries). Enhancing transparency in land planning and promoting easy and inexpensive access to land and property registries will spur entrepreneurship and investment and expand access to capital markets, while also reducing risk and vulnerability.

vii) **Promote deeper and more competitive financial markets so as to support private sector development, enhance the productivity of other factors of production and mitigate the risk and vulnerability of the poor in case of shocks.** Access to finance and diversified financial instruments are crucial for providing incentives for entrepreneurship and investment, increasing productivity, capturing the benefits of trade liberalisation and FDI linkages and reducing risk and the vulnerability of the poor. Integration of microfinance institutions into the mainstream banking system, disaster insurance and insurance against shocks, new savings instruments and flexible delivery mechanisms can better address the risk mitigation needs of the poor, improve access of the poor to capital and increase resources available for further financial intermediation.

viii) **Advocate the use of gender analysis tools in development programmes.** Failure to focus on women's market access reduces the effectiveness of policies to promote pro-poor growth. Gender-disaggregated value chain analysis that identifies opportunities to strengthen women's participation in markets can help in unleashing women's potential to contribute to the generation of significant pro-poor outcomes.

ix) **Encourage private provision of basic services and infrastructure to the poor through public-private partnerships.** This can be done by strengthening the capacity of developing countries to provide the necessary legal, regulatory and administrative frameworks for the establishment and smooth functioning of public-private partnerships at national and local levels.

In dialogue and work with developing country governments, the following additional aspects are important to consider:

i) **Mainstream strategies for private sector development for pro-poor growth into national development frameworks such as national development plans and poverty reduction strategies (PRS).** Without substantial reductions in income poverty, governments will most likely be handicapped in implementing sustainable poverty reduction strategies for improving the human, political, and socio-cultural conditions of the poor, and reducing their risks and vulnerability.

ii) **Link and, to the extent possible, merge private sector development programmes and governance programmes under a comprehensive strategy,** since private sector development and governance reforms and administrative improvements are interlinked. A more holistic approach is likely to contribute to the creation of mutual trust and bridge the cultural gap between the public and private sectors. A holistic approach will also be more efficient in respect of resource utilisation on the part of the government, donors and other concerned stakeholders.

iii) **Facilitate structured, inclusive and effective public-private dialogue processes, as a key element in successful institutional reform. Organise it at national, sub-national and local levels, as well as between these levels, and sequence reforms.** The political economy of reform processes necessitates high quality and inclusive stakeholder dialogue and the building up of constituencies. To date, neither poverty reduction efforts nor private sector development strategies have taken sufficient account of the poor as part of the private sector. Unless structured and inclusive dialogue is established at all levels and between them, conditions enabling pro-poor growth may not receive sufficient consideration in private sector development and governance programmes. To help decrease vulnerability and build up coalitions around reform, the sequencing of reform processes is important.

iv) **Build capacities within stakeholder groups to organise themselves, to analyse key constraints, to participate in policy dialogue and monitoring of results and to advocate and negotiate systemic change.** Both the public and private sectors lack capacity to analyse issues and constraints and to identify appropriate responses to foster pro-poor growth. Capacity building within the public sector, including at local levels, is essential since obstacles to an enabling environment may also need to be resolved by local government officials. Governments should allocate requisite capital and operational budgets to set up administrative systems and train civil servants at national, sub-national and local levels. Private sector representative organisations also need capacity building in evidence-based advocacy and monitoring of results.

To improve donors' approaches and enable them to increase the leverage of their private sector development activities on poverty reduction, the following recommendations are offered:

i) **Integrate private sector development as a central theme of donors' country strategies,** combining economic and governance reform, support for private sector development and livelihoods, and risk and vulnerability interventions under a common framework.

ii) **Employ a programmatic approach,** while incorporating sufficient flexibility for implementing innovative and experimental interventions; include an exit strategy that allows ownership from the core of public and private sector entities themselves.

iii) **Consider the merits of longer-term interventions,** as reforming institutions and policies and enabling them to take root in practice requires time.

iv) **Improve and formalise donor co-ordination, alignment and harmonisation mechanisms,** to prevent overlap, omissions and conflicting programmes. Consolidate and share lessons learnt and best practices generated and contribute to commonly shared toolkits.

v) **Consider organisational changes** to facilitate co-ordination of the work of sector and skill departments within the development agency. Build up analytical capacity in related areas including governance, gender and the environment.

Notes

1. Institutions consist of the rules of the game and the governance exercised over them. They include social norms and values, rules and informal communication processes and are, to a large extent, determined by many historical and societal factors.
2. This report is available on the Internet at: *www.oecd.org/dataoecd/53/21/34055384.pdf*.
3. Guidance on some other important issues is also available from other sources. For example, for guidance related to business development services, see the "Blue Book" published by the Committee of Donor Agencies for Small Enterprise Development (*www.sedonors.org/resources/item.asp?resourceid=1*). For guidance related to microfinance, see the "Key Principles" developed by the Consultative Group to Assist the Poor (*http://cgap.org/keyprinciples.html*).
4. Levenstein, M.C. and V.Y. Suslow (2001), Private International Cartels and their Effects on Developing Countries, Background paper for the World Bank's *World Development Report 2001*.

Hot Topic Papers

To provide more specific guidance to donors on using official development assistance more effectively to increase the impact on private sector development on poverty reduction, the DAC has explored six Hot Topics in greater depth: i) *removing barriers to formalisation;* ii) *implementing competition policy;* iii) *promoting the supply-side response;* iv) *the financial sector's contribution to pro-poor growth;* v) *enhancing women's market access; and vi) constructing inclusive public-private dialogue. This series of topics is not exhaustive – some other essential subjects such as trade and labour markets are not covered – but it does include areas where donors can have a large pro-poor impact, where there is a need for further reflection and where better understanding will benefit the DAC, as well as the donor community more broadly. The Hot Topic papers are anchored in and build on the analytical framework "Accelerating Pro-Poor Growth through Support for Private Sector Development".*

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PART II

Chapter 6

Removing Barriers to Formalisation

What is the issue and why is it important?

The informal economy forms a large part of the economies of many developing and transition countries. It comprises 42% of value added in Africa, 41% in Latin America and 35% in the transition economies of Europe and the former Soviet Union, compared with 13.5% in OECD countries. The informal economy provides employment and income for many who lose or cannot find work in the formal economy, and it includes a disproportionate number of women, young people and others from disadvantaged groups. For example, it has been estimated that informal employment accounts for 84% of women's employment in sub-Saharan Africa.

There is a continuum between informality and formality, with formalisation being a gradual process. Few firms follow all the rules governing enterprise behaviour and few follow none of them. Entrepreneurs make repeated economic calculations of the costs and benefits of following the rules, and embrace formality up to the point where the potential benefits outweigh the costs.

In the long term, informality does not provide a solution for poverty eradication. Countries with the highest *per capita* income have smaller informal sectors, while poorer countries have higher informal economy shares of total output. Thus, while informal enterprises may provide a short-term solution to a household's livelihood needs, creating an economy with a higher proportion of formal enterprises and jobs is important to long-term welfare creation, stability and poverty reduction.

While formalisation by itself does not promote enterprise growth in the short run, bringing more enterprises into the formal economy over the long term should:

i) Provide higher quality, better paid, more sustainable jobs.

ii) Reinforce the social contract between citizens and their state.

iii) Strengthen the reliability of agreements between firms.

iv) Build investor confidence (and increase investment).

v) Broaden the tax base (potentially permitting lower tax rates).

vi) Increase information on local enterprises to facilitate deal-making and strengthen frameworks for policy advocacy.

vii) Reduce the cash economy and provide more resources for intermediation by the formal financial sector.

viii) Improve access to business services, formal markets and productive resources such as capital and land.

Formalisation may also increase welfare in some marginalised groups by confirming their right to take advantage of market opportunities.

There is a growing body of research on business environments and their effects on economic growth and investment. Many donors sponsor research and interventions involving informal economy enterprises. However, few studies and projects focus

specifically on barriers to formalisation. The general assumption is that improving the enabling environment for all micro, small and medium-sized enterprises (MSMEs) will help informal firms move towards greater formality. This paper examines what has been learned about the main barriers to formalisation of enterprises and what good practice examples exist for reducing these barriers.

The current evidence: Informality, economic development and growth

The "Doing Business" initiative of the International Finance Corporation is generating benchmarks and indicators for different aspects of the business environment world-wide. Its 2005 report contains data for 145 economies on starting a business, hiring and firing workers, registering property and getting credit. Countries performing better in these areas (simpler procedures, shorter waits and lower costs, etc.) have smaller informal economies. Complementary statistical analysis has shown, however, that no single indicator is a key factor in promoting formalisation. This is because countries that did well in one aspect of the business environment also did well in others, *e.g.* countries with high business start-up costs also had high worker dismissal costs. The effects of the various factors are therefore difficult to untangle statistically.

Barriers to formality from the entrepreneur's perspective

Much of the available research focuses on barriers to growth in informal and smaller enterprises, rather than on the actual formalisation decision. Nonetheless, it is reasonable to infer from the research that some barriers to growth, *i.e.* those that impact on the smallest enterprises, are likely to correlate with barriers to formalisation. The sub-set of material on barriers to formalisation supports this, with regulatory and administrative barriers standing out as a particular concern. Barriers to formalisation fall into several categories including: *i)* regulatory barriers; *ii)* administrative barriers; *iii)* fees and financial requirements; *iv)* corruption in public administration; *v)* socio-cultural attitudes; *vi)* lack of key business services; and *vii)* criminality. There is a strong global body of evidence to suggest that regulatory, administrative and financial barriers, along with corruption, have the most direct influence on the formalisation decision. Reducing these barriers will help informal enterprises move along the continuum towards a greater degree of formality.

i) **Regulatory barriers** are inappropriate requirements stemming from governments that do not appreciate the impact on firms (particularly smaller firms) of additional reporting, inspection and other compliance procedures. The time entrepreneurs require to maintain and grow their business is not valued. Various studies have identified burdensome and costly government regulation as the most significant determinant of informality, and as a source of corruption. In general, years of poor quality law-making in developing countries have created a tangle of complexity and inconsistency that presents an almost insurmountable obstacle to the enterprises seeking formality. Regulatory (and administrative) burdens have a strong cumulative effect on the business environment.

ii) **Administrative barriers** stem from the way regulations are enforced. They include: excessive paperwork, inefficiency/delayed decisions, inaccessibility of services, bureaucratic obstruction and abuse of authority. These barriers have many sources, including over-complicated regulations, out-dated ways of working, lack of capacity, over-centralisation of authority, distrust of the private sector and – linked to all of this – corruption. In many countries, little effort has been made to raise awareness among

public servants of the private sector's needs, nor to create a more service-oriented culture with respect to entrepreneurs (as opposed to a culture that sees its role as one of control and enforcement).

iii) **Fees and financial requirements** consist of regressive fees that penalise smaller firms, overly complex tax regulations and poor tax and tariff administration. In a number of countries, initial business registration and licensing fees are set at too high a level. Informal enterprises shy away from joining tax regimes for other reasons: they are worried about tax levels; they do not understand how to comply with tax requirements; they fear the behaviour of revenue officials; or they do not believe they will receive services in return for payment. Unfortunately, little work on improving tax administration focuses closely enough on the informal economy to understand which of these obstacles are more problematic and in need of attention. Too little tax reform work considers alternative, more indirect approaches to income-based taxation, which is a burden to smaller firms.

Financial barriers are integrally entwined with regulatory and administrative barriers related to the general registration of business activity and licensing for operations in specific sectors. The main registration obstacles are excessive costs and time spent dealing with bureaucracy. Registration and licensing become confused in some developing countries: registration should be a straightforward administrative process with little discretion involved, but it often takes on aspects of sector-specific licensing, such as site visits, annual re-licensing and review by committee of the application. This can act as a significant disincentive to registration. Some countries use "licences" as a primary means of annual revenue collection for local authorities (as in East Africa). In a number of countries, entrepreneurs must travel to the capital or other distant towns to conduct these procedures.

Informality is one way of avoiding labour laws and their associated costs (social insurance, etc.). In many countries businesses face major hurdles in taking on their first "formal" employee. The additional costs related to labour regulations are estimated to be the most important disincentive to participating in the formal economy for small firms in Latin America.[1] Overly rigid labour laws often hurt the people they are meant to protect, keeping employees in the informal economy and inhibiting economic growth that could create new jobs.

iv) **Corruption** is a major factor deterring formalisation, as businesses stay off registers and tax rolls in order to minimise contact with corrupt public officials. A study of 69 countries found a direct link between decreases in corruption and increases in the size of the formal economy. Corruption erodes the trust that businesses have in government and leads informal businesses to conclude that their long-term prospects in the formal economy are poor. Therefore, efforts to reduce barriers to growth and formalisation will be thwarted if corruption is not also tackled. Reducing and simplifying regulatory and administrative requirements diminishes opportunities for corruption, but this also explains why there can be a reluctance to pursue such reforms.

v) **Socio-cultural barriers.** In some countries, there is a degree of resistance to formalising because of socio-cultural obstacles. The informal economy comprises strong networks of trust and interdependence, often cemented by collective historical experience, *e.g.* of oppression or social exclusion. When an informal entrepreneur has a history of

successful trade with other informal entrepreneurs in the same social group, the motivation to formalise can be lacking. In some failed or very weak states, the informal economy is entrenched and has had, for many years, to self-regulate and carry out many of the functions of the state.

vi) **Lack of key business services.** Some argue that having more services (finance, registration of land titles, infrastructure, public procurement opportunities, management support, etc.) available for formal businesses attracts informal enterprises into the formal economy. Increasing the potential benefits for formal enterprises might correspondingly increase tolerance for the compliance costs of rules and regulations. This hypothesis is compelling. Unfortunately, it is virtually impossible to prove. Whether or not formalisation has been an explicit goal of services improvement, most monitoring and evaluation of the new services did not consider their impact on formalisation, focusing instead on business income, job creation and other quality-of-life and work improvements. What little evidence could be found raises some doubts as to the strength of a service-driven formalisation motive.

vii) **Criminality.** Some individuals are reluctant to provide information about their personal wealth and circumstances to government officials, because they are concerned that this information may be passed to people involved in serious and organised crime and make them targets for criminal activity.

Knowledge gaps and different approaches to informality

While much is known about how barriers restrain private sector growth both in the formal and informal economies, there is little specific research into why firms do not formalise. Understanding is limited of which barriers are the most significant and how they impact on the decision-making process, although much can be deduced from surveys of general barriers to growth. Nor does the research have much to say about the links between formalisation and enterprise performance, or about short-term *versus* long-term effects.[2] There is scope for further primary research in these and other areas.

The informal economy is complex and donor interventions should be based on sound research. There is a risk of making false assumptions. For example, research and interviews with donors revealed a predominant view that many informal economy workers would prefer to return to formal waged employment as soon as it became available. However, there is credible evidence to suggest that this is not necessarily the case: in a recent survey in South Africa, the majority of informal sector respondents indicated that they would prefer to remain in business rather than take a job if one were available. Another recent survey of women entrepreneurs in the MSME sector in Ethiopia found that three out of four would not forego their current businesses if offered a permanent job elsewhere.

The heterogeneity of the informal economy and varying donor emphases have created a variety of approaches to understanding and addressing the informal economy. Two potential conflicts have emerged:

i) **Improving livelihoods within the informal economy while encouraging formalisation.** Some researchers and donor programmes view the informal economy as a long-term, structural feature of modern economic development. Given this, some interventions are aimed at improving the welfare of the people who find themselves in the informal economy, rather than helping them to formalise. Other donor interventions consider formalised economic growth to be a central goal of development and a primary driver of

poverty reduction. These are accordingly focused on encouraging formal economy growth. In between these two views, there is a place for interventions that help actors in the informal economy to take gradual steps in the formalisation process, for instance by creating associations with a formal status to facilitate access to such services as micro-credit, insurance, land tenure and physical market places. The challenge is to determine how interventions can be devised that improve the livelihoods of the poor while not removing incentives to formalisation.

ii) ***Improving employment conditions for informal economy workers versus increasing competitiveness of the local private sector.*** Some approaches view the informal economy from a labour-market perspective and look for ways to reduce employment deficits and to improve the quality of formal work opportunities. This approach has the potential to conflict with approaches that emphasise the competitiveness of informal economy enterprises, the need for workforce flexibility to maintain comparative advantage and the need to keep employment law compliance burdens to a sensible minimum. The relatively new "Decent Work" approach seeks to strike a carefully constructed balance between helping enterprises grow while also promoting improved work conditions, but its impact is not yet well understood.

Good practice in removing barriers to formalisation

There are a number of ways of trying to reduce informality. The following is a summary of current donor good practice in reducing regulatory and administrative barriers to formalisation:

i) **Support broad programmes of regulatory reform. Introduce Regulatory Impact Assessments.** Institute programmes of reform that examine regulatory burdens from the enterprise point of view. Programmes should be informed by surveys of the barriers of most concern to enterprises, including those that are identified as barriers to formalisation. Choose sectors according to their capacity to generate growth and employment. New laws should be subject to assessments of their impact on MSMEs, including the formalisation decision.

ii) **Design measures to create a business-friendly culture in government and to improve service provision.** Even without significant increases in resources, there are steps that can be taken to improve the delivery of services to business by government. Donors should support efforts to create service charters in ministries and local administrations. They should also support one-stop shops in accessible locations to help firms understand and comply with their obligations and play an intermediary role between enterprises and government services, pressing the latter to improve service delivery when necessary.

iii) **Simplify official administration for businesses.** Review and reduce paperwork for businesses and make use of information technology (IT) where possible. Keep official forms to a minimum. Consider exemptions for smaller firms, or more appropriate thresholds for entering into regulatory regimes.

iv) **Avoid retroactive taxation for businesses that formalise.** Enterprises will be reluctant to formalise if they fear a large tax bill.

v) **Simplify tax administration.** Tax administration is more often cited as a problem than tax rates. Consider single taxes for MSMEs as a way of reducing the number of payments. Offer different payment options, one-off or by instalment.

vi) **Share information on what taxes are used for,** and how businesses will benefit from enhanced services. Evidence suggests that compliance rates go up when businesses know what they are getting in return for their payments.

vii) **Rationalise business registration and licensing regimes.** Make registration a simple, administrative process that is separate from licensing. Use IT where possible. Separate the function of revenue generation from business registration and licensing. Remove registration from (usually overburdened) courts wherever possible.

viii) **Limit licensing to those activities where it is justified** on health, safety, environmental or other grounds. Avoid multiple licences and make it easier to submit applications. Eliminate licensing for as many firms as possible.

ix) **Make it easier to register business and producer associations.** Socio-cultural traditions can be transformed from barriers to opportunities through the formalisation of business or producers' associations. Whilst barriers to formalisation may seem insurmountable to individuals, it may be easier to encourage the formalisation of such producer groups and, through them, to make the benefits of formalisation available to individuals.

x) **Reduce registration fees and statutory requirements.** Make sure that fees are set at a reasonable level and that any requirements, *e.g.* for fixed premises or capital, are fully justified.

xi) **Promote labour law reform** which protects essential rights while making it easier to hire and fire workers and to employ people on flexible contracts.

In addition to these micro-level reforms, four higher-level business environment reforms are important to support efforts to encourage formalisation:

i) Initiating dialogue with participants in the informal economy, in order to understand their constraints (including resistance to formalisation), is vital. Town hall meetings, radio talk shows and focus groups are just some of the ways that have been used to include the informal economy in policy making.

ii) There are decentralisation initiatives underway in many parts of the world; evidence suggests however that many local authorities are ill-equipped to undertake greater responsibilities and that they do not understand the needs of informal entrepreneurs. Worse, some local authorities view enterprises primarily as a source of short-term revenue. Donors can support programmes that build the capacity of local government to support improved services to business, enterprise growth and formalisation.

iii) Efforts to tackle corruption are likely to have a significant impact on restoring entrepreneurs' confidence in public administration and their willingness to formalise.

iv) The potential for misunderstandings around issues of informality speaks to the need for donors to co-ordinate their activities in this area, permitting a complementary, gradualist approach to formalisation.

Policy and practice recommendations for donors

In addition to the specific recommendations aimed at removing barriers and at supporting measures, a number of policy and practice recommendations for donors emerge:

i) Develop a commonly shared toolkit that encompasses the full range of successful donor interventions that have an impact on formalisation.

ii) Promote formalisation by creating a regulatory environment that is generally enabling.

iii) At the same time, work with willing partners to remove barriers to enterprise growth and formalisation at local level. Wholesale legal reform is not always possible, but progress can still be made to streamline administration (as through one-stop shops).

iv) Support measures to reduce corruption at the main interfaces between government and business in the process of formalisation (particularly in registration and licensing procedures).

v) Educate government officials at local and national levels about the importance of the informal economy and the role they can play in increasing formalisation by offering improved services. Demonstrate that facilitating long-term growth of the tax base is preferable to extracting short-term gains and encouraging firms to hide their activities.

vi) Ensure that programmes to increase welfare in the informal economy do not reduce incentives to formalise. In return for assistance, require a *quid pro quo* from informal enterprises in terms of movement towards formalisation.

vii) Support dialogue between government and informal enterprises (or their associations) to reveal barriers to formalisation and build trust and understanding on both sides.

viii) Consider the merits of longer-term interventions, such as reforming regulatory and administrative barriers; changing the culture of government takes time. Where longer-term interventions are not possible, adopt more modest and targeted objectives.

ix) Assess the capacity of local governments to implement policies to reduce barriers to formalisation and take steps to plug gaps between centrally-approved initiatives and local capabilities.

x) Undertake and share further research on the impact of reforms to the enabling environment on formalisation.

Notes

1. See Tokman (1992). The IDB also estimated that restrictive labour laws accounted for a 6% increase in the informal sector share of total employment in Latin America between 1990 and 1996 (cited in Krebsbach, Karen, *Global Finance*, 1999).
2. There certainly are cases where the costs of formalisation have reduced enterprise profits in the short run, and there are cases where investment climates are improving but informal economies continue to grow in the short run. However, there is no denying the strong correlation between proportion of GDP in the formal economy and overall economic well-being of countries, as cited at the beginning of this paper.

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PART II

Chapter 7

Implementing Competition Policy in Developing Countries

Why is the topic important for pro-poor growth?

Achieving the Millennium Development Goals requires rapid and sustained growth in developing countries. It is now widely accepted that the private sector must be the engine of growth, and that governments must create environments that allow the private sector to flourish.

Competition is essential if markets are to work well for the poor. When firms have to compete vigorously, they must find better ways to produce and distribute goods and services. Competition benefits consumers both directly, through lower prices, better quality and an improved choice of products, and indirectly, through its impact on economic growth. As women constitute a larger share of very poor people, women especially will benefit from the impetus given to growth by the existence of competitive markets.

The provision of services by central and local governments contributes significantly to the welfare of the poor. Competition is important for the effectiveness of government procurement (for example, in the provision of rural infrastructure), as anti-competitive practices by suppliers will reduce what governments can achieve with the funds available.

Jobs are an important route to poverty reduction. Competitive markets are more likely to provide the poor with opportunities to be employed or to start their own small business. These opportunities include export-oriented industries. "Competitiveness" is not synonymous with "competition", but firms and sectors are far more likely to be competitive internationally if they operate within competitive domestic markets.

Competitive domestic markets benefit farmers. They will be in a more favourable position if the markets in which they buy their inputs, arrange transport of their crops to market and sell their outputs are competitive.

The analytical framework "Accelerating Pro-Poor Growth through Support for Private Sector Development" reflects the importance of competition policy to the poor. It discusses the effects of entry and exit barriers to entrepreneurship and the contribution made by competition to innovation and productivity.

Such views are complemented by a growing body of evidence on the link between growth and poverty reduction. The World Bank's *World Development Report 2005* emphasised the importance of competition for investment and noted how competitive pressure leads to innovation, new products and new technology. When it released *Asian Development Outlook 2005* in April 2005, the Asian Development Bank headlined its view that effective competition policies are needed "if Asian countries are to maintain their high rates of growth and employment".

The existence of competition policy reduces uncertainty for business and is an important element of a good regulatory package for private sector development. There are also indications that, by reducing the scope for arbitrary decisions by officials, competition law reduces the scope for corruption, which hurts the poor. However, given the practical implications of transition, it will also be necessary to adopt measures to assist any groups adversely affected by such changes.

Competition policy, including competition law, is needed because markets do not always work well. Anticompetitive actions by firms are one cause, but inappropriate regulations by national, state and local governments are also frequent causes of market failure.

What do we know so far and what do we still need to know?

There is a widely held view that competition policy makes a positive contribution to economic growth. An OECD paper, based on a survey of members and invited non-members who participated in the 2002 Global Forum on Competition, concluded that: "There are strong links between competition policy and numerous basic pillars of economic development … There is persuasive evidence from all over the world confirming that rising levels of competition have been unambiguously associated with increased economic growth, productivity, investment and increased average living standards".

Competitive markets allow new firms to enter, efficient firms to thrive and sub-standard firms to fail and exit. An OECD study of 53 countries conducted in 2002 found a strong correlation between the effectiveness of competition policy and growth (Dutz and Hayri, 2002). In 1999, the Australian Productivity Commission found that its National Competition Policy reforms mean that "national output [is] … 2.5% higher than otherwise – an amount equivalent to almost one year of economic growth". This estimate did not include the dynamic efficiency gains also expected to flow from the competition reforms.

There is increasing information on the harm anti-competitive practices in both national and international markets can do to developing countries. Examples of domestic anti-competitive practices that especially affect the poor include:

i) Ring tendering for polythene pipe supplied to the Nepal Drinking Water Corporation,[1] and for school construction in China.[2]

ii) Flower exports from Morocco being made uncompetitive by the combined effects of a trucking cartel, a freight forwarding cartel and compulsory use of the national airline.[3]

iii) Cartels of companies buying tea, sugar and tobacco forcing down returns to farmers in Malawi,[4] and cartels for retail sales of flour, bread and poultry affecting retail prices in Peru.[5]

iv) "Bundling"[6] by dominant firms, such as the action of a gas company in south-western India forcing new customers to buy hot plates when they were connected to the gas supply.[7]

Studies of international cartels investigated by the European Commission and United States competition authorities illustrate their large impact on poor countries. The World Bank's *Global Economic Prospects 2003* noted that six international cartels overcharged developing countries by USD 3 to USD 7 billion in the 1990s. A 2001 paper[8] estimated that 16 international cartels overcharged developing countries by between USD 16 and USD 32 billion in 1997 and found that prices fell by 20% to 40% following the break up of the cartels. A study of cartels for aluminium, steel and heavy electrical equipment estimated that they had overcharged Kenya by USD 111 million, Zimbabwe by USD 141 million and Southern African Customs Union members by USD 1.1 billion in 1999.[9] A study of one major cartel (vitamins) found that suppliers had overcharged developing countries that lacked a competition law by more than countries that had such a law.[10]

Much has been written by economists on the harmful effects of monopoly on prices, output and consumer welfare. However, there has been little empirical research into the impact of competition policy on national economies and very little on the impacts on developing countries.

There are several possible reasons for this, including limits on the availability of data. Most developing countries have a relatively short history of competition law. Countries that have adopted competition laws since about 1990 often accompanied it with other significant policy changes including privatisation, deregulation and trade liberalisation. Separating the effects of these policies is a challenge.

In the case of transitional economies, the appropriate sequencing of policy changes, including the introduction of competition, is of great importance. The experiences of Russia and Syria, for example, highlight the need for better understanding of how to introduce competition to transitional economies.

More empirical research on the harm caused to developing countries by inadequate competition, and on the effects of increasing the intensity of competition through the adoption of competition policy and law, would be of value.

Developing countries are short of finance and skilled people and must choose carefully how to use them to their best advantage. For small countries that are members of regional groups, a regional competition law could enhance the impact of the domestic law. Co-operation arrangements with developed countries could provide help with staff training through exchange programmes and information exchanges.

What are the big controversies?

Competition policy and law is still new in much of the world and there are a few areas of controversy. The main ones seem to be:

Does every country need a competition law?

Some people argue that if a country is open to trade and investment, it does not need a competition law. Openness to trade and investment can have large and beneficial impacts on competition. However, foreign investment can bring heightened concern in developing countries about competition and, in any case, some goods and services cannot be traded internationally. Competition policy and law can benefit all countries, whatever their size and level of development, but the law must be appropriate to their needs.

What is the right relationship between competition law and sector regulators?

Sector regulators are required where competition cannot work effectively, such as with natural monopolies. Regulated sectors generally include major public utilities that are important for consumer welfare. Decisions made by sector regulators include technical issues and pricing or profit ceilings. However, some decisions by regulators are on matters that affect competition. In these cases, their decisions should reflect competition principles. If not, there can be distortions in the use of national resources that can harm consumers, including the poor.

Does having a competition law mean developing countries cannot have an industrial policy?

Every national competition law includes some allowances for national priorities, and there is no necessary conflict between competition and industrial policy. Well-designed policies can be complementary. The "Development Box" approach in the World Trade Organization (WTO) arrangements is relevant not only for industry, but also for agriculture.

How should the introduction of competition policy, including its enforcement structure, be sequenced?

There are specific constraints that are characteristic of the degree of development of an economy, and of its society as a whole. There is a need to investigate the extent to which a blueprint approach can be used to address the question of sequencing.

What sort of policy implications and suggestions for donors can we give?

The overall policy implication for donors is the need to recognise the contribution that effective competition can make to the welfare of the poor. As the 2001 Nobel Prize winner Joseph Stiglitz said: "Strong competition policy is not just a luxury to be enjoyed by rich countries, but a real necessity for those striving to create democratic market economies".

Increasingly, developing countries want to adopt appropriate competition regimes, but need help. Specific national issues must be identified clearly and the analysis of what help is appropriate requires close attention. In providing the help needed, it is desirable that donors harmonise their activities to avoid the possibility of duplication or of leaving gaps. There is significant scope for additional support from donors in four major areas:

Policy research to build and disseminate the evidence base

More empirical research on the impact of competition policy and law in developing countries, as well as on best practice, would be of considerable value. Worthwhile areas for research include the four areas of controversy previously mentioned.

Culture of competition

A "culture of competition" is where the rules and benefits of competition are widely known and form a natural part of the background for decisions by firms and governments. Building a culture of competition and an effective competition regime is a long-term endeavour, and not just a matter for one-off events. Competition must be "mainstreamed" in all sectors.

Advocacy is needed for a new competition regime to succeed. Politicians and officials need to understand why competition is good for the economy, and how to apply its principles to government decisions. There is a need to overcome opposition from the business sector by emphasising the benefits competition law can provide, such as cheaper inputs and the contribution competition law and policy can make to creating a good pro-investment climate.

Some NGOs, especially consumer groups, can be strong allies for competition policy and law because they know how it can benefit consumers. Donors could find it effective to fund relevant work by reform-minded NGOs, especially those based in developing countries. For example, the UK Department for International Development (DFID) has funded research and advocacy programmes (such as the Consumer Unity and Trust Society

[CUTS] 7-Up projects)[11] that include participation by local consumer groups, and has funded the preparation of materials by Consumers International for use by consumer organisations.

Bilateral technical assistance and capacity building

Help is needed in formulating a competition policy and law, and in developing and strengthening the institutions that will enforce the competition law, including the training of specialist staff. Assistance can be provided by funding training programmes organised by the competition authority in the donor's country, including staff exchanges, and by funding studies of barriers to competition in important sectors of the economy.

There is scope for donors to support proposals for roundtable forums on competition policy and law for senior policy makers from developing countries.

Programme funding

Donors can fund the technical assistance and capacity building programmes of international and regional organisations.

The United Nations Conference on Trade and Development (UNCTAD) has a well-established programme of technical assistance and capacity building activities.[12] It also organises annual meetings of the Intergovernmental Group of Experts on Competition Law and Policy (IGE), a useful forum for competition officials in developing countries.

Membership of the International Competition Network (ICN) is open to competition authorities of all countries. A "virtual" organisation, the ICN addresses both practical enforcement issues and policy issues, and seeks convergence of best practice. The ICN's Competition Policy Implementation Working Group seeks to identify the key elements needed for successful capacity building and competition policy implementation in developing and transition economies.

The World Bank is active in policy research and capacity building on competition policy issues.

While competition policy has been removed from the scope of the Doha Round, the WTO continues to provide technical assistance on competition to a number of developing countries.

"Peer reviews" can be a valuable way to objectively assess the operation of national competition laws. Some have been undertaken by the OECD, with donor support,[13] and UNCTAD presented peer reviews of Jamaica and Kenya at its conference in November 2005.

Donors can assist organisations working to create a regional competition policy as part of a regional economic structure, such as Carribbean Community (CARICOM), Common Market for Eastern and Southern Africa (COMESA), West African Economic and Monetary Union (UEMOA) and *Mercado Común del Sur* (MERCOSUR). Assistance may be needed by Africa, Caribbean and Pacific countries (ACP) in identifying and negotiating their objectives in the forthcoming Economic Partnership Agreement (EPA) negotiations.

Recommended best practices

Modern regulatory regimes for private sector development should include competition policy regimes. Some of the practices to be encouraged in the design and operation of a competition law are outlined below.

i) The design of the law should reflect the level of economic development of the country concerned, the structure of its economy and its constitution and culture. A competition law should not simply be transplanted from a developed country, or even from another developing country. A competition law should not stand alone, but should be part of a well-designed package of measures to create the right environment to allow competitive markets to benefit the poor.

ii) The introduction of competition policy should be reflected in the annual and medium-term plans and budgets of governments. Activities supported by donors should be adequately planned and appropriately monitored.

iii) The focus of a competition law should stay as close as possible to the objective of fostering competition in markets. Other social and political objectives should, ideally, be targeted through more specific measures in other legislation. Exceptions and exemptions should be minimised as competition law is most effective when applied broadly to the economy, including to state-owned enterprises.

iv) Whatever division of responsibility between sector regulators and the competition authority is chosen regarding competition issues, there should be an effective working relationship between the regulators and the authority.

v) A competition authority should be independent of government in its day-to-day decisions. This has implications for the selection of people to be appointed to the authority. The authority should have an adequate budget and should be staffed by competent officials.

vi) A new competition authority needs to prioritise its work carefully. A good rule of thumb, at least initially, is to concentrate on cases where entry barriers seem high, where prices seem high and where consumers will benefit most. These initial targets should include those with the least substantial vested interests that would oppose change. That is, to improve support from consumers and politicians for the new competition law, the competition authority should choose an early "winner".

Notes

1. Adhikan, R. (South Asia Watch on Trade, Economics and Development, Kathmandu), presentation at FIAS Conference, Sri Lanka, June 2004.
2. OECD (2002), Global Forum on Competition 2002.
3. USAID (United States Agency for International Development) study reported at International Competition Network Workshop, Paris, February 2002.
4. CUTS (Consumer Unity and Trust Society, India) (2003), *Spine Chilling Experiences of Anti-Competitive Practices in Malawi*.
5. CUTS (2002), *Challenges in Implementing a Competition Policy and Law*.
6. "Bundling" involves a dominant firm compelling purchasers of the product for which it is dominant to buy another product as well, which they might not want or might be able to obtain more cheaply elsewhere.
7. CUTS (2002), *Competition Policy and Law Made Easy*.

8. Levenstein, M.C. and V.Y. Suslow (2001), "Private International Cartels and their Effects on Developing Countries", background paper for the World Bank's *World Development Report 2001*.
9. Jenny, F. (2002), paper presented at WTO Regional Workshop on Competition, Mauritius, November 2002.
10. Clarke, J. and S. Evenett, (2003), "The Deterrent Effect of National Anti-Cartel Laws: Evidence from the International Vitamins Cartel", *Antitrust Bulletin,* No. 3.
11. CUTS is an NGO based in Jaipur, India. The first "7-Up" project undertook research and advocacy on competition policy in seven developing countries that had adopted competition law (four in sub-Saharan Africa and three in south Asia). This two-year project, funded by DFID, concluded in February 2003. CUTS is currently undertaking "7-Up 2", a study of competition policy in several countries in Asia. This project is funded by SECO (the State Secretariat for Economic affairs of Switzerland) and DFID. CUTS recently commenced "7-Up 3", which will undertake research and advocacy on competition policy in seven countries in sub-Saharan Africa, and which is being co-funded by NORAD and DFID.
12. See Competition policy for Development: A report on UNCTAD's Capacity Building and Technical Assistance Programmes (2004), *http://r0.unctad.org/en/subsites/cpolicy*.
13. DFID funded the peer review of South Africa's competition law and policy undertaken at the OECD Global Forum on Competition in 2003.

Further reading

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Mehta, P. (ed.) (2005), *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, New Delhi, India.

World Bank (2004), *World Development Report 2005: A Better Investment Climate For Everyone*, World Bank and Oxford University Press.

The competition sections of the websites of the OECD, the WTO, UNCTAD and the World Bank, and the website of the International Competition Network (ICN) contain extensive information that includes material on the development impacts of competition policy and law.

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PART II

Chapter 8

Promoting the Supply-side Response: Technical and Financial Assistance for Pro-poor Growth

Why is the supply-side response important for pro-poor growth?

The economic reform programmes introduced in many developing countries during the 1980's stressed the need for a propitious enabling environment for the private sector. Initially there were high expectations that a package of macroeconomic reforms ("getting the prices right") would give quick dividends in terms of economic growth. There has been growing disappointment with the growth record in many developing countries. During the 1990's only 18 out of 117 countries with populations of more than half a million people were able to sustain growth rates exceeding those of industrialised countries.[1] Today, there is widespread awareness that much more comprehensive investment climate reforms are required and that such reforms are time consuming and challenging exercises.

Economic research has shown that as well as the level of economic growth, the pattern of growth is crucial for achieving pro-poor growth and reducing poverty in accordance with the Millennium Development Goals (MDGs).[2] There is a concern that the pattern of growth is not sufficiently pro-poor in a number of developing countries, which means that growth does not contribute as fully as it could to poverty reduction. An important reason is that the results of economic reforms have been weak, especially in markets and economic sectors in which a majority of poor people are active. This calls for greater focus on those markets that are important for the poor in their roles as entrepreneurs, employees or consumers.

Traditionally, donors have attempted to strengthen the enabling environment for the private sector by providing support to economic institutions and infrastructure. In parallel, considerable support has been provided directly to individual firms or groups of firms. Such support has included technical support *e.g.* business development services (BDS), often provided through public organisations or through donor projects. This support has frequently been supply-side oriented and has often included subsidies provided directly to individual firms. Financial support has also been provided for banks in the form of credit lines earmarked for specific types of company, in many cases with subsidies to reduce the cost of borrowing.

The rationale for direct support at the firm level has been described as follows:[3]

- Direct support may be necessary to overcome **market imperfections and/or market failures**.
- Such support may help **improve the response to reforms** in the policy environment.
- Support to business champions and leaders may **create demonstration effects** for other firms and thereby stimulate the supply-side response.

Over the last decade, the shortcomings of subsidised and targeted support to individual firms or groups of firms have been widely recognised.[4] Important lessons have been learnt and many donors are now reviewing their practices in order to make their support for private sector development more strategic.

The market-based approach that is now emerging can be seen as a reaction not only to the shortcomings of direct support to the private sector, but also as a realisation that efforts to improve the general investment climate are not sufficient. This approach puts the focus on the supply response, especially in markets of importance for poor men and women. It aims to identify obstacles to the development of specific sub-markets and to improve the institutional environment of those markets that benefit poor people – directly and indirectly – with special attention to small and medium-sized enterprises.

Lack of access to various kinds of services has been shown to be a critical constraint on the development of enterprises. Improving firms' access to business development services is one of the core instruments for promoting income and employment generation for poor people. The same applies to financial services where a deepening of markets for such services is an important element in many programmes aimed at stimulating pro-poor growth. Access to other productive resources, such as land and technical knowledge, can also be critical constraints.

What do we know so far and what do we still need to know?

Commenting on selective interventions at the firm level as a complement to broad-based investment climate reforms, the "World Development Report 2005" states that "in theory, selective interventions can yield positive social outcomes. In practice, cases of unambiguous success are rare, and there are many examples of costly failures, even in developed countries with abundant technical expertise and well-established checks on rent-seeking".

A general problem with interventions at the firm level is that they do not address the fundamental causes of market failure, but instead provide support to reduce the symptoms *e.g.* lack of access to credit. They can even deepen market distortions by preventing services from becoming available at cost price. Another main criticism is that by providing assistance only to selected firms ("picking winners") donors distort the competitive environment and retard market development in specific industrial sectors. Firms benefiting from such support schemes often resist their removal.

Today, there is a well established consensus among donors that whenever assistance is provided at the firm level, the leverage effect of such interventions on the business environment, and on relevant markets, must be carefully considered.

BDS was one of the first areas in which the new market-based approach to private sector development was broadly applied. In 2000, the donor community agreed on guiding principles for BDS interventions[5] which may be summarised as follows:

i) Look at the target groups (entrepreneurs, farmers, etc.) as clients and not as beneficiaries (**demand orientation**).

ii) Develop transactional relations with clients instead of a charity relation (**cost recovery**).

iii) Supply BDS *via* **providers** that are themselves **business-oriented and market-led**; they may be individuals, private enterprises, non-governmental organisations (NGOs), chambers of commerce, business associations, parastatal bodies or government agencies.

iv) Strengthen the **capacity and competence of service providers** to compete successfully in a market for BDS (no continued subsidies and clear points of exit for donor-funded interventions).

v) **Stimulate the market** for BDS, *e.g.* through initial subsidies to clients (*e.g.* vouchers, matching grants or cost-sharing) for purchasing BDS on the market.

vi) **Donors should act either as facilitators or supporters** of national/local BDS-facilitators, rather than providing services directly by themselves to the target groups.

There is today a growing amount of experience from implementing this market-based BDS approach, some of which can be summarised as follows:

i) A high proportion of BDS donor programmes claim to address (explicitly) the poor, but empirical evidence is lacking; in general, market-based BDS for micro-enterprises, small farmers etc. still seems to be poorly developed.

ii) BDS market development for poorer target groups has increasingly been based on market-led approaches; furthermore, there is a growing awareness of the importance of separating or "unbundling" business and welfare-oriented services (including from NGOs and public service providers).

iii) Donor interventions aimed at BDS market development are increasingly directed towards agricultural sub-sectors and transformation of agricultural products in rural areas, where BDS markets are particularly weak.

iv) BDS market development is increasingly part of broader programme approaches, *e.g.* development of value chains and local and regional economic development (LRED) or cluster promotion. However, empirical evidence on the pro-poor impact of such integrated approaches is still lacking.

What are the controversial issues?

While there is now a consensus among donors on the need to move towards more market-oriented approaches, opinions differ regarding how this should be dealt with in practice. For example, although there is common recognition that market-based approaches have limitations, there are different views regarding the appropriate criteria for diagnosing such situations and the steps that should be taken when markets fail.

Against the background of contributing to the MDGs, donors may be tempted to strive for short-term achievements and, as a consequence, neglect the principles of the market-based approach. Considerable resources may be spent on highly subsidised or even free services and goods (*e.g.* fertilisers, tools or infrastructure) in order to achieve some measurable results in direct poverty alleviation. This type of intervention may threaten attempts by other donors to promote systemic and structural change including broad market outreach, sustainability and efficiency, which can only be achieved in the medium or long term.

For the extreme poor and particularly for vulnerable groups, *e.g.* persons living with HIV/AIDS and handicapped people, the livelihood services approach has proved to provide a successful mix of group delivery mechanisms, subsidies, income generation activities and social mobilisation. Key challenges for donors in this context are developing appropriate exit or graduation strategies and striking the right balance between providing "charity" and supporting more business-like and sustainable approaches.

A core element in the market-based approach is that the providers of financial as well as technical support to enterprises should themselves be business-oriented and market-led. Although there is common agreement that any support to such providers should be market-oriented, opinions vary regarding the design of such support. The debate on the use of intermediaries for provision of financial services is one example.

Policy implications for donors

The emerging approach for support to private sector development is based on the concept of systemic change; altering the incentives within markets to deliver pro-poor outcomes rather than providing direct support to enterprises.

The following key criteria and guiding questions may be applied by donors in connection with assessment of proposals that involve support to individual or groups of firms:

i) Define the **rationale** for intervention: The focus should be on the sources of problems, not on the symptoms. What is the market failure that justifies a direct type of intervention? Is the proposed intervention the most appropriate response to the problem? Are there any risks that the intervention in itself may cause market distortions or retard the development of markets?

ii) **Level playing field:** All firms should have an equal opportunity to access support instruments. This promotes competition and creates better chances for cost efficiency in the use of such support.

iii) **Avoid or minimise subsidies to firms and intermediaries:** The subsidy component of credit and technical assistance provision should be as close to market terms as possible. This will ensure that the assistance reaches the firms that see a real value addition from the assistance provided. Instruments that minimise the required financial inputs, *e.g.* guarantee schemes that share risks with commercial banks and provide them with incentives to lend to small and medium enterprises, may be useful in the appropriate context.

iv) **Provide subsidies to end users:** In situations where there is clear rationale for the public sector to provide subsidies, *e.g.* for social or infrastructure services, subsidies should preferably be provided in a transparent way to end users, rather than being channelled through providers of goods and services. Applied in this way, subsidies strengthen the demand for services and stimulate competition and market development.

v) **Apply principles of "output-based aid":** To support the delivery of basic services, explicit performance-based subsidies may be justified to complement or replace user-fees. Affordability issues for particular groups of users, positive externalities or the infeasibility of imposing direct user fees are examples of the types of concerns that could motivate the use of public funds to support the delivery of basic services. The principles for output-based aid have been defined by "the Global Partnership on Output-Based Aid" (*www.gpoba.org*).

vi) **Clear exit strategies:** A predefined exit strategy should always be prepared in connection with support to firms.

There may be situations when market development approaches are not applicable. Particularly in post-conflict situations or after natural or man-made disasters, in the short term, direct firm-level assistance seems to be the most appropriate way to re-establish affected enterprises. The fundamental challenge is on the one hand to identify the right point of exit and, on the other, to find the right starting point for a gradual shift to a market-based approach that aims to rebuild the supporting institutional environment for the private sector. There is often a need to differentiate and sequence donor support depending upon the type of firm and the stage of development.

Direct assistance at the firm level may provide valuable learning and insights into actual business problems and policy obstacles that can play an important role in advocacy for reform by donors and private business associations.

In the provision of technical and financial support at firm level, donors have often co-operated with a number of different stakeholders. For this and other reasons, donor support has often been scattered and duplication is common. The market approach requires concerted efforts to align donor support with national strategies and to strengthen aid co-ordination mechanisms.

Donors should review the way they internally organise themselves to support private sector development. There may be possibilities to promote synergies and cross-breed experience between different types of instruments. For example, the "transaction experience" among people who are involved in support at firm level may be very useful for colleagues specialised in the development of the enabling environment. Likewise, experience of analysing market institutions may provide valuable inputs for preparation of firm-level support. At the country level, it is often important to combine and co-ordinate interventions at different system levels; *e.g.* support to macroeconomic reforms with support at the meso (market) and/or micro (firm) level.

Impact monitoring should be an integral part of donor programmes aimed at market-based development of technical and financial assistance. Relevant information should be gathered regularly. Emphasis should be placed on learning rather than on proving. Amongst other measures, monitoring information should be used to keep the programme "on track", and if necessary for adjustments. The monitoring system should include indicators which allow for measuring the impact of market development on the productivity of firms and on income and employment generation, with special focus on poor women and men.

Recommended best practices

It is not possible in a brief paper to provide more detailed recommendations on best practice within a large knowledge area. However, there is a wealth of sources that provide guidance and best practice on various aspects of firm-level assistance. Recommendations on some titles for further reading are given at the end of the chapter.

The following are some concrete examples of practices to be encouraged in the field of BDS:

i) **BDS market assessments** should take into account the livelihood systems and the views of the targeted poor, including socio-economic, cultural, gender and other relevant aspects, by making use of participatory instruments.

ii) This also applies to **value-chain analysis**, which should look into the links in the value chain and sub-sectors with a potential for value addition, thereby resulting in higher incomes and employment for marginalised populations.

iii) Special attention should be given to services of particular relevance to the poor such as: *i)* commercially oriented **input suppliers** to small-scale farmers; *ii)* **market access distribution systems**; *iii)* **embedded services** for rural micro-entrepreneurs and small farmers; and *iv)* **buyer or supplier credit schemes** linking producers to alternative financing mechanisms.

iv) **BDS in rural areas:** Poverty is particularly widespread in rural areas. At the same time, there are clear constraints regarding the absorptive capacity of urban agglomerations. Therefore, it is extremely important to make BDS markets work for the poor in rural areas. The various approaches such as the sector approach in agro-business and food-processing, value-chain development or the promotion of local and rural economic development offer ample scope for creating improved income and employment opportunities. Interventions in favour of these inter-firm relations are usually geared to the development of a competitive edge for the whole cluster, sector, industry or region, and less to individual enterprises. This may bring about the systemic change that is so greatly required.

v) **Possibilities of public-private partnership (PPP):** In developing value chains as well as in local and regional development, public and private partners could join forces to provide commercial and sustainable business services in the scope of business linkages. Depending on the partners, these can also result in the provision of cost-effective, high-quality, embedded services, such as market access or extension services.

Notes

1. World Bank (2005), *Economic Growth in the 1990s: Learning from a Decade of Reform*, Washington DC, *www1.worldbank.org/prem/lessons1990s/index.htm*.
2. Operationalising Pro-Poor Growth Reseach Program (2005), *Pro-Poor Growth in the 1990s – Lessons and Insights from 14 Countries*, Washington DC.
3. See Snoddgrass, D. and J. P. Winkler, (2004).
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5. The Committee of Donor Agencies for Small Enterprise Development (2000), *BDS for small enterprises. Guidelines for Donor Intervention*, often referred to as the "blue book".

Further reading

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PART II

Chapter 9

The Financial Sector's Contribution to Pro-poor Growth

Why is the topic important for pro-poor growth?

First and foremost, a well-developed financial sector – understood as the central bank, commercial banks, non-banking financial institutions (which include microfinance institutions and alternative finance institutions such as co-operatives, credit unions and savings banks), as well as the financial markets – is important for promoting private sector development and subsequently the contribution of the private sector to alleviating poverty.

The financial sector contributes to reducing poverty and improving opportunities for the poor directly, indirectly and by making economic growth more pro-poor.

The financial sector can have a more direct impact on poverty reduction in two ways:

i) A well-developed financial system allows the poor to have access to financial services, which they are often denied. They need to have access to a large array of financial services, such as saving facilities, payment instruments, credit, and insurance. When the poor accumulate savings as a precaution against unforeseen events or with a view to financing investments in housing or child education, it is important for them to have their savings in liquid assets and in a safe place. They also need credit on various occasions: to finance equipment or inputs needed for revenue generating activities, to pay for education or to help them recover from difficult situations resulting from economic crises, natural disasters or health accidents. Credit is of particular importance in rural areas where farmers have to face a time lag before they receive the proceeds from selling their crops. They also sometimes suffer from drought, flood or shocks. There is increasing evidence of the ways in which financial services touch the lives of poor directly.[1] However, in the absence of well-functioning formal markets, individuals and firms seek other less efficient means of risk management. Informal systems are common in the early stages of development. As they emanate from local cultures and customs, the procedures are simple and easily understood by the population, but such systems are usually characterised by high risks and usurious rates of interest.

ii) The financial sector can facilitate the financing of investments for the provision of basic services to the poor. Improving access for the poor to basic services such as water distribution, power, health services and education is necessary to reach the Millennium Development Goals. However, current volumes of official development assistance (ODA), foreign direct investment (FDI) and domestic savings fall short of what is needed to finance the corresponding investments. Additional private resources will be required to augment those coming from the public sector. A sound financial sector will not only reassure private investors but also facilitate financial flows and create new opportunities.

The financial sector can also contribute to poverty reduction indirectly, as a diversified and competitive financial sector plays an important role in economic development generally. Indeed, a well-functioning financial sector contributes to the maintenance of economic stability; it provides a means of payment and makes possible secure financial and commercial transactions; it helps to mobilise domestic and external savings; and it is

crucial for the efficient allocation of capital to productive investments. As growth contributes to poverty reduction, at least in absolute terms, the financial sector therefore facilitates and contributes indirectly to poverty alleviation.

In addition, the financial sector is essential for making economic growth pro-poor. Indeed, growth is not always pro-poor and in order for poor men and women to benefit from economic growth, the poor need to have access to markets and thereby be able to take advantage of opportunities. As highlighted in "Accelerating Pro-Poor Growth through Support for Private Sector Development", market outcomes are influenced by policies and institutions in five main areas: providing incentives for entrepreneurship and investment, increasing productivity, harnessing international linkages, improving market access and functioning and reducing risk and vulnerability. In each of these areas, the financial sector plays an important role:

i) ***Providing incentives for entrepreneurship and investment:*** access to financial services ensures that entrepreneurs have the facilities with which to do business and provides credit to allow them to make productive investments (in new technology, for example); monetary and fiscal discipline is also important for providing stability and reducing risks for vulnerable people and small businesses.

ii) ***Increasing productivity through competition and innovation.*** Investments in equipment, technology or education need to be financed and are key to increasing the productivity of individuals as well as of enterprises.

iii) ***Harnessing international linkages*** to take advantage of trade liberalisation and private capital flows. Dynamic trade flows require a proper payment system as well as trade financing mechanisms. The financial sector should provide safe, cost-effective and transparent formal channels for money transfers, including remittances. Moreover, a stable financial system is important for securing FDI as well as portfolio flows.

iv) ***Improving market access and functioning.*** Financial markets are one of the markets for which access is vital for the poor. By enabling the poor to draw down accumulated savings and/or to borrow to invest in income-enhancing assets (including human assets *e.g.* through health and education) and to start micro-enterprises, wider access to financial services generates employment, increases incomes and reduces poverty. Deepening the financial sector also gives more opportunities to the poor to have access to capital markets.

v) ***Reducing risk and vulnerability.*** Financial sector policy is crucial for macroeconomic stability, in order to avoid collective bank failure, inflation or currency crises. The development of insurance services, including those serving the poor, can also mitigate risks. By enabling the poor to save in a secure place, the provision of bank accounts (or other savings facilities) and insurance allows them to establish a buffer against shocks, thus reducing vulnerability and minimising the need for other coping strategies such as asset sales that may damage long-term income prospects.

What do we know so far?

The links between financial sector development, growth and poverty reduction

Despite measurement and definitional problems, most research has found evidence of a correlation between financial sector development, growth and poverty reduction.[2] It is legitimate to infer that, while there is a circular causation mechanism between financial sector development and growth, in developing countries the impact of financial sector development on growth is more important than the reverse. There is evidence that the less developed an economy the stronger the impact of the financial sector on economic growth.

In particular, it has been highlighted that a country with a high level of education cannot reap the full benefits of this unless the financial sector is reasonably well developed. It is also clear that the underdevelopment of the financial sector has a negative impact on growth. Some research goes as far as identifying a poverty trap, meaning that a weak financial sector limits the number of market players and creates a vicious circle, as low market development leads to low growth and to an even weaker financial sector.

Development of the financial sector has also been shown to have positive effects on poverty reduction, although it is difficult to split out the direct effect of access to financial services on poverty from the indirect effect via overall economic growth, partly because of a lack of data.

Microfinance institutions

At the micro level, there is also evidence of the positive effect of providing the poor with access to the financial sector through microfinance institutions (MFI), when they are properly managed.[3] The positive role of MFIs in poverty reduction is well established and documented, even though this sector encompasses a wide variety of institutions, with differences in the quality of management and efficiency.

Deficiencies in financial sectors in developing countries

Despite improvements in the last decade, the financial systems of developing countries still suffer from shortcomings and market inefficiencies that have an impact at various levels of the business environment.

Financial systems are fragile

Whatever the immediate macroeconomic and financial policy errors (exchange rate policy, for example), the 1997-98 financial crisis in Asia highlighted some fundamental flaws in developing country financial sectors. These flaws are linked to: *i)* problems caused by governments interfering in the allocation of resources through credit controls and regulated interest rates; *ii)* the lack of regulatory, accounting and operating procedures that comply with international standards, coupled with poor quality and opaque supervision and a lack of transparency; and *iii)* the almost systematic reliance on short-term foreign funding because local debt and equity markets are insufficiently developed.

Since the financial crisis of the last decade, the international community and governments have become aware of the necessity of achieving financial stability and transparency to avoid systemic risks and have been working continuously in this direction.

Financial systems are incomplete

First and foremost, formal financial systems in developing countries are incomplete and deficient. The majority of people do not have access to basic formal financial services. It is estimated that the proportion of people without a bank account reaches 90% in some African countries.

The weakness of the formal financial sector is a severe handicap for developing countries. Capital and money markets are still under-developed. Very few developing countries enjoy the macroeconomic stability needed to create even medium-term, let alone long-term, debt markets. They do not have government securities that can provide the reference values needed to establish an interest rate curve and few investors are willing

to invest beyond a one or two-year time horizon, most of them fearing that the large-scale macroeconomic fluctuations to which these markets are exposed will compromise returns on investments.

There is little competition in the financial sector, which is often dominated by a handful of foreign banks, a few residual state-owned banks and under-capitalised local banks that operate in a segmented market. It is easier to create a vigorous financial market when there is genuine competition.

Lending to the private sector is insufficient. There is a lack of medium and long-term lending and a lack of instruments and institutions adapted to business needs, while the cost of credit is often too high for want of competition.

This situation is partly the result of deficient legal and regulatory frameworks that do not ensure a favourable business environment. Arbitration procedures and court decisions are too slow and open to influence and do not provide enough certainty, especially as regards debt collection (difficulty in realising mortgage guarantees, weak property rights). Banking regulations are ill suited to medium and long-term credit, which is often treated in the same way as short-term lending. Rules on contingency provisions are too strict for small-scale transactions (acknowledgement of mortgages only, which are expensive to register) and microfinance institutions do not always have a specific regulatory status.

What is controversial – supporting the enabling environment or direct interventions: Exclusive or complementary practices?

The case against direct intervention

Direct intervention, *i.e.* direct financial support to enterprises, banks or MFIs, in the past has often produced disappointing outcomes and some donors tend to advise against it, giving higher priority to actions related to improving enabling environments and institutions.

Direct intervention may result in market distortion and crowding out of the private sector through unfair competition. Such distortions could lead to misallocation of resources, thus reducing growth. There is a risk, for instance, that donor funds provided to an individual bank would give it an unfair advantage and prevent market forces from selecting the best competitor.

Donor funds may be better used to help build an enabling environment for the development and the deepening of the financial sector as a whole; in other words, direct support could be a sub-optimal use of donors' funds.

There is a risk that direct intervention might not bring about sustainable financial sector development, meaning that the services or the financing provided may disappear when donor support is no longer available.

Even if they are efficient, the impact of direct interventions depends on other factors such as the existence of an enabling environment. A study[4] shows that credit guarantee schemes can be effective in promoting sustainable changes in lender behaviour, leading to financial sector deepening, but only in situations where specific factors for success exist. These factors include the existence of an open, competitive banking environment, a dynamic and/or expanding business sector and a policy environment in which initiatives are co-ordinated and other government or donor initiatives do not crowd out market-driven initiatives, in particular through the provision of subsidised credit or other financial products and services. In such scenarios, guarantee schemes have the potential to play a role of accelerator rather than driver in deepening the financial sector.[5]

The case for direct intervention

While recognising the importance of the enabling environment and institutions, some donors consider that direct intervention is still beneficial, provided precautions are taken to avoid market distortion. There are a number of contexts in which direct intervention remains justified:

i) The recourse to public-private partnerships (PPPs) can lead to donors and development financial institutions (DFIs) directly participating in financing an activity or in a guarantee structure for it. PPPs are especially needed to finance infrastructure, including water or power distribution projects that are essential for increasing services for the poor. In these cases, donors' and DFIs' roles, as catalysts to attract private financing, are key. It is a good way to maximise the leverage of ODA.

ii) Appropriate interventions of donors on the market may open new channels, help develop new activities or create new instruments. For instance, providing guarantees to a special purpose vehicle issuing bonds on a local market may be a useful way of directing under-used savings towards investments and of avoiding foreign exchange risk thanks to the provision of loans in local currencies. Concessional credit lines to banks where the use of the grant is strictly limited to a specific development objective can have a strong demonstration effect.

iii) Changes in institutions or in regulation take time and while they are a necessary condition for developing the market they are not sufficient. For instance, in fragile states or in post-crisis situations, donors' direct interventions can have a powerful leverage effect on financial flows and provide an appropriate response to the emergency and the high level of risk in such situations. In less urgent cases, even if interest rates are liberalised and banks can legally extend medium or long-term loans, they are not ready to do it, due to lack of expertise, insufficient information or aversion to risk. Financial engineering introduced and supported by donors can address this, by promoting instruments such as guarantees, credit enhancements and specific financial vehicles. Microfinance is a good case in point: even in developed countries with a sophisticated financial sector, the poor have difficulty accessing financial services. All the more so in developing countries; a good competitive banking system does not guarantee that the needs of the poor will be addressed. In such countries, direct donor intervention has allowed microfinance institutions to grow, which in certain cases has attracted banks into this activity.

Best practices

When designing priorities for support, donors should consider the type of financial sector in which they intervene. In countries with less developed financial sectors, a pro-active approach should be applied. Priority should be given to assistance geared towards creating an "enabling environment": support for the regulation, supervision and promotion of financial systems. In more sophisticated economies, donors should be pro-active and support policies and projects that extend the provision of financial services to the poor. These types of approaches are complementary and not exclusive but some attention should be paid to the sequencing of donor support.

When contributing to the creation, development or strengthening of the legal and regulatory environment, which is essential, donors should closely co-ordinate their actions at a macro-level, making sure there is no overlap or contradiction between approaches.

However, when donors extend support to financial intermediaries, different views and practices can foster innovation, provided that some basic principles are respected, especially the avoidance of market distortion.

When conditions are met for donors to play a catalytic role in building public-private partnerships by using public funding, they could consider blending concessional and non-concessional resources, setting strict rules concerning the use of concessional funding. The decision on whether to offer concessional funding should be independent of the nature (public/private) of the intermediary, but when the intermediary is a private entity great care should be taken so as to avoid market distortion. It means in particular that the concessional resources should be allocated in a transparent way to deserving beneficiaries or uses such as: *i)* investments aimed at strengthening the sector's environment; *ii)* providing services for poor people who do not have easy access to private services; *iii)* supporting public borrowers who implicitly play a balancing role between social action and profitable business; or *iv)* investments with a strong environmental and/or social impact. Finally, donors should only use concessional funding during pilot stages and seek to build sustainable solutions that will exist after their withdrawal.

Donors should aim for sustainable, long-term impacts from their interventions when providing financial support for small and medium-sized enterprises (SMEs). Therefore, if they provide credit lines or guarantees to financial intermediaries, it is particularly important that they cover only a portion of the risk and make sure that a significant part is borne by the lender. If such precautions are taken, this type of assistance can have a demonstration effect and help financial intermediaries to learn how to manage the risk of lending to SMEs. It can also help to build expertise and reduce information asymmetries by giving the lending institutions the opportunity to gather information on SMEs' credit worthiness.

When refinancing microfinance institutions, donors should avoid subsidies, except in some instances such as capacity development, and use subordinated debt instruments in local currencies. Subsidies, which may have been necessary at the beginning of microfinance, are not the right tool when it comes to mature institutions that are already sustainable and only need help to grow. Indeed, the donor's role has evolved with the development of microfinance, and donors should now aim to consolidate existing microfinance institutions and strengthen their financial and institutional viability.

Policy implications and suggestions for donors

Information on financial sectors in developing countries

Designing strategies for financial sector development, and connecting the poor to this sector, requires a better understanding of initial conditions and constraints. Therefore, in order to increase the focus on the issue of access, there is a need for more information on levels of access to financial services, barriers to widening access, scale and the nature of unmet demand. Donors and DFIs should encourage the collection of such data by financial institutions or through household surveys on access to financial services.

Business environment

The development, strengthening and consolidation of the institutional and legal environment is of particular importance in broadening and deepening the financial sector. The main aim of donors' interventions should be to make sure that the authorities have the

willingness and all the necessary tools to develop the financial sector. They should also be encouraged to remain focused on the objective of enhancing access to financial services, including in financial sector assessments such as the Financial Sector Assessment Program (FSAP) run jointly by the World Bank and the International Monetary Fund (IMF). In this respect it is mainly the responsibility of multilateral organisations to act, for instance the IMF when it comes to monetary, financial or fiscal policies, but bilateral donors also have a role to play. They could in particular encourage the professionalisation of supervisory authorities and market regulators. They could also support the development of financial infrastructure, for instance helping to set up credit bureaux and asset registries.

It is also necessary, in order to improve the quality and the transparency of the financial sector, to help developing countries to implement international financial standards and codes; this concerns in particular corporate governance, international accounting and auditing systems.

Financial intermediaries

Strong financial intermediaries will lead to better resources allocation. As part of a long-term strategy to make financial markets respond better to the needs and constraints of the poor, there may be a need for donors to provide support to financial intermediaries such as banks, insurance companies, institutions specialised in refinancing local authorities, and microfinance institutions. Modernisation of payment systems is also an important issue: in particular the spread of electronic money and the transfer of remittances. Donors could also consider interventions that help intermediaries that operate in sectors where returns are low or deferred, for example, education, healthcare, housing, small business, farming and refinancing.

Financial engineering

Financial instruments are needed to devise innovative and well-adapted solutions, while increasing the leverage of donors' funds. This is of particular interest for the financing of investment in pro-poor infrastructure, such as water or power distribution. But it can also be of value in other instances. For example, a bank may have a portfolio with a lower risk rating than that of the bank itself; in such a case donors could help the bank to raise money through a securitisation transaction. New resources could then be tapped on more favourable terms and via the local market. It is worth promoting instruments such as guarantees, credit enhancement, specific financial vehicles and public-private partnerships as ways of increasing the leverage of public sector resources on private sector ones. In this regard, donors who can draw on the requisite specialist expertise could play the role of a catalyst: they can help structure specific financing schemes to attract other investors (foreign or local) and they bring expertise, help to create new instruments and contribute in this way to the broadening of the financial sector.

Savings mobilisation

One important donor policy orientation should consist of supporting increased mobilisation of savings. This will allow the use of domestic resources available for investment as a whole, as well as helping the poor to accumulate more savings on a secured basis. To this end, donors can help to structure and develop financial markets by supporting specialised financial intermediaries and institutional investors (*e.g.* collective savings management instruments, life and pension insurance, pension funds).

Remittances

Migrants contribute in an important way to the informal and formal financial sectors in their country of origin. The whole system (banking, savings, and credits) needs to be adapted to allow them to contribute to the fight against poverty. A significant proportion of immigrants in host countries as well as their families in home countries remain "unbanked". Therefore, one of the major challenges confronting traditional financial institutions and other financial service providers is to integrate unbanked senders and receivers into the financial system through better outreach, new technologies and more cost-efficient and transparent services.

CGAP principles

The Consultative Group to Assist the Poor (CGAP) have developed a set of Key Principles of Microfinance[6] that provide good practices for the sound development of microfinance and which most donors follow. Under these principles, three important orientations should be given particular attention. The first is the promotion of a favourable legal and institutional environment. In this respect, it is important to support the efforts of national and regional monetary authorities to develop appropriate legal and regulatory frameworks for microfinance. Second, donors should help to consolidate existing financially viable microfinance institutions with the aim of helping them to attain a critical mass and to increase their number of beneficiaries. Third, it is advisable to promote linkages between microfinance institutions and banks to capitalise on their synergies and draw on the different skills and capabilities of each.[7]

PRSPs and financial sector policies

Notwithstanding the general recognition that the development of the financial sector is important for growth and poverty alleviation, the coverage of financial sector policies in Poverty Reduction Strategy Papers (PRSPs) is very uneven and a number of PRSPs cover financial sector issues only marginally or even not at all. This calls for additional dialogue between donors and partner countries in order to raise awareness and identify objectives at the policy level.

Conclusions

In addition to the more traditional focus of financial sector policy makers and regulators on efficiency and stability, it is important to realise that the financial sector plays a central role in enabling the poor to participate in and take advantage of economic growth. This paper highlights the importance of focusing on ways to promote wider access to financial services for the poor. In doing so, donors will help to open up the financial sector by the provision of new funding mechanisms and the encouragement of new financial activities.

In designing such strategies, donors should consider the following priorities:

i) Encourage the collection of data on levels of access to financial services, barriers to widening access and the scale and nature of unmet demand.

ii) Encourage greater professionalism in supervisory authorities and market regulators and help with the implementation of international financial standards and codes.

iii) Strengthen financial intermediaries and help them to find sound instruments to serve sectors where returns are low or deferred.

iv) Play a catalytic role by structuring specific financing schemes to attract other investors or by bringing expertise, helping in the creation of new instruments.

v) Support an increased mobilisation and prudent intermediation of savings.

vi) Bridge the gap between microfinance institutions and the formal banking system.

vii) Encourage partner countries to cover financial sector issues in PRSP documents.

Notes

1. S. Rutherford (2002), "Money Talks: Conversations with Poor Households about Managing Money", Finance and Development Research Programme Working Papers series No. 45, IDPM University of Manchester; O. Ruthven (2001), "Money mosaics: Financial Choice and Strategy in a New Delhi Squatter Settlement", Finance and Development Research Programme Working Papers series No. 32, IDPM University of Manchester.
2. For instance: Beck *et al.* (2004), "Finance, inequality, and poverty : cross-country evidence", World Bank Policy, Research Paper No. WPS3338, 2004; "The importance of financial sector development for growth and poverty reduction", DFID, August 2004.
3. AFD (French Development Agency) (2005), "Microfinance", in Parole d'Acteurs (Key players' views), No. 4.
4. DFID (2005), *Do credit guarantees lead to improved access to financial services?,* London.
5. A related controversial issue pertains to the treatment of guarantees in ODA accounting. Guarantees are counted as ODA only when the risk occurs (such as in the event of default), and when the guarantee is called. Considering the role of guarantees, at least as an accelerator of financial sector deepening, and more generally to leverage private local and foreign capital to finance private investment in developing countries, this accounting system underestimates the role of guarantees as a development instrument. It even may have a disincentive effect on donors in the present context of increasing ODA flows. Several DAC members have proposed changing how guarantees are recorded in DAC statistics but there is no consensus to modify the current system.
6. CGAP (Consultative Group to Assist the Poor) and World Bank (December, 2004), *Building Inclusive Financial Systems: Donors Guideline on Good Practice in Microfinance.*
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PART II

Chapter 10

Enhancing Women's Market Access and Promoting Pro-poor Growth

Why is the topic important for pro-poor growth?

The majority of workers in the developing world cluster in small and medium-sized enterprises in the private sector. They may be own-account workers in services or agriculture, or employees in small and medium-sized firms in manufacturing. Some of these enterprises are informal and unregistered, others are fully integrated into the national tax base, reporting income and expenditures and complying with laws and regulations that govern hiring, firing, production and sales. Whatever their status as enterprises, these economic activities are critical for workers and owners alike.

Entrepreneurship and investment influence the rate and pattern of growth, the types of forward and backward linkages that develop in an economy, the labour demanded and the human capital investment required to meet these labour demands (Ranis, Stewart and Ramírez, 2000). Rapid growth can contribute effectively to poverty reduction (OECD, 2004). If growth is broad-based and inclusive, benefiting multiple sectors and economic activities, it is likely to provide greater opportunities for the poor to increase their incomes, acquire skills and assets and transform and upgrade their livelihoods. Rapid growth is also frequently associated with greater international trade and regional development linkages (OECD, 2004). Greater integration has the potential to stimulate foreign direct investment (FDI), raise productive capacity and generate benefits that accelerate the transfer of skills and knowledge. Yet for these gains to be equitable, and evenly distributed throughout the economy, requires markets where access is unrestricted, information flows freely and competition is encouraged.

The cost of gender inequalities in market access

Women are a significant entrepreneurial force whose contributions to local, national and global economies are far reaching. Women produce and consume, manage businesses and households, earn income, hire labour, borrow and save, and provide a range of services for businesses and workers. Women represent an increasing proportion of the world's waged labour force and their activity rates are rising. In Africa, Asia and Latin America, they are over one third of the officially enumerated workforce (WISTAT, 2000). Women-run businesses can be found in emerging sectors such as the production and marketing of consumer goods, commercial banking, financial services, insurance, information services, communications and transport. As owners of small and medium-sized enterprises (SMEs), women furnish local, national and multinational companies with ideas, technology, supplies, components and business services (Jalbert, 2000). These activities are likely to prove fundamental as developing economies transition from primarily agricultural to industrial production and become more urbanised. Furthermore, as economies liberalise and open their borders, women-owned and operated SMEs are engaging in international trade – enhancing the prominence and visibility of women entrepreneurs globally.

Even as women enter markets and engage in production, however, they may face different constraints and opportunities than their male counterparts. Social and cultural

proscriptions assign productive and reproductive roles to men and women that can limit their access to markets and restrict their occupational and sectoral mobility. Throughout many countries and regions, the gender division of labour within the household underpins fundamental differences in the rights and responsibilities of men and women. In many rural societies, for example, women are responsible for household provisioning: food crop production, gathering fuel and hauling water, and caring for children and the aged. In return, men are expected to meet certain cash requirements of the household. This division of labour affects women's ability to participate in paid employment and access education and training and influences their choice of productive activities.

Although there are variations across countries, social norms strongly influence men's and women's work and working environments. Some tasks and jobs are considered more appropriate for men or women and overt or covert screening filters out applicants who defy these norms. These gender norms frequently underpin sex-segmented labour markets and activities. Highly sex-segmented labour markets typically confine women workers to low-wage low-productivity employment and can limit the responsiveness of labour markets to new demands for higher skilled workers. Sluggish or unresponsive labour markets can impede adjustment, distort human capital investment and inhibit a firm's ability to switch into new activities and compete in a dynamic and globalising market.

Sex-segregated labour markets precipitate a number of efficiency losses that can provide a drag on growth and compound income inequality. A chief inefficiency is that sex-segregated labour markets lead to welfare losses (reducing total output) arising from the misallocation of the labour force: competent female workers are excluded from some of the more productive activities. Sex-segregated labour markets are associated with higher gender wage inequality (Cartmill, 1999; Tzannatos, 1999), which distorts investment in human capital, prioritising male income earners and undercapitalising women earners. Finally, substantial evidence suggests occupational segregation is associated with less security in employment for women and fewer prospects for promotion, as well as lower wages (Cartmill, 1999; Elson, 1999). These outcomes are likely to compound the inter-generational transmission of poverty, particularly for girls and women.

Highly sex-segmented labour markets and production may also compound or accentuate macroeconomic imbalances. For example, gender-based wage differences can create a competitive advantage for some semi-industrialised countries, providing a stimulus to growth – particularly in countries that have invested in assembly production with substantial, flexible, low-wage work in traded goods. Strategies based on gender-wage and gender-production inequalities can also result in a slow but steady deterioration in the terms of trade as a whole *vis-à-vis* industrialised countries, particularly if economic activities are concentrated in low value-added production where competition in the value chain exerts downward pressure on wages and labour costs (Cagatay, 2001). As the terms of trade decline the cost of importing capital and retooling or diversifying production rises. Declining terms of trade also mean declining reserves and can lead some economies to require balance-of-payments support or even default on debt service.

The role for policy and programmes

Development occurs within an institutional and economic environment that is similarly shaped by customs, social norms and implicit and explicit codes of conduct (World Bank, 2001). Yet social and cultural norms are not immutable: throughout history there is evidence that they are in flux. Policy and programmes can provide impetus for

change – promoting greater equity and efficiency. For example, improving economic institutions, so that productivity rather than gender, race, caste or age becomes the primary criterion for employment and compensation, can contribute to overcoming barriers that exclude entry and participation. Facilitating the free flow of market information, so that it is not controlled by powerful elites, can undermine monopolies and broaden access and participation. Creating markets for child-care and ensuring household access to energy and water has the potential to reduce the domestic workload for women and girls. Facilitating access to labour markets for women can increase the returns to investing in women's human capital. Removing systematic barriers to market access for excluded groups can facilitate broad-based growth and is more likely to reduce poverty than strategies that focus on narrow market niches and existing elites, preserving privileges and potentially accentuating existing inequalities.

What do we know so far and what do we still need to know?

Clearly, women workers and entrepreneurs are not an undifferentiated mass. Age, literacy, education, rural or urban location, ethnicity, language, health and physical well-being also influence market access. Differentiating those factors that make some women entrepreneurs and workers more vulnerable, or less able to take advantage of new and existing opportunities to expand and upgrade their activities, will prove essential for the appropriate design and delivery of policy, programmes and projects. Documenting and analysing the impact of gender barriers to market access on the economy will provide critical information about the costs of gender inequality and the trade-offs implied.

Labour markets

Women and men often work in distinct activities that offer different rewards and career opportunities even though they have similar education and labour market skills. In many economies, women work in jobs characterised by low wages, high job insecurity, low levels of unionisation and poor working conditions. For example, women tend to cluster in informal employment[1] (Carr, Chen and Tate, 2000). There is also evidence, given the size, scale and location of women's small and micro-enterprises, that when they contract workers they do so informally. Consequently, women workers may face more insecure employment with fewer benefits and lower wages than their male counterparts (Charmes, 1998; Benería, 2003). Unequal access to labour markets and highly sex-segregated occupations generate a host of inefficiencies that compound gender-wage inequalities, depress investment in women's human capital and can distort market signals.

Financial markets

The design and delivery of financial services greatly affects access – particularly for the poor. Financial intermediaries often require traditional forms of collateral (land, housing, machinery), for which women frequently lack title. Complicated application procedures and documentation requirements can prevent women with lower education and few skills from applying. Minimum loan sizes and inflexible repayment schedules, stipulations that may be required for efficient credit disbursement, often preclude women applicants seeking smaller loans for activities that yield income over longer or more infrequent intervals. Similarly, sectoral priorities may favour male economic activities over those of women. The lack of knowledge about women's economic activities, and documentation that can substantiate their profitability, reduce women's access to credit

and insurance products. Additionally, mobility constraints that limit women's ability to travel can restrict their access to financial institutions that are not in their community or neighbourhood. Finally, where women concentrate in informal economic activities, or enter and exit the labour market more frequently to bear and care for children, they are less likely to acquire pension rights or have access to financial instruments for retirement, death and burial.

A dynamic financial sector is critical for sustaining long-run growth and ensuring poverty reduction. The financial sector contributes to growth by facilitating capital accumulation and investment and accelerating the rate of technological progress (DFID, 2004a; b). An efficient financial sector mobilises savings for investment, encourages inflows of foreign capital (including FDI, portfolio investment, bonds, and remittances) and optimises the allocation of capital between competing uses, ensuring that capital flows to the most productive activities. Where women may be disproportionately excluded from participating in financial markets and women's economic activities are underserved, market signals fail and capital bypasses potentially dynamic sectors and productive opportunities.

Goods markets

Women and the poor may face differential access to goods markets. Markets for goods and inputs, like most markets, are frequently regulated. Trading is typically not anarchic and conventions and rules regulate participation and sales. A variety of factors may impede access to goods markets or increase the cost of entry. For example, distance from the market may limit an individual's ability to sell or purchase in that market. Women may disproportionately face mobility constraints that limit their ability to travel or sell in markets at some distance from their households and communities. The lack of permission or certification to trade in certain markets will prevent market entry: small farmers and women are typically confined to domestic markets because they do not have the required certification to trade produce internationally. The volumes traded in some markets may be too large for small producers or buyers – effectively precluding their access to large, centralised, domestic and international markets. Information may not be readily available about the type of goods sold or the prices at which they are sold – or may flow to select groups. Finally, collusive activity on the part of buyers or sellers may squeeze out competitors and prevent outsiders from gaining access to certain goods markets. These types of collusive and restrictive practices may disproportionately affect women and small producers.

Gender-related barriers to goods markets affect both earnings and efficiency. The costs of unequal access have implications for producers as well as households. Pro-poor growth strategies that fail to take account of how gender affects access to and outcomes in goods markets are likely to compound existing inequalities, reduce producer and consumer surplus and limit the potential to maximise value added and deepen forward and backward linkages.

Service markets

Access to service markets may also be affected by gender. Service markets describe the delivery, purchase or hiring-in of activities that can enhance or transform production processes. Access to training and workforce development can upgrade skills, raise productivity and improve earnings and wages. Small business development services and information and communications technologies can provide targeted assistance to expand existing activities, penetrate new markets and improve efficiency. Extension services can

increase output, diversify and improve production, reduce risk and raise the quality and price of the goods traded. Although some of these services are traded, others may be provided by governments or intermediaries, as partially or fully subsidised programmes, to fulfil distributional or efficiency goals.

Women may face particular barriers accessing service markets. For example, women's agricultural activities in Africa are frequently oriented towards subsistence production and domestic markets. They produce lower-value products, on smaller tracts of land, with less access to capital, labour and chemical inputs. Lack of funds and social prohibitions on engaging with male extension workers preclude many women farmers from accessing or hiring extension services that can transform their production, reducing their ability to benefit from liberalisation or respond to price signals by shifting into tradables. Similarly, because of their household and reproductive responsibilities, women workers may be less able to participate in and benefit from workforce development initiatives.

Where women face restricted access to service markets, their production is likely to be concentrated in lower-value, lower-return activities. The inefficiencies that this imposes upon women's businesses can also be a drag on growth, fostering uneven and unequal development.

Micro-meso-macro linkages

While much is known about gender-specific exclusions and inequalities in market access, there remains a need for policy and programmatic research on the impact of these barriers to market access on local, national and regional growth patterns. These types of analyses should focus on the micro, meso and macro linkages as well as on the implications of inequalities in market access for the intergenerational transmission of poverty.

Gender inequalities in market access limit longer-term growth. Understanding how women access markets as producers and wage labourers is likely to prove critical for fostering pro-poor and inclusive economic growth. Analysing where women are in the global value chain, and documenting the resources they use and transform, will provide information about how to strengthen local economies and maximise forward and backward linkages. Reducing women's barriers to market access, improving their position within the value chain and enhancing their productivity is likely to benefit local, national and regional economies as well as households.

What controversies exist?

Entitlements and capabilities approaches[2]

An entitlements approach focuses on increasing women's access to resources and inputs that enable women to enter markets, raise their productivity or scale up their existing activities. Micro-credit is an example of an entitlement project that allows women to enter markets, purchase capital to raise their productivity or scale-up their existing activities. Capabilities projects provide resources and services that increase women's ability to deploy their existing resources or enter new markets. Capabilities projects typically focus on enhancing women's voice or agency and improving their bargaining power or skills. Training and workforce development projects provide a useful example of a capabilities approach that enhances women's existing skills, raising their productivity as workers and producers and enabling them to enter new labour markets and earn higher

wages or overcome under- and unemployment. Donors are unclear about the type of intervention and approach to use, or the appropriate mix and sequence of approaches in different contexts.

Level of intervention

Disproportionate attention may be being paid to women at the micro-level at the expense of meso- and macro-levels of intervention. Some projects and programmes respond to concerns that gender-based exclusions are more visible at the micro-level and that acting on the policy and programmatic environment to enhance women's productivity and efficiency as micro-entrepreneurs can overcome initial barriers to market access. However, micro-level activities are frequently being promoted in increasingly saturated markets where the potential to scale-up is limited.

Gender integration

Many donors develop women-focused programmes as separate components of other activities or as a programme in its entirety. Fewer programmes emerge from a process of gender integration where a systematic gender analysis of inequalities in access to resources and power motivates interventions and activities. Controversies about when to target women exclusively or whether to pursue a gender approach appear to emerge from a lack of knowledge about how to undertake a gender analysis of market barriers. Similar controversies exist about whether to target mixed organisations and institutions, enhancing women's role and agency within these, or whether to invest in parallel organisational structures that are exclusively for women.

What are the policy implications and recommendations?

The failure to focus on women's market access reduces the effectiveness of policies to promote pro-poor growth. Sex-segmented labour markets contribute to gender-wage inequality, depress investment in human capital and prevent women from entering higher productivity occupations. Market failures coupled with high transactions costs in the financial sector reduce the flow of capital to women's economic activities, contributing to underinvestment and limiting productivity and growth. Barriers to entry in goods markets frequently confine women to spot markets where monopsonists exert undue influence over prices – reducing producer surplus, depressing incomes and inhibiting further investment in women's economic activities. Service markets that bypass women curtail their ability to scale-up existing activities or augment productivity. The combined effect of these gender-based exclusions can limit local and regional growth and may contribute to macroeconomic imbalances. Growth is more likely to spur poverty reduction where inequality is low. The removal of gender-barriers to market access and gender-based exclusions will reduce inequality more effectively and can prompt more sustained poverty reduction.

Promote an enabling environment. Policies designed to remove or ameliorate structural barriers to women's participation in markets can be particularly powerful. For instance, policies that enable women to own, buy, sell and inherit land – individually or with joint title – can increase women's access to financial markets by providing collateral. These same policies can make women's contributions in agriculture more visible, permitting them to scale-up existing production by accessing extension services that may previously have been directed at male farmers. Similarly, pro-poor policies that enhance the

provisioning of household water and energy have the potential to alleviate women's time-burdens in the household enabling them to access markets and engage in remunerated productive activities.

Recommended best practices

Apply gender analysis tools to develop programmes and interventions. Gender analysis focuses not just on women, but on the social relations between men and women. Applying gender analysis tools allows practitioners to uncover the inequalities in power that underlie gender-differentiated outcomes in markets, identify points of intervention, as well as strategies to engage potential beneficiaries.[3]

Undertake gender-disaggregated value chain analyses. These identify opportunities to strengthen women's participation in markets. The analysis should focus on forward and backward linkages to maximise multiplier effects in global value chains where women cluster as workers and producers. Analysing the global value chain and the rents generated provides opportunities to target assistance and inputs. The analysis may also provide policy makers with information to create incentives to reduce the number of intermediaries, increase the bargaining power of producers and ensure access-appropriate processing technology, storage and transport facilities to enable resource-poor producers to capture more of the value added in the global value chain.

Improve micro-meso-macro linkages. Focusing on larger-scale economic activities, such as medium-sized enterprises that are owned or run by women, and supporting the development of more robust, complex markets with extensive forward and backward business linkages has the potential to improve women's access to markets along the value chain. Linking smaller suppliers and buyers can minimise predatory pricing and monopsony impacts and overcome concerns about volume and production reliability that larger entrepreneurs have regarding small entrepreneurs.

Minimise risk and vulnerability. The character of production and labour markets is in flux. Households pursue creative strategies to preserve livelihoods and respond to exogenous shocks such as illness, death, environmental disaster and crop failure. Some interventions and support to increase market access may need to be short-run and agile: emergency food-for-work programmes; retraining for retrenched workers; and the provision of transport and storage as nascent markets develop and deepen. Other programmes may need to create and encourage the expansion of financial instruments and social insurance to mitigate risk, insure inventories and provide access to pensions and social security.

Support entitlement as well as capabilities programmes. Successful projects and programmes pay attention both to inputs and to the individual or group ability to deploy these inputs. Many successful interventions address both entitlements and capabilities within a single project. Programmes and projects that improve women's bargaining power with monopsonists, provide information and communications technologies that enable women producers to sell in higher value markets or purchase critical inputs can raise productivity and incomes. Programmes that facilitate access to child-care can enable women to enter markets or receive training and engage in workforce development initiatives.

Promote clustering and networking. Groups of women producers may be able to access services collectively that they might not be able to purchase as individual entrepreneurs. This is particularly true in the informal economy. Clusters and networks of women can

facilitate their access to resources and achieve economies of scale. Additionally, groups of entrepreneurs requiring the same service are usually in a better negotiating position with potential suppliers or can bargain more effectively with buyers than they could alone.

Expand access to credit and financial services. Micro-finance remains a powerful tool to provide financial resources to the under-served and compensate for the absence of financial markets. Micro-credit can also provide an essential platform for graduating women's businesses and women's production to formal sector financial services. Offering products that include risk, inventory, health, life and funeral insurance has proven to be particularly important for poor women. Working on policy, institutional or social changes that address structural impediments to women's access to financial services can improve their ability to access markets. Among such projects are those that improve women's inheritance rights and their access to collateral resources such as land and other productive assets.

Address informality. Women cluster in informal markets and face particular barriers to formalising production. Efforts to reduce administrative and regulatory barriers, promote tax reform that can lift burdens on smaller enterprises, and generalise access to social security, pensions and health benefits can greatly affect the terms and conditions of women's employment and enhance their security in the informal economy.[4] Additionally, lessons can be learned from the experience of the Self Employed Women's Association and Bangladesh Rural Advancement Committee[5] about organising women in the informal economy and facilitating their access to productive resources as well as critical services such as health, housing and child-care.

Notes

1. See for example: Women in Informal Employment: Globalizing and Organizing (WIEGO), *www.wiego.org/*.
2. This draws on Sen's entitlements and capabilities analysis of poverty and material deprivation (Sen, 1999).
3. See for examples tools developed by UNIDO (Business Development Services: *www.unido.org/*), and ILO, DFID and CIDA (Canadian International Development Agency) (Trade capacity and small enterprises: *www.siyanda.org*).
4. See for example Gamser, M. and D. Welch (2005) "Formalising the Informal Sector: Barriers and Possible Solutions", Development Alternatives Inc., and Bannock Consulting, Ltd., June 2005.
5. See for example *www.sewa.org/* and *www.brac.net/*.

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PART II

Chapter 11

Constructing Inclusive Public-private Dialogue

What is the issue and why is it important for pro-poor growth?

Whether economic growth is pro-poor depends on the extent to which the rate and pattern of growth provide opportunities for the poor and the degree to which they are able to take advantage of these opportunities. Governments in developing countries have a responsibility to ensure that a favourable business environment exist for **all** private sector actors. They therefore need to be aware of the key constraints for different private sector entities in realising their potential to contribute to pro-poor economic growth. Targeting services to poorer entrepreneurs, mostly composed of micro, small and medium-sized enterprises (MSMEs), informal firms and workers and smallholder farmers, is one approach towards accelerating pro-poor growth and generating employment (OECD, 2004).

It is increasingly recognised that private sector development is an integral part of poverty reduction strategy programmes (PRSPs). The process of conceiving the second generation of PRSPs has therefore aimed to include a wider range of private sector representatives in consultations. Nevertheless, problems that hamper pro-poor private sector development from the grassroots perspective can still be insufficiently addressed in the resulting PRSP document. Clearly, consultation of the private sector during PRSPs is not enough and needs to be accompanied by mechanisms for regular public-private dialogue (PPD) by sub-sector or at the appropriate policy level, combined with bottom-up communication processes to ensure that local-level issues are fed into higher level policy processes. Making private sector development policy more responsive to private sector needs depends on the way in which PPD is organised, especially with respect to approaches and mechanisms that ensure that MSMEs, informal firms and workers and smaller agricultural producers can voice their concerns.

PPD is an institutional arrangement that brings together a group of public and private sector actors. PPD discussion forums range from highly formal and structured to more informal and *ad hoc*, and initiatives may last from only a few hours or continue over several years (Bannock, 2005). Objectives of PPD include building trust and bridging gaps to laying the foundation for a joint problem analysis and identification of policies and institutional reforms that contribute to a more conducive environment for private sector development. Governments that engage in PPD are more likely to promote sensible, workable reforms, while enterprises participating in meaningful PPD processes are more likely to support these (Bannock, 2005; Herzberg and Wright, 2005). Without a more equitable dialogue, governments tend to follow the loudest, most powerful voices, which rarely speak in the best interest of broad-based private sector growth, let alone poverty reduction. The policy process should not be limited to a small elite with privileged access to political and governance structures, but must build on structures and process that are deliberately set up to elicit citizen participation in policy formulation and implementation, and promote accountability of policy makers (Hertzberg and Wright, 2005).

Although not the only condition for accelerating pro-poor growth, PPD can be a first, important step in an institutional reform process aimed at improving the business environment for all. Most likely, a number of the bottlenecks identified will be known and

will already have been voiced before. Reform may be blocked because "inefficiencies" can be a source of income to some, offering opportunities for corruption or political patronage. Firms may also defend anti-competitive or rent-seeking interests. On the other hand, parts of the public sector may not understand the private sector and may not believe that dialogue is useful. At most, it may regard the private sector as a useful cash cow. Moreover, a coherent formal policy making process is lacking in many countries. For these reasons, PPD can be effective where and when there is an explicit commitment and willingness to act on its outcomes by the public and private sector. This paper explores how, in such conditions, PPD can be organised and how donor organisations can contribute to it.

A framework for institutional analysis regarding PPD

Pro-poor private sector development cannot be achieved by focusing interventions on either the private or the public sector alone. Moreover, many constraints that the private sector faces can only be resolved in collaboration with the public sector. Private sector development and governance programmes should be integrated into one comprehensive intervention strategy. In such a holistic approach, PPD is a prerequisite for arriving at broadly supported institutional reform.

Institutions. In this paper, institutions are taken to be the rules, organisations and social norms that facilitate co-ordination of human action.[1] Thus, interventions to develop institutions not only address constraints resulting from the performance of organisations, such as business licensing agencies, tax revenue authorities, government ministries, chambers of commerce or producer organisations, etc., but also focus on the formal and informal "rules of the game" and social norms that influence private sector development. For example, to what extent can resource-poor entrepreneurs access business organisations and networks, do they experience barriers to access to financial services, markets, licences, information and contacts with policy makers, are these barriers different for men as compared to women?

Institutionalising PPD. PPD, as a mechanism for diagnosing the problems and opportunities for private sector development, is useful at all levels where public and private sector entities meet, be it at the national, sub-national, local or sub-sector levels. Misunderstanding, uneasy relationships and distrust between public and private sector actors is common in many countries, resulting in limited responsiveness of public sector institutions to requests voiced by some parts of the private sector. Suspicion and non-co-operation leads to inefficiency and waste, which inhibits growth, investment and poverty reduction (Herzberg and Wright, 2005). This needs to be overcome effectively before any sustainable reform can take place (Jütting, 2003). Key challenges for PPD are therefore promoting sub-sector and horizontal dialogue processes and improving vertical linkages and communications to ensure that issues that have to be addressed at a higher policy level are indeed taken up.

Dealing with the diversity of the private sector. The private sector includes a multitude of different actors varying from international companies, (privatised) state-owned enterprises, business of different size, active in different sub-sectors and locations. Their goals are not necessarily the same: there is self-interest, mutual suspicion and some are severe competitors. Others are prepared to co-operate to defend their interest via a business organisation. (Former) state-owned enterprises, some international companies and larger firms might find it easier to maintain informal dialogue with government officials, while looking for one-to-one deals. The interests of (former) state-owned

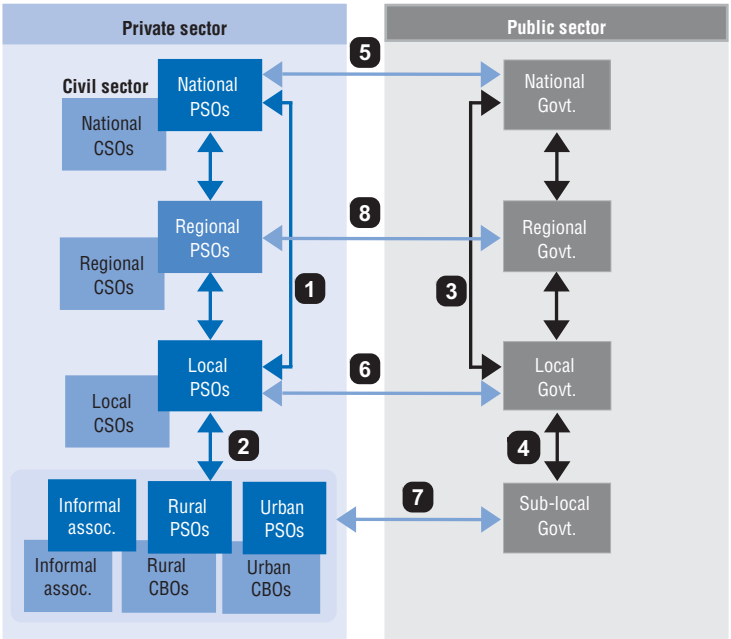
companies may dominate decision-making on private sector development, which can run contrary to the interest of privately owned enterprises, faced with a different set of constraints than (former) state-owned companies.

Organisational set up of the public sector. The public sector also consists of many different actors, and it may be difficult for an outsider to know to what department or agency a certain private sector development-related question should be addressed. The position of government officials differs with respect to the level of operation, authority and resources at their disposal. Moreover, elected officials such as mayors, councillors, parliamentarians and other politicians play an important role in policy making and implementation. The difference between private and public sector is not clear cut, as government officials and politicians may have business interests of their own or may have previously worked for private enterprises.

PPD structured in time. Four stages of policy reform can be distinguished in which PPD is essential: *i)* assessing and agreeing on problems; *ii)* designing and legislating solutions; *iii)* implementing reforms; and *iv)* monitoring and evaluating the impact of reform. Even when PPD is taken into account in the first two phases, neglect of private sector participation during implementation can still derail promising initiatives (Bannock, 2005), whereas the monitoring and evaluation phase must guarantee continuity.

Public-private dialogue framework. Figure 11.1 proposes a PPD framework-tool that can be used for identifying and analysing the different levels of dialogue and decision making on private sector development, both vertically within the private and public sectors respectively, as well as horizontally between these different sectors (van der Poel *et al.*, 2005). It is inspired by the institutional setting in Tanzania, and may require adaptations when used in other countries.

Figure 11.1. **Public-private dialogue framework**



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The PPD framework-tool consists of two vertical columns, each showing the different levels of the public (grey) and the private (blue) institutional structure. The private sector column also pictures civil society organisations (CSOs) involved in private sector development for each level. The framework shows eight numbered key dialogue or communication interactions.[2] These four vertical and four horizontal lines each depict a particular intra or inter-sector dialogue process. Of course, many diagonal communication lines may exist as well, *e.g.* between a particular local level private sector organisation (PSO) and a sector ministry at the national level, but this type of interaction tends to be incidental and informal.

The public sector column shows the administrative set up of a country: from central government via sub-national or provincial level to local level, such as district or municipal councils, and further down to sub-local level, *e.g.* divisions, wards or individual villages. The presence and status of these various entities, and the degree to which the vertical relations are hierarchical, varies from country to country. Bureaucratic procedures and social norms can seriously affect the ability to communicate with superiors at higher levels.

The private sector column presents formal and informal linkages between private sector organisations (such as the national chamber of commerce), sub-national level business organisations (district branches of the chamber of commerce), and sub-sector or product organisations (*e.g.* local organisations of coffee producers or livestock owners). In both rural and urban areas, many formal and informal associations exist at the grassroots level that are often organised around a certain trade in a particular location, *e.g.* informal associations of local fruit vendors, farmer organisations, savings and credit groups or a local association of shop owners. At this level, the distinction between PSOs and CSOs is often blurred as objectives may overlap.

The lack of horizontal dialogue processes between public and private institutions at different levels (lines 5 to 8, Figure 11.1), in combination with limited capacity for analysis and weak bottom-up communication, all contribute to a limited understanding of the real constraints to pro-poor private sector development and economic growth, which may lead to inadequate policies and programmes that sometimes even aggravate the climate within which the private sector operates. In addition, policy makers can only learn from local experiences when functional, bottom-up vertical communication processes are in place (lines 1 to 4, Figure 11.1).

Pro-poor public-private dialogue: Good practice and challenges

The aims

A structured and inclusive public-private dialogue is needed to identify bottlenecks, opportunities and possible interventions for private sector development. The way in which such a dialogue is organised, facilitated and institutionalised and the quality of participation and commitment to the process largely determine the outcome and thus its potential contribution in guiding reforms. The PPD process has three aims, which can be seen as outcomes of and preconditions for different stages in the process:

i) Awareness of those representing PSOs and the public sector of the root causes underlying the identified constraints on pro-poor private sector development and economic growth at various levels.

ii) Ability to transfer these issues to the appropriate decision making levels in both private and public sector organisations (horizontal as well as vertical, bottom-up dialogue and communication).

iii) Translation of these issues into appropriate policies, strategies and plans (design of reform) to resolve them effectively.

However, PPD remains important during the stages of implementation and monitoring and evaluation of reform and should be institutionalised accordingly.

Good practice

Essential steps in preparing a specific PPD. Obviously, the way a PPD is designed has to be context specific and adjusted to prevailing institutional arrangements, as shown in Figure 11.1. Issues that need to be considered carefully are: what will be the first issue for discussion, with which participants, level and structure, focus, communication strategy and also the role of donors (Herzberg and Wright, 2005; Bannock, 2005). Good planning is vital, such as the preparation of clear and concise agendas in advance, timeframes that show milestones for each specific outcome, good chairing of meetings and ensuring that all present can participate, agreement on minutes and accountability of the secretariat to the participants (Bannock, 2005). A number of experiences with PPD have been documented recently and analysed for good practices and pitfalls. Most cases refer to PPDs set at the central level, but sub-sector PPDs and processes at district or municipal level have also taken place (Bannock, 2005; Herzberg and Wright, 2005). The next few paragraphs focus on issues that need to be considered in particular for making PPD pro-poor.

Focus of PPD. For a PPD to be effective, it has to focus on problems that include those of MSMEs, that are not too sensitive or politicised, and have the prospect of attainable results in the short term. Business registration may be more neutral than land registration; improving tax administration is less controversial than revising tax rates. PPD is most effective at the lowest level at which entrepreneurs and government services interact (van der Poel *et al*., 2005). Sectoral dialogue has been the most effective in producing results, but central-level PPDs are rarely conducive to MSME participation (Bannock, 2005). Most of the constraints that MSMEs and informal firms and workers face are likely to concern local-level situations that have to be solved there and not at the central level (Figure 11.1). Generally, for MSMEs, the level of urban or rural local government, or the lowest interface with line ministries for certain sub-sector issues, are the most relevant. Still, some of the constraints they face may need policy changes at higher levels.

The weak enabling environment for MSMEs – in terms of overly complex legal and regulatory frameworks, registration, licensing and tax regimes, corruption and limited provision of support – are an obvious area for dialogue. At the same time, this situation is the reason why these entrepreneurs are reluctant to trust the government in the first place. For many, their only contact with government is through the police over regulations and with tax collectors. Before a PPD can be fruitful, local government authorities first need to understand that by collaborating with the private sector they stand more chance of achieving their development objectives and improving their revenue base, while the private sector should understand its obligations but also its right to demand accountability and better services, such as good infrastructure.

Challenges

Importance of strong private sector organisations. The presence of well-organised, accountable and capable private sector organisations organised at various levels makes PPDs more relevant. A lack of such organisations is one of the biggest challenges to be addressed. National-level umbrella or apex organisations would be the best way for the private sector to express its voice, but few such organisations exist that truly defend mutual interests. Most chambers of commerce and business organisations bring together only a small part of the private sector. Membership fees can be high in comparison to the perceived immediate value of services delivered, especially for MSMEs. Few poorer entrepreneurs are members of business organisations and, when they do join, their specific interests may carry limited weight. In all-inclusive organisations, even if most of the membership comes from MSMEs, the small group of larger companies tends to run the show. However, some opportunities for collaboration may exist, in particular when larger firms have many backward and forward linkages with MSMEs in a certain sub-sector.

A shortage of associations that represent the diverse issues of specific sub-sectors or product groups is apparent at all levels. When such organisations do exist, they often lack capacity and resources to effectively voice the opinions and concerns of their constituency and become a serious dialogue partner. Moreover, many grassroots-level private sector organisations are not linked to apex organisations such as chambers of commerce at the regional or central level, which potentially could have taken care of their interests in national-level dialogue processes. This situation hampers dialogue at all levels, vertical as well as horizontal.

A level playing field. An inclusive PPD process requires a level playing field. Even when MSME organisations are invited to a PPD, the effectiveness of their participation may be limited. Small businesses' voices can be drowned out, even in well-established PPD systems with formal structures. Larger firms will always have better informal links to policy makers, so MSMEs need to be well-organised and focussed to make a difference. The design and quality of the PPD can prevent the process and the issues covered being dominated by larger, more powerful businesses. Moreover, convenors cannot limit their work to just inviting the associations and organisations that claim to represent MSMEs. Before starting the PPD, they may have to organise a broader consultation process with MSMEs and assist them in selecting representatives for the PPD, provide training and coaching to these individuals so that they can make their case effectively and assist them with the design of mechanisms for consultation and feedback.

Representation and champions. The composition of a PPD and the quality of the dialogue determines whether the process can make a meaningful contribution to private sector development. The number of participants in a PPD is limited in order to make dialogue possible and the issue of whom to invite and who decides is crucial, particularly when starting up the process. Commitment to the process of respected PSO representatives with a broad support base as well as influential representatives of the public sector are an important condition for arriving at a successful dialogue. Individuals may play an important role in driving such a process (or blocking it). Finding the right "champions" for a PPD is an important factor for a successful PPD. Some successful PPDs have been driven by handpicked individuals (the "champions") but who were not necessarily perceived as accountable to a constituency. The PPD will have to demonstrate legitimacy in order to contribute effectively to reforms, and therefore it can be useful to arrange public awareness and education campaigns related to PPD activities.

Box 11.1. **Value added taxes in Tanzania: An example of a PPD that failed to take account of implications of a new policy for poor entrepreneurs**

Tanzania adopted a VAT system in 1998 under strong pressure from the international development community, and in consultation with private sector representatives. This consultation took place at the national level and mainly involved larger firms. The new VAT system is acceptable for medium and large firms but causes problems for MSMEs and agricultural producers for two reasons. First, many small enterprises are not VAT registered and can therefore not claim back taxes paid on purchases. To alleviate the VAT burden for farmers, agricultural inputs such as fertiliser and seeds are VAT exempt but other production factors such as transport are not. This has led to an increase in production costs of 10%-20%. Second, Tanzania adopted a VAT system based on monthly instead of yearly summaries, which is a major constraint for seasonal businesses (van der Poel *et al.*, 2005). It has been claimed that introduction of the VAT system is one of the main reasons why the realised economic growth has not benefited the poor (Tanzanian Vice President Office, 2005). However, most development partners, government officials and business organisations at the national level were unaware of the costs of the VAT for poor entrepreneurs, suggesting inadequate bottom-up communication processes in both the private and the public sector column in Figure 11.1.

Quality and effectiveness of participation. There is a trade-off between "representativeness" and "capacity for dialogue". General business associations tend to have many members (in some cases membership is compulsory) and should have a broader perspective of the business environment. However, they have less in-depth knowledge of key sectoral issues and very limited grasp of MSMEs concerns. Sectoral organisations and specialised organisations have a deeper understanding of their areas of work, but this may lead to tunnel vision. They may be effective in informal dialogue, but their narrow mandate is a drawback in formal dialogue.

The quality of the PPD, including at the local level, may suffer from the inability of participants to contribute effectively to the analysis of root causes and to developing evidence to support requests for policy reform. Such PPDs tend to produce laundry lists of symptoms. Approaches and tools that facilitate participatory analysis of problems and identify opportunities by local actors exist and can be adapted to local level PPDs.

Facilitation by third parties, providing a neutral space and tools. Third parties who are perceived as impartial and able to provide a neutral space and to facilitate processes play an important role in PPDs. Their contribution is particularly important where there is a history of lack of co-operation and distrust. They may also initially host PPDs by setting up independent secretariats. Ultimately, a public sector organisation should become the convener, to ensure that the outcomes of PPDs will indeed influence public policy, planning and implementation (Bannock, 2005). Apart from providing a neutral space, specialised organisations may also be better equipped to help apply participatory tools for analysis and planning, such as tools for identifying opportunities and risks, and indicators determining the quality of the business environment as perceived by local entrepreneurs and potential entrepreneurs.

Costs and benefits of participation, and danger of allowances. Since structured dialogue processes and mechanisms have a greater financial and time burden, these tend to disproportionately penalise smaller firms and their organisations. Larger enterprises can more easily afford to invest in processes as they are better resourced and often have more capacity

at their disposal. Simply providing *per diems* and fuel allowances to individual participants can undermine a PPD as this has often led to attendance but not to commitment. A more structural approach is, on the one hand, providing support to PSOs and, on the other hand, ensuring that the participants in a PPD experience the benefits. Government officials, however, may prefer a series of formal dialogue events simply to secure the *per diems* and fuel allowances on offer and many of them may be less inclined to participate in more informal gatherings. This attitude may also extend to private sector participants if they too start receiving such allowances. A danger of paying allowances is the potential emergence of private sector organisations (or other types of membership organisation) growing rich on donor funding whilst losing touch with their membership base.

Policy implications

Facilitating pro-poor PPD processes

PPD can provide an important contribution to the PRSP process as well as to more specific reforms aimed at promoting private sector development. Flexible structures (respected convenors, facilitators, resources) need to be in place to accompany PPD processes. A PPD will not automatically promote the specific interests of poorer entrepreneurs unless special efforts are made by convenors and facilitators. It is vital that poorer entrepreneurs are invited and represented, but also equipped to present their interests in a coherent and analytical manner. They may even need research support to gather the evidence that gives credibility to their case (Bannock, 2005). A policy towards pro-poor PPDs therefore needs to include support for facilitators that encourage more effective participation of MSMEs. Approaches and tools need to be made available to MSMEs that enable these actors to see the wider picture, make a diagnosis of their situation and formulate proposals for reform.

Building and supporting organisations representing poorer entrepreneurs' interests

Strong business associations that genuinely speak for MSMEs can be extremely helpful in making sure that the concerns of MSMEs are heard. Two policy approaches are needed: *i)* encouraging self-organisation by MSMEs and co-operation with apex organisations; and *ii)* stimulating general business organisations to become more representative (MSME membership) and enhancing awareness and understanding of MSME issues. Policies in relation to existing organisations need to focus on organisational strengthening and promoting mechanisms that enhance accountability and transparency, as well as capacity building on issues such as sub-sector analysis, lobbying and advocacy in order for them to participate effectively in local PPDs.

Strengthening responsiveness of the public sector to private sector development

Before a PPD can have an impact, policies may be needed that change the mindset of civil servants, especially at district/municipal government level, as well as to ensure that the role of government changes from a controlling to a facilitating and service-oriented influence. Accountability and the establishment of mechanisms to resolve complaints and malpractice need to be addressed too. This policy can only be successful when implemented in top-down processes that require continuous, strong leadership and drive over a considerable period of time, and if it is also accompanied by incentives for local government officials to change behaviour (van der Poel *et al.*, 2005).

Decentralisation

Participatory planning and budgeting processes from the village level upwards are being institutionalised in more and more developing countries with the spread of devolution. These bottom-up processes provide an opportunity to promote pro-poor private sector development. Policy support to PPD processes can provide the foundation for such co-operation. Effective local policy making and implementation further requires that the strengthening of local government authority is accompanied by the allocation of sufficient resources by the central government, so that these entities can adequately perform their role and take care of their responsibilities. Fiscal redistribution and equalisation mechanisms may be needed to support poorer parts of the country.

Institutionalising mechanisms that promote bottom-up communication

In many developing countries, vertical communication and dialogue processes (Figure 11.1) are mostly top-down, while mechanisms for meaningful bottom-up communication processes are weak or absent. The policy measures needed to respond to this situation include the creation of effective and efficient communication lines between different sector ministries and their local counterparts. This will also involve better information provision and capacity building at the local level. Many local government officials lack awareness, information and knowledge on private sector development programmes, strategies and policies.

Implications for donors

Overall, donors need to adopt a more daring attitude towards PPD: treat it as a high risk, but highly essential investment, with a healthy tolerance for failure and the flexibility for innovative and experimental ideas, including an exit strategy that allows ownership of the process by the public and private sector entities themselves (Bannock, 2005). It can be accompanied by support for knowledgeable business journalism or international benchmarking of the business climate. Donors can give more weight to PPDs and support their work by referring to these processes in discussions with policy makers, in publications, etc.

However, donors should stay clear of imposing their own agendas on the PPD process or creating a situation that in the end makes public and private sector entities respond more to donor priorities than to those of their constituencies. Donor support has to be in balance with allocations of time and resources by participants in PPDs. “Buy-in” by both the public and private sectors to PPDs is essential for their success.

Donors can contribute to making PPDs more pro-poor by encouraging PPD organisers to take MSME participation seriously, supporting independent facilitators who have the knowledge and skills to get MSME representatives prepared for a PPD and ensuring a level playing field during the PPD process. MSMEs and representatives of informal firms and workers can be supported with capacity building, guidelines and tools for policy analysis, lobbying and advocacy.

Supporting the emergence and strengthening of private sector organisations representing the interests of MSMEs and informal firms and workers is another important issue that donors may decide to support. However, too much cash can undermine these organisations, by making them lose touch with their membership base. It is therefore

recommended that donors concentrate on developing capacity, while using their influence to ensure that PSOs are included in the policy dialogue.

Development partners can assist with the design of support mechanisms that ensure that PPD processes will be sustained over longer periods of time instead of depending on large one-off financial contributions. In addition, sudden opportunities for constructive dialogue with the public sector may present themselves. It is therefore important that mechanisms are in place that can seize such opportunities for PPD. Experience exists with establishing independent and flexible trust and challenge funds, which are made available to PPD processes. These funds have offered critical flexibility and responsiveness to PPD processes that cannot be provided through donor aid processes (Bannock, 2005). Moreover, donor experience has shown that it is more effective to build capacity for setting up inclusive PPDs at central, sub-sectoral and local level in response to needs and opportunities, rather than to focus on a specific PPD process.

Better co-ordination of reforms for private sector development, and PPDs in particular, is required to prevent overlap, omissions and conflicting programmes. Lessons learned and best practices generated in the many different interventions should be more widely shared and disseminated to ensure incorporation of these into national-level strategies, policies and follow-up programmes. The PRSP process, providing a comprehensive framework for donor support, is one of several on-going reform processes aimed at improving private sector development that is accompanied by a series of PPD-type endeavours. Co-ordination of different private sector development programmes is needed and PPDs may contribute to this.

Notes

1. World Bank (2002), *World Development Report 2003: Sustainable Development in a Dynamic World: Transforming Institutions, Growth, and Quality of Life,* World Bank/Oxford University Press, New York.
2. No specific distinction is made in the framework between informal or formal dialogue, although the focus of this paper is more on formal – and therefore transparent – forms of PPD. Informal dialogue constitutes an important and powerful mechanism too, and may consist of horizontal, vertical and diagonal interactions.

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Executive Summary

Agriculture's central role in stimulating pro-poor growth

In most poor countries, agriculture is a major employer and source of national income and export earnings. Growth in agriculture tends to be pro-poor – it harnesses poor people's key assets of land and labour, and creates a vibrant economy in rural areas where the majority of poor people live. Agriculture connects economic growth and the rural poor, increasing their productivity and incomes. The importance of agriculture for poverty reduction, however, goes well beyond its direct impact on rural incomes. Agricultural growth, particularly through increased agricultural sector productivity, also reduces poverty by lowering and stabilising food prices; improving employment for poor rural people; increasing demand for consumer goods and services; and stimulating growth in the non-farm economy.

A positive process of economic transformation and diversification of both livelihoods and national economies is the key to sustained poverty reduction. But it is agricultural growth that enables poor countries, poor regions and ultimately poor households to take the first steps in this process.

A more challenging context for agriculture growth

Today, rural households face challenges much different than those faced by the "green revolution" producers who achieved sustained gains in agriculture productivity only a few decades ago. Over the past 20 years there has been a substantial decline in public sector support for agriculture and many producers have lost access to key inputs and services. While public sector provision of these services was not very efficient, it often provided the sole linkages to markets for poor rural producers. Today, such links are tenuous and complicated by much greater integration of the global economy. Smallholder producers now compete in markets that are much more demanding in terms of quality and food safety, and more concentrated and integrated than in the past. OECD agricultural subsidies further distort many of these same markets.

Economic integration is accompanied by other challenges that further weaken the socio-economic position of the rural poor. In parts of the world, especially in sub-Saharan Africa, rural areas are hard hit by the HIV/AIDS pandemic, which is disrupting the transfer of knowledge, destroying traditional land allocation systems, and dramatically changing the demographic composition of many rural communities. Climate change with growing population density is increasing pressure on an already fragile natural resource base that

is the mainstay of rural livelihoods. Conflict conditions, many of which result from, or are provoked by poverty, are further eroding the livelihood systems and resilience of rural poor women and men.

The urgency of a new agenda

Attention to agriculture in terms of policy commitments and investment levels has declined in both international donor and developing country policies and programmes, despite the demonstrated high rates of return and the reductions in poverty that come from such investments. Yet achieving the internationally agreed poverty reduction targets will depend on establishing higher rates of economic growth, which equates to growth in agricultural sector productivity for the majority of countries where these targets are relevant. And a more robust agriculture sector will need to be framed within a new agenda that not only matches today's rural and global realities but engages and enables poor households to generate sustainable livelihoods.

Principles of the new agenda

This report identifies four principles of engagement at the core of the new agenda. These principles are essential in defining how the new agriculture agenda should be promoted, and how the investment and policy options proposed under the new agenda should be articulated. These principles are:

- Adapt approaches to diverse contexts.
- Build institutions and empower stakeholders.
- Support pro-poor international actions.
- Foster country-led partnerships.

Adapting approaches to diverse contexts…

Current reality in rural areas is defined by a highly diverse range of stakeholders involved in agriculture – with considerable variation in their assets and access to markets and the way institutions promote or constrain their interests. To address the needs of the rural poor, policy needs to be informed by the dynamics in these processes. That, in turn, needs to be based on an understanding of the place of agriculture in the rural economy and in people's livelihood strategies, in the productive potential of the land and labour involved in agricultural production and the opportunities for agricultural enterprises.

A typology of five "rural worlds" can guide policy makers in understanding the diverse rural and agricultural systems and dynamics and respond with appropriate pro-poor policies. These rural world categories are not mutually exclusive. The typology of rural worlds is used throughout Part III as a guide rather than a rigid framework for differentiating rural households. By using a more differentiated analysis based on people's livelihoods, it makes clear that poverty is located unevenly across and within rural populations, that policy in and for agriculture affects different groups in different ways and that the actions of one rural group can improve or impair the livelihoods of others.

- Rural World 1 – large-scale commercial agricultural households and enterprises.

- Rural World 2 – traditional agricultural households and enterprises, not internationally competitive.
- Rural World 3 – subsistence agricultural households and micro-enterprises.
- Rural World 4 – landless rural households and micro-enterprises.
- Rural World 5 – chronically poor rural households, many no longer economically active.

Local contexts vary in their agro-ecological potential and in the accompanying economic transformation – the contribution of agriculture gradually declines as the economy diversifies. Public policy linked to agriculture should be tailored to a country's agro-ecological potential and the stage of transformation that it has attained. Policies need to be flexible enough to adapt to success and allow for resources to be transferred to other areas of the economy.

Building institutions and empowering stakeholders…

Much of the failure of agriculture to achieve its potential is institutional. Support by the state has been unresponsive to the needs of the poor and inefficient in marketing producers' output, sometimes preventing the natural development of markets for producers. Public institutions need to be strengthened in their capacity to develop an appropriate blend of policies, regulatory frameworks and investments to re-launch the agricultural sector. At the same time, the role of private sector institutions needs to be strengthened to help address a range of problems including: limited access to financial services including credit and risk management instruments, to key inputs such as seed and fertiliser, and to output markets. These problems are often magnified for female producers.

A strategy to strengthen institutions must also develop the skills, the capacity, and the organisation of poor rural producers to maximise their input in the policy processes and ensure accountability of policy makers. A major challenge, particularly in public extension and research services, is the capacity of the institutions themselves to deliver client-focused services for households in Rural Worlds 2 and 3. Years of under-funding and relative neglect have greatly weakened these institutions to deliver in the new agricultural environment, which requires a demand-led rather than supply-led approach.

Supporting pro-poor international actions…

Three important processes can have major impacts on the successful implementation of the new agenda for agriculture. One is the global trade negotiations to reduce agricultural subsidies. A second is a major scaling up of aid in response to the challenge of meeting the Millennium Development Goals. A third is the multi-donor commitment to improve aid effectiveness, as set out by the Paris Declaration of March 2005. On agriculture specifically, G8 heads agreed to support the New Partnership for Africa's Development (NEPAD)-inspired, comprehensive set of actions to "raise agricultural productivity, strengthen urban-rural linkages and empower the poor". The way these processes play out in the short and medium terms will have an important bearing on conditions for enabling pro-poor growth through agriculture.

Fostering country-led partnerships…

The Paris Declaration calls for an ambitious reform in the way aid is managed and donors should be guided by these principles in helping countries unlock agriculture's potential contribution to pro-poor growth. National poverty reduction strategies (PRSs), the

main point of reference at the country level for operationalising the aid effectiveness agenda, are critical for implementing the new agenda for agriculture. But agriculture and rural development have been neglected in past PRSs, largely due to an inadequate understanding of the agricultural and rural dimensions of poverty. A key challenge is to redress the imbalance in the PRSs – to raise the profile of the productive sectors in general, and of agriculture in particular. More specifically, attention must be given to effective monitoring frameworks in supporting improved decision making, flexible implementation, and increased accountability. Development processes are the outcome of power, knowledge and information relationships. It is therefore important to promote the participation of all PRS stakeholders, including rural producers and their organisations, in the development of policies and investments with the aim of influencing and eventually re-orienting their implementation.

Priorities for action in the new agenda

Efforts to stimulate agriculture's role in pro-poor growth should, on the basis of the principles above, be used to guide renewed attention to three priority areas. These are to:

- Enhance agricultural sector productivity and market opportunities.
- Promote diversified livelihoods on and off the farm.
- Reduce risk and vulnerability.

Enhancing agricultural sector productivity and improved market opportunities…

Improving sector productivity and expanding market access is at the core of a more robust agricultural economy. Productivity gains will depend upon a supportive policy environment that enables rural producers to use the resources available to them more efficiently and sustainably. Secure and equitable access to land and water resources, rangelands, fisheries and forests is a key ingredient of this policy environment. The development of rural financial services is equally important to allow for purchases of inputs and equipment in order to increase the productivity of land and labour and stimulate income-generating activities. Productivity gains will also depend upon access to information and technology developments framed by a demand-led and multidisciplinary approach. Market access will depend on improved physical access and reduced transactions costs, particularly through appropriately targeted infrastructure and better transport services. Support for producer associations will enhance capacity to engage in market places dominated by increasingly large food processing and modern food retail industry such as global supermarket chains.

Promoting diversified livelihoods…

The connections between the agricultural and non-agricultural rural economies are key drivers of diversified livelihoods. A thriving agriculture sector underpinned by improved productivity will expand the rural economy and influence wages and food security. Traditionally, agricultural policy has focused on increasing agricultural production, neglecting investment in post-harvest enterprises and non-agricultural assets for more diversified rural livelihoods while treating as socially undesirable those household strategies involving movement out of rural areas. To reverse this trend,

governments and external partners should improve their understanding of labour markets and migration patterns and incorporate that understanding in national policies; establish functioning land markets, so that people are more able to move to new forms of economic activity; promote entrepreneurship; and tailor investments in infrastructure, education and health services to new livelihood patterns.

Reducing risk and vulnerability…

Poor households with livelihoods dependent on agricultural production face numerous shocks and stresses, some potentially catastrophic. The level of risk facing poor rural households has risen with increased market exposure linked to globalisation matched by the retrenchment of the state for the direct provision of services such as those provided through state marketing boards, subsidies and price controls. Domestic shocks, such as the HIV/AIDS pandemic, have further weakened the position of many poor households. Reducing levels of risk, where possible, and provision of instruments to reduce vulnerability has to be a central element of pro-poor agriculture policy. This not only provides social protection for poor people, but enables them to undertake new, viable but more risky livelihoods, increase their participation in markets and generate pro-poor economic growth.

Managing the change process

In the real world the transformation from a system wholly dependent on low-productivity agriculture and a weak agricultural sector to one that is diverse and dynamic and that presents broader opportunities to poor people is not entirely virtuous. The main challenge is that poverty persists in communities with poor market access, poor natural resource endowments and little political capital. Many rural households remain vulnerable to shocks of various kinds, and their livelihoods are exposed to high levels of risk. Pro-poor policies must remove and relax the barriers and constraints faced by poor households as well as provide new incentives and support for their sustainable participation in more equal, market-based relations and exchanges. This does not mean that policies in and for agriculture should become social policy. But it strongly suggests that economic policy, including agricultural policy, should be consistent with social objectives and, where possible, address them directly.

Against this background, donors will need to find ways to work effectively with their partners to promote sustainable, country-driven and programme-based development that recognises the important contribution of agriculture to pro-poor growth. Donors can help build research and institutional capacity to underpin and inform the change processes. They can facilitate the involvement of rural stakeholders in shaping these policies, institutions and investments to ensure that they respond to livelihood needs. They can foster dialogue and support efforts to establish open, participatory monitoring frameworks. And they will need to do this in a way that responds to the partner country's long-term vision for agriculture in a pro-poor growth context.

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PART III

Chapter 12

Why we Need a New Agenda for Agriculture

Throughout history, increases in agricultural sector productivity have contributed greatly to economic growth and the reduction of poverty. The past 30 years have seen global successes in food production lead to an overall decline in world food prices; increased caloric intake; reductions in the percentage of undernourished people; and boosted rates of return to some key investments in agriculture.

We know that economic growth is essential for reducing poverty and that agriculture has in many places connected broader economic growth and the rural poor, increasing their productivity and incomes. Those higher rural incomes increase the demand for consumer goods and services, in turn stimulating the rural economy, boosting growth and reducing poverty even further. Agricultural sector growth reduces poverty by harnessing the productive capacity of the poor's key assets of land and labour, by lowering and stabilising food prices, by providing labour-intensive employment for the poor and by stimulating growth in the rural economy.

In recent decades, however, this virtuous set of relationships has been threatened. New global trading conditions have been disadvantageous to poorer producers. Developing countries continue to give high levels of protection to their own markets. Recent policies for economic restructuring have not produced positive results. Gaps opened by the removal of public support to agriculture have not been filled by the private sector. And public investment in agriculture has declined.

At the same time, the focus on reducing poverty has sharpened. International donors and national governments are targeting poverty more explicitly, through new and more effective approaches. But these efforts have not yet given enough attention to what economic growth can do to reduce poverty or how agriculture can contribute to that growth.

This is the new context for agricultural policy, and a new agriculture agenda is needed to address it. The new agenda must promote investments in higher productivity activities and links to new market opportunities in urban centres and in regional and global markets. In tandem with improved productivity, it must encourage the development of the broader agricultural sector and rural economy, so that the benefits from agriculture can be realised. It must also make it easier for small producers and landless agricultural workers to diversify out of agricultural production. And it must reduce risk and vulnerability across the rural world. In short, there has to be a shift from a traditional sectoral agenda for agricultural production to a broader agenda for the agricultural sector and rural livelihoods.

Understanding the diversity and dynamics of rural livelihoods

Devising the right policy environment requires in-depth knowledge of the livelihood strategies of rural households and careful consideration of ways to protect and promote

those strategies. It also needs to reflect the large disparities among the many categories of rural households, or "rural worlds". Consider five:

Rural World 1: Large-scale commercial agricultural households and enterprises.

Rural World 2: Traditional land holders and enterprises, not internationally competitive.

Rural World 3: Subsistence agricultural households and micro-enterprises.

Rural World 4: Landless rural households and micro-enterprises.

Rural World 5: Chronically poor rural households, many no longer economically active.

These categories are not mutually exclusive, and there will always be important exceptions to the general classifications here. The typology (Orden, 2004) is intended as a guide rather than a rigid framework for differentiating rural households.

The interdependencies among these rural worlds are critical to understanding the challenges facing the rural poor and to finding solutions. They deserve close examination – and good understanding of the local rural economy. The main factors in developing this typology include the financial and physical holdings of the household; the access to labour and product markets and to a variety of services needed to sustain livelihoods, including finance, information and infrastructure; the provisions for health care, education, and training and upgrading skills (especially for women); and the social networks that enable households to benefit from their participation in economic, political and social institutions and organisations.

Livelihoods in rural areas are complex and diverse, affected in different ways by policies to promote agricultural growth. Policies for effective poverty reduction need to be informed not just by the evidence of agriculture's contribution to pro-poor growth but by a good understanding of the realities and dynamics of both the agricultural sector and rural livelihoods – and of how poor rural households are constrained or supported by policies and institutions. The challenge for policy makers is to base policies on good understanding of their complexity and diversity.

In addition, the feminisation of agricultural work requires a clear gender perspective to be integrated into policies for effective poverty reduction (Box 12.1). Not only are women the mainstay of the agricultural food sector, labour force and food systems – they are also largely responsible for post-harvest activities (CIDA, 2003).

Box 12.1. **Cambodia: Agriculture feminised**

In Cambodia 65% of the agricultural labour and 75% of fisheries production are in the hands of women. In all, rural women are responsible for 80% of food production. Half the women producers are illiterate or have less than a primary school education; 78% are engaged in subsistence agriculture, compared with 29% for men. In rural areas only 4% of women and 10% of men are in wage employment.

Households headed by women are more likely than households headed by men to work in agriculture, yet they are also more likely to be landless or have significantly smaller plots of land. Policies, programmes and budgets for poverty reduction must thus address the situation of Cambodian women.

Source: Gender and Development Network and NGO Forum on Cambodia (2004).

The rural world typology helps in beginning to understand these systems and dynamics and to develop pro-poor policies (see the spotlight at the end of this chapter) (Mahoney, 2004). By using a more differentiated analysis based on people's livelihoods and how these livelihoods are situated in the local agricultural and broader rural economies, the typology makes it clear that poverty is located unevenly across and within rural populations, that agricultural policy affects different groups in different ways and that the actions or activities of one group of rural people can improve or impair the livelihoods of others.

This analysis of rural livelihoods in relation to the agricultural sector reveals the rising dependence of many people on sources of support from outside the household's agricultural production unit, from activities outside the broader agricultural sector and from urban (even regional and global) markets. It also reveals how some rural households have few or no assets for productive activity and are highly vulnerable to all sorts of shocks (Box 12.2).

Box 12.2. **Defining agriculture**

Agriculture includes households engaged in farming, herding, livestock production, fishing and aquaculture. Also included are other producers and individuals employed in cultivating and harvesting food resources from salt and fresh water and cultivating trees and shrubs and harvesting non-timber forest products – as well as processors, small-scale traders, managers, extension specialists, researchers, policy makers and others engaged in the food, feed and fibre system and its relationships with natural resources. This system also includes processes and institutions, including markets, that are relevant to the agriculture sector.

Agriculture's importance for pro-poor growth – the evidence

Agriculture accounts for the bulk of employment in developing countries and contributes significantly to national income and export earnings. Given its dominance in the economy, it will remain a primary source of growth and means of poverty reduction for some time. It remains the backbone of the rural economy, and employs the majority of the world's poor people. The proportion of poor people remains highest in sub-Saharan Africa, where slow economic growth has left millions at the margins of survival. In sub-Saharan Africa alone, more than 314 million people continue to live on less than USD 1 a day. And in most regions poverty remains a largely rural phenomenon.

The contribution of primary agricultural activities to the economy of developing countries averages about 13%, ranging from 8% in Latin America and the Caribbean to some 28% in South Asia, with much heterogeneity among countries in the different regions. In addition, "extended agriculture", which incorporates farm and non-farm agricultural enterprises, contributes a much greater share of gross domestic product (GDP) – in Latin America, 30% of GDP. As countries develop, primary agriculture's share in national income declines. For example, the share of agriculture in India's GDP declined from about 45% in the early 1970s to 27% in 2001. Despite this decline, some 60% of India's people still depend on agriculture for their livelihood. In sub-Saharan Africa, agriculture accounts for 20% of GDP, employs 67% of the total labour force and is the main source of livelihood for poor people. The World Bank estimates that in African countries women do at least 70% of the agricultural work (Mark Blackden, interview, World Bank, 23 February 2005). Although the share of GDP in agriculture is declining in many countries in the region, it is increasing in others, as agricultural value added rises or non-agricultural sectors shrink (Dixon *et al.*, 2001).

At the macro level, growth in agriculture has consistently been shown to be more beneficial to the poor than growth in other sectors. In several South Asian countries poverty reduction through growth in agriculture was higher than that through growth in manufacturing (Warr, 2001). Similarly, for every 1% of growth in agricultural GDP the positive impact on the poorest was greater than that from similar growth in manufacturing or services (Gallup *et al.*, 1997). Such impacts are usually best realised where there is an equitable distribution of assets, particularly land (de Janvry and Sadoulet, 1996). Rural-urban links are also important. Growth in India's rural sector reduced poverty in both rural and urban areas, while urban growth reduced rural poverty (Datt and Ravallion, 1996).

Variations in poverty reduction mirror the variations in per capita agricultural growth. And agricultural growth, particularly the growth of agricultural sector productivity, plays a significant role in poverty-reducing growth (Thirtle *et al.*, 2001). Very few economies around the world have achieved broad-based economic growth without agricultural and rural growth preceding or accompanying it (Mellor, 2000; Pinstrup-Andersen and Pandya-Lorch, 2001).

In Asia, the rapid productivity gains of the Green Revolution offered a route out of poverty by increasing incomes and labour rates, lowering rural and urban food prices and generating new upstream and downstream livelihood opportunities. This productivity growth further stimulated and sustained wider economic diversification and transformation beyond agriculture. But in much of sub-Saharan Africa, with a different set of predetermining factors, productivity has stagnated or even fallen (Nkamleu *et al.*, 2003).

The multiplier effects of agriculture on the economy are estimated to be in the range of 1.35 to 4.62 (Thirtle *et al.*, 2001), though those for sub-Saharan Africa are at the lower end, with important implications for investment decisions in agriculture there (Box 12.3). Income from agriculture tends to be spent on a range of goods and services at the local or sub-national level, fostering opportunities for local diversification. So, while agriculture remains a primary contributor to growth, particularly in the early stages of development, it cannot function in isolation from the wider economy. It requires a supportive environment, including the removal of factors constraining its growth such as infrastructure. Nor can it drive growth alone – also needed are structural changes that support knock-on effects in local product and labour markets (Dorward *et al.*, 2004).

Box 12.3. **What impact can higher agricultural sector productivity have on reducing poverty?**

A lot. Consider these figures:

- A 10% increase in crop yields leads to a reduction of between 6% and 10% of people living on less than USD 1 a day (Irz *et al.*, 2001).
- The average real income of small farmers in south India rose by 90% and that of landless labourers by 125% between 1973 and 1994 as a result of the Green Revolution (World Bank, 2001).
- A 1% increase in agricultural GDP per capita led to a 1.61% gain in the per capita incomes of the lowest fifth of the population in 35 countries (Timmer, 1997).
- A 1% increase in labour productivity in agriculture reduced the number of people living on less than USD 1 a day by between 0.6% and 1.2% (Thirtle *et al.*, 2001).

A recent companion study to this report, *Pro-Poor Growth in the 1990s: Lessons and insights for 14 countries,* confirms what agricultural growth, with its strong links to non-agricultural growth, can do to reduce poverty. In the case study countries, most of the reduction in poverty was among households primarily (though not exclusively) engaged in agriculture. This was true even though non-agricultural growth was generally faster and even though agriculture contributed only 10%-30% of GDP. Agricultural growth had its greatest impact when it was driven by the crops that poor farmers cultivated most (World Bank, 2005a).

The changing context

In recent decades the context for formulating and implementing agricultural policy has changed fundamentally. Today's explicit focus on poverty reduction informs international and national policy. But public investment in support of agriculture has been withdrawn. Markets important to poor producers have deteriorated, partly a result of protectionist measures in the developed world. New health and other shocks are changing the demographics in rural areas, reducing productive capacity. And the natural resource base that agriculture depends on is succumbing to environmental pressures.

Some key details:

- Since the Green Revolution of the 1960s – the main benchmark historical event for understanding agriculture's impact on poverty reduction – prices for the main commodities produced by developing countries have declined steeply. In more recent times, retail chains and their high product standards have become more influential, often leaving poor small-scale producers, especially women, unable to engage.
- Policies for more market-based development – promoted by the international financial institutions that poorer countries depend on – have not been very successful in agriculture. Indeed, they have constrained governments from providing support to producers. Many producers have in the process lost access to key inputs and services, including credit and extension.
- Many producers continue to lack financial services, are poorly linked to markets and do not have the information or knowledge to exploit beneficial technologies. The private sector has failed to fill gaps created by the withdrawal of public services because of the inherently risky nature of agriculture and because governments have failed to generate positive and stable enabling environments.
- The new context has particular impacts on women, given their prominence in agriculture. Their mobility is often restricted to the neighbourhood, to daytime and to interactions with familiar locals, clearly reducing their access to work, markets and transportation. The implicit lower ranking of women in society is associated with less ownership, access to and control of resources and decision-making.
- The natural resource potential for agricultural development is different from that in the 1960s. The degradation of resources is more common. The opportunities for irrigating new areas are more limited. And climate change might disrupt agriculture in many areas.

An important dimension of the new context for agricultural policy is the record of poverty reduction in the world's different regions. Although poverty persists in parts of South and Southeast Asia, the projections are reasonably promising. The reverse is so for sub-Saharan Africa, where poverty is in many areas becoming deeper and solutions seem

very difficult to find. The relatively poor status of sub-Saharan Africa is highlighted in the UN's recent assessment of the Millennium Development Goals, which indicated little or no progress being made across the main targets in sub-Saharan Africa while greater progress was being achieved in the other regions (UN, 2004). International efforts thus need to be focused predominantly (but not exclusively) on sub-Saharan Africa. Because the conditions there are so different from those in Asia in the 1960s, this poses new challenges for agriculture. Can an African process be established to match that of Asia in the 1960s?

Another important dimension is that the imperatives of policy have shifted to a more explicit focus on the reduction of poverty, with increases in agricultural production seen as means to that end rather than ends in themselves. International objectives – such as the Millennium Development Goals and national poverty reduction strategies – have become major determinants of the priorities for public investment. It is now recognised that achieving internationally-agreed poverty reduction targets depends on establishing higher rates of economic growth, which means growth in agriculture for the majority of countries where these targets are relevant. For most developing countries, poverty targets will not be reached without increases in agricultural output and sector productivity.

Given this new context, a new response is needed from agriculture. In the new agenda, many of the needed investments and actions will be recognisable from traditional approaches to agriculture. Some of the new agenda is about delivering on such neglected fundamentals as infrastructure and the development of new technologies. But some is about looking at the wide range of rural livelihoods and coming up with policies, institutions and investments that increase the productivity of households across that range. Some is about supporting diversified livelihoods off the farm. And some is about reducing risk and vulnerability.

What's needed for pro-poor growth in agriculture? The new agenda

Part III identifies three priority actions at the core of the new agenda that should guide policy formulation, institutional development and investments for and by the poor:

- Enhancing agricultural sector productivity and market opportunities (Chapter 2).
- Promoting diversified livelihoods (Chapter 3).
- Reducing risk and vulnerability (Chapter 4).

The potential for enhanced agricultural sector productivity to stimulate pro-poor growth has been demonstrated most vividly in the Green Revolution, but there has been a failure to realise this potential more widely through existing policy and market arrangements. Greater harnessing of this potential has to be a central policy objective, especially in areas where the natural resources are available for sustained increases in productivity and in countries at a stage where agriculture can make a significant contribution to economic development. In these countries, small production units predominate and account for a large share of employment. A focus on enhancing the productivity of small producers is thus justified because of the greater impact on poverty and growth generated through increases in employment.

It has been realised for some time that rural people do not specialise in crop production, fishing, forest management or livestock-rearing to the exclusion of other sources of income. Instead, they combine a range of activities and occupations to build a diverse portfolio of activities. One reason for this diversification is the need to address the inherent risk and vulnerability of an activity that is dependent on the vagaries of nature

and is thus inherently risky. Although few longitudinal studies exist, there is general agreement among researchers that the diversification of occupations and the proportion of income from sources outside the household's agricultural production unit are increasing.

The importance of non-production unit occupations for reducing poverty may be recognised by governments and donors, but policy has not reflected it. Why? Perhaps because it is widely believed that agricultural growth is the most important driver of the rural economy. The focus has thus remained on increasing producer incomes, with supplementary efforts to enhance skills and improve access to credit and productive assets.

The neglect of the largely unrecognised potential in input enterprises and post-harvest agricultural enterprises continues to hinder the development of policies and supports to encourage and expand the agricultural industries and services that add value to produce. There is substantial scope to marry improved production-unit productivity and market access with agricultural enterprises that contributes to the local and national economy through increased employment and new investments.

Recent research on rural livelihoods shows, however, that many diversified occupations are closely linked to urban areas. The synergy between agricultural sector growth and urban-based enterprises is a key to local economic development and, at a wider level, to pro-poor growth (Tacoli, 2004). It is also becoming more apparent that many diversified occupations, especially those pursued by people in marginal areas, are situated in urban locations – and given the poor prospects for substantial increases in household incomes in these marginal areas, those occupations are providing an important livelihood source.

There is also growing awareness of the problems facing those in many marginal areas – where mutually reinforcing environmental, physical, institutional, social and political factors trap them in low-productivity agricultural production and low levels of diversification, with few prospects for exiting poverty. But policies remain ill-informed about such constraints – and are ill-equipped to support multi-locational livelihoods. Indeed, governments often discourage mobility and informal activities, vital for livelihood diversification, in an effort to control urban "explosions".

What is needed, therefore, is a broader entry point for poverty reduction, one tailored to the diversity of livelihoods, not just to increasing the incomes of production units. Better understanding is needed of the market and non-market constraints facing the poor in rural areas – and of how greater mobility and stronger rural-urban links can reduce poverty and promote regional development (Box 12.4).

While strategies for diversified incomes enable both men and women to increase their income, they may also create problematic livelihood situations. Many who cannot obtain a livelihood from their land must migrate to cities or to other rural areas for seasonal work. The needs and realities of migrant women and men, seasonally employed in the agricultural sector, need to be addressed, and gender-sensitive services need to be adapted to their livelihood patterns.

Box 12.4. **What's new in the broader agenda for agriculture**

Views under the traditional agenda	Views under the new agenda
Policies, institutions and investments in agriculture	Policies, institutions and investments *in* and *for* agriculture
One rural world	Multiple rural worlds
National markets	National, regional and global markets
Production units	Livelihood units
Agriculture = production	Agriculture = agricultural sector (inputs + production + post-harvest + manufacturing)
One work location	Multiple work locations
Single sector approach	Multi-sectoral approaches
Public sector	Public and private sectors
Food crops	Diverse income streams
Growth only	Growth that minimises risk and vulnerability
Driven by supply	Driven by supply and demand
Fundamentals acknowledged	Fundamentals delivered
The fundamentals are science, technology, infrastructure, land policy and education, extension and training.	

Implications for policy

Economic transformation reduces the direct opportunities for poor people in primary production agriculture but also increases the opportunity for them elsewhere in the economy, including agricultural and non-agricultural industries and services. If policy is to have a much greater impact on poverty, it needs to address the needs of poor people, including those who have to move out of agricultural production. Policy, to be genuinely *pro-poor*, should at a minimum not constrain the access of poor people to the new opportunities – and should preferably make it easier for them to participate in those opportunities, be they rural or urban based. It must also have an integrated gender perspective.

In the real world the transformation from a system wholly dependent on low-productivity agricultural production to one that is diverse and dynamic and that presents broader opportunities to poor people is not entirely virtuous. It is a process with serious imperfections. The main one is that poverty persists in communities with poor market access, poor natural resource endowments and little political and social capital. Many people remain vulnerable to shocks of various kinds, and their livelihoods are exposed to high levels of risk. So for policy to be pro-poor, it should take account of the needs of people left behind. Again, this does not mean that agricultural policy should become social policy. It strongly suggests, however, that policy should be consistent with economic and social objectives and, where possible, address them both directly.

Within agriculture, policies are needed to ensure that small producers and the landless have a viable future. Unlike the rich countries, which can afford to subsidise their small producers, the preponderance of small production units in most developing countries requires that, net of the costs of assisting them, those units add to national economic growth, not detract from it. Needed therefore are public policies and investments that promote small producers and are tailored to the local context.

Implications for institutions

One of the main constraints to pro-poor growth through agriculture has been the weak link between poor rural households and public and private institutions for research, extension, marketing and finance. The most effective roles for government and the private sector are not well understood. The private sector has been slow to fill the gaps left behind when public sector support was withdrawn. In many cases, institutional arrangements limit the extent to which poor people can be engaged. Inappropriate service locations and staff capabilities, coupled with the low education levels and meagre assets of producers and landless labourers, continue to result in widespread and deeply embedded failures to address the problems of poorer households.

Overcoming these constraints requires a fundamental realignment of the institutions that provide agriculture-related services to poor rural households. It requires innovative institutional arrangements, including partnerships among public, private and civil society organisations. It requires appropriate services for poorer men and women and for more market-oriented producers. These new arrangements must be matched with processes that encourage staff within those organisations to work with poor households and to build their capacities to do this work. The capacities of agricultural producers, both individual and collective, must also be built through educational and social processes that can enable them to shape the nature and quality of services they receive. Meeting this challenge of institutional reform will require substantial commitments and resources from the public sector.

Implications for investments

Many poor rural households suffer from "ecological poverty", their livelihoods constrained by the impoverishment of the natural resources they depend on. Investing in natural capital can be a central part of poverty reduction strategies addressing the needs of poor rural households. These investments must be coupled with efforts to ensure that the poor obtain a fair share of the benefits generated by the natural assets they already own and manage. And greater attention must be devoted to sound stewardship of "open access" environmental resources, often appropriated by the more economically powerful in society, to the disadvantage of poor people.

Aid needs to be channelled through effective mechanisms, such as those linked to the poverty reduction strategies of governments, especially where economic growth and rural poverty are being targeted. For Development Assistance Committee (DAC) member countries, this implies substantial, long-term commitments and a more harmonised approach to aid investment. For national governments it implies policies, developed with the participation of the poor, that give priority to the reduction of poverty and are conducive to the promotion of pro-poor growth.

Spotlight on Five Rural Worlds

Rural World 1 – large-scale commercial agricultural households and enterprises

Rural World 1 households and enterprises engaged in high-value, export-oriented agriculture, make up a very small minority of rural households and firms in the developing world. In addition to their land and other holdings, producers and firms in this category have direct access to finance, risk management instruments, information and infrastructure necessary to remain competitive in their business operations. Most have an influential voice in national policies and institutions affecting their enterprises and, perhaps even more important, close ties to buyer-driven value chains associated with global agriculture. Rural World 1 producers and firms are considered to be important sources of employment because they depend on inexpensive labour and reliable contract farming agreements to ensure a timely supply of quality produce.

The economic power of this group enables them to influence the political affairs of their countries. They often use this influence to shape public policies that favour their interests and to steer public expenditures to investment priorities that meet their needs. They are well positioned to meet the strict new regulations imposed by importing nations and by retail buyers expanding operations in regional and national markets.

Rural World 2 – traditional landholders and enterprises, not internationally competitive

Rural World 2 accounts for a substantial number of rural households and agricultural firms in the developing world. The one word that most aptly characterises them is "traditional". They are frequently part of the local elite but have little influence at the national level. They have sizable landholdings often devoted to both commercial and subsistence agriculture. They previously had access to basic services, such as finance, but with the advent of liberalisation and the consequent withdrawal of the state from a direct role in agriculture, the availability of these services declined rapidly. Access to formal risk management instruments is limited.

Rural World 2 producers have few ties (if any) to the important agribusiness supply chains. Their traditional orientation, embedded in local networks, is becoming less appropriate as national and international interdependencies reshape rural societies throughout the developing world. Some researchers argue that with better access to improved technologies and infrastructure services, Rural World 2 producers could regain some of their competitiveness, particularly in food staples. The more entrepreneurial members of this group are learning from their Rural World 1 neighbours and becoming more commercial. They are also benefiting from investments in services directed primarily at Rural World 1, such as improved transport systems.

Rural World 3 – subsistence agricultural households and micro-enterprises

Rural World 3 households – fisherman, pastoralists, smallholders and associated micro-enterprises – are survivalist. Food security is their main concern, and their small production units are almost totally dedicated to home consumption. Their assets are poorly developed, and they have very limited access to services (credit) that would enable them to increase the returns to their assets. Their ability to manage risk and associated vulnerability is limited to informal means, thus severely constraining their ability to take on higher risk, higher return livelihood opportunities. Many live in fragile ecosystems or less favoured regions and depend on off-farm employment for a significant percentage of their livelihood. This group embraces many women and female-headed households, who are among the poorest and most exposed in rural areas. The social sphere of Rural World 3 rarely extends beyond local communities, and their voice is almost unheard in the broader socioeconomic and political affairs shaping their lives. The economic fortunes of Rural Worlds 1 and 2 greatly affect Rural World 3's employment and income-earning opportunities, and sustained periods of growth give some the option of leaving subsistence production altogether.

Rural World 4 – landless rural households and micro-enterprises

Rural World 4 households are landless, frequently headed by women, with little access to productive resources other than their own labour. Sharecropping or working as agricultural labourers for better-off households in their communities is perhaps the most secure livelihood option for many of them. For others, migrating to economic centres on a daily, seasonal or even permanent basis is their best hope for survival. But their low education levels are a major barrier to migrating out of poverty.

Community ties, the glue in this group's socioeconomic sphere, can be an important asset in seeking out alternative livelihood options. But participation in more influential economic and political networks is not common. As for Rural World 3, the fortunes of Rural World 4 rely on Rural Worlds 1 and 2 for employment and income-earning opportunities.

Rural World 5 – chronically poor rural households, many no longer economically active

Rural World 5 households are chronically poor. Most have sold off or been stripped of their asset holdings during periods of crisis. Remittances from relatives, community safety nets and government transfers are vital to their sustenance. As a result of the HIV/AIDS pandemic, many more households are facing this precarious situation. Entrenched gender inequalities exacerbate this problem. Social exclusion often typifies the relationship of Rural World 5 to the larger community. Cash and in-kind transfer schemes will be critical for this group for some time.

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PART III

Chapter 13

Increasing Productivity and Improving Market Access

Increasing productivity and improving market access

Successful pro-poor growth strategies led by agriculture depend on increased agricultural sector productivity and improved access to domestic, regional and global markets. But there is potential for further production unit – based productivity growth, which has not been fully exploited under existing policy and market arrangements. Harnessing this potential will immediately improve conditions for poor rural households – either directly through market prices or indirectly through labour markets.

The weak human capacity of producer households and inappropriate and risky technologies can undermine efforts to achieve higher levels of productivity and diversify production into higher value products. Insecure and limited access to land, water and finance compound these weaknesses. Sustained and targeted policies that address these challenges and take account of local contexts can help realise agricultural households' production potential. Delivering such policies requires combined and co-ordinated efforts by public, private and civil society organisations.

Market access is critical for agriculture to become the main driver of pro-poor growth. Households and firms in Rural Worlds 1 and 2 rely heavily on access to markets for their agricultural production and on the labour from Rural Worlds 3 and 4 to produce surpluses. Reasons for poor market access include the global "rules of the game" – restrictions, standards and subsidies of wealthy states – down to local-level factors. They also include the poor organisation and influence of producers, weak transport and communications infrastructure and limited market information. Addressing these constraints requires policy shifts at the regional and global levels – and substantial investment in the transport infrastructure to enable produce to move from production units to the marketplace. Strengthening social capital, in such forms as producer organisations, can ensure that agricultural households have the ability to negotiate in the marketplace and secure fairer prices for their products.

Agricultural households in Rural Worlds 2 and 3 can improve their incomes through enhanced engagement with the market place underpinned by an ability to increase productivity in a sustainable way. Commercial producers and firms in Rural World 1 provide employment opportunities for households in Rural Worlds 3 and 4 and their pioneering in regional and global markets open future opportunities to producers in Rural Worlds 2 and 3. These commercial agricultural businesses can be viewed as "engines of growth" within the wider rural economy, stimulating and sustaining the labour market and opening commodity markets.

Framing agriculture's contribution to pro-poor growth in the new context

Agricultural sector productivity gains and market access lie at the core of a more robust agricultural economy and of pro-poor growth. Endeavours to increase sector productivity and expand market access must recognise from the outset, however, that the challenges facing today's rural households are much different from those confronted by

the Green Revolution producers who recorded rapid and sustained gains only two or three decades ago. Many of today's poorest producers live in less favoured or fragile regions, whose agricultural potential is being jeopardised by degradation of the natural resource base and constrained by inadequate attention to infrastructure needs.

In sub-Saharan Africa, where many of the poorest rural households are located, there is no dominant food-production system. Instead, a wide variety of production systems serve as the livelihood foundation for agricultural communities. The demography of these and many other rural communities is also changing rapidly, as agriculture is increasingly becoming feminised through the effects of migration and the impacts of HIV/AIDS. Many producers lack access to key inputs and services, including credit and extension. Moreover, many small producers now compete in markets that are much more demanding in quality and food safety and distorted by OECD agricultural subsidies and the trade barriers of developing countries.

In many poor countries, especially in Africa, there still is excellent growth potential for small producers in the food staples sector (cereals, roots and tubers and traditional livestock products). For Africa as a whole, the consumption of these foods accounts for the lion's share of agricultural output and is projected to double by 2015. This will add another USD 50 billion to demand (in 1996-2000 prices). Moreover, with more commercialisation and urbanisation, much of this added demand will translate into market transactions, not just additional household consumption.

No other agricultural markets offer growth potential on this scale to reach huge numbers of Africa's rural poor. Many small producers could double or triple their incomes if they could capture a large share of this market growth. Simulations with economy-wide models at the International Food Policy Research Institute confirm this conjecture. For Ethiopia (a poor and food-deficit country) the fastest way to reduce poverty by 2015 is through productivity growth in food staples. This strategy outperforms a strategy built around increasing the production of high-value products (Hazell, 2004). If small producers are to capture a fair share of this growth in food staples, particularly in Africa, they will have to become more competitive, especially against cheap food imports from abroad.

In many middle- and higher-income countries in Asia and Latin America, food staple market opportunities are more constrained, with demand growth linked more to growth in livestock feed or export opportunities than to domestic human consumption. In these cases small producers need urgently to diversify into higher value products that face much better demand prospects. A challenge for this "new" high-value agriculture is to make it pro-poor. Left to market forces alone, the major beneficiaries of the new high-value agriculture will mostly be the larger and commercially oriented producers and producers well connected to roads and markets. The majority of small producers are likely to get left behind. Fortunately, there is great opportunity to guide the new high-value agriculture so that small producers and even many backward regions can participate.

Influence in society, both in official organisations and informal village associations, is distributed along gender lines. Hence policy needs to consider women's access to, and interaction with, informal and formal networks, marketing organisations and administrations – as well as training for women producers and entrepreneurs to learn about and adapt to new economic structures and marketing.

Increasing the agricultural sector's productivity

The productive potential of agriculture is highly varied and depends on the natural endowment, geographical location, links to the rest of the economy and social dimensions of the population. But the general failure in recent decades to achieve sustained rates of agricultural sector productivity and the pro-poor growth linked to it, especially in sub-Saharan Africa, can be put down to inappropriate policies; inadequate institutions and services; failures to invest in appropriate infrastructure; and failures to invest in the development of the human, social and natural capital that agricultural households need to achieve higher productivity.

Governments need to make choices in allocating resources for the support of agriculture. There is a strong argument to prioritise such support to producers and enterprises of Rural Worlds 2 and 3, where the stage of economic development of a country and the availability and relative cost of labour mean that there would be a greater impact on poverty from government support (Box 13.1). For poorer countries the attraction of small production units lies in their economic efficiency relative to larger units. They can create large amounts of productive employment, reduce rural poverty, support a more vibrant rural economy and help reduce rural-urban migration.

The very limited capacity of the vast majority of poor rural households to access, analyse and utilise new knowledge on improved practices is a binding constraint to enhanced productivity. Research, development and information services that address this constraint have been weakened by years of under-funding and by failures of institutions to respond in relevant ways to the needs of agricultural producers, especially those in Rural Worlds 2 and 3 (IFAD, 2004). As a result, producers who lack the resources to obtain it on their own have not had access to the information and technologies that would enable them to adopt improved production strategies and increase the income and well-being of their households.

Pro-poor strategies for agricultural research and its dissemination need to be tailored to the needs of the rural worlds and be aware of the broad range of factors affecting their adoption of new technology. Research strategies need to incorporate knowledge from local actors, and an institutional framework based on much greater participation of a wide range of stakeholders needs to be developed. Innovative approaches to the delivery of associated information services, including public, private and civil society actors, also need to be developed.

In identifying the constraints to productivity enhancement in the different rural worlds it is important to recognise that both land and labour productivity are central to pro-poor growth. In the early stages of development, land productivity is most critical in order to create additional employment opportunities in agricultural production. In the later stages, labour productivity increases in importance as off-farm wage rates rise but demands for agricultural workers remain high. Three broad categories of technology are available to increase the productivity of agricultural households: intensifying input-based production, managing natural resources better, and diversifying outputs in primary production or household post-harvest processing to capture more value added.

Box 13.1. **Why should we care about the future of small-scale agriculture?**

The efficiency of smaller production units in most developing countries is demonstrated by an impressive body of empirical studies showing an inverse relationship between unit size and land productivity (Heltberg, 1998). Moreover, small producers often achieve higher land productivity with lower capital intensities than large units. These are important efficiency advantages in many poor countries where land and capital are scarce relative to labour.

The greater land productivity of small units stems from their greater abundance of household labour per hectare cultivated. Household workers are typically more motivated than hired workers are, and they provide higher quality and self-supervising labour. They also tend to think in terms of whole jobs or livelihoods rather than hours worked, and are less driven by wage rates at the margin than hired workers. Small producers exploit labour-using technologies that increase yields (hence land productivity), and they use labour-intensive methods rather than capital-intensive machines. As a result, their land and capital productivities are higher and their labour productivity is typically lower than that of large production units. This is a strength in labour-surplus economies, but it becomes a weakness for the long-term viability of small-scale production as countries get richer and labour becomes more expensive.

In poor, labour-abundant economies, small producers are not only more efficient but they also account for large shares of the rural and total poor, so small production unit development can be win-win for growth and poverty reduction. Asia's Green Revolution showed how agricultural growth that reaches large numbers of small units could transform rural economies and raise enormous numbers of people out of poverty (Rosegrant and Hazell, 2000). Recent studies show that a more egalitarian distribution of land not only leads to higher economic growth but also helps ensure that the growth achieved is more beneficial to the poor (Deininger and Squire, 1998; Ravallion and Datt, 2002). Small producers also contribute to greater food security, particularly in subsistence agriculture and in backward areas where locally produced foods avoid the high transport and marketing costs associated with many purchased foods.

Small producer households have more favourable expenditure patterns for promoting growth of the local rural economy, including rural towns. They spend higher shares of incremental income on rural non-tradables than large production units (Mellor, 1976; Hazell and Roell, 1983), thereby creating additional demand for the many labour-intensive goods and services that are produced in local villages and towns. These demand-driven growth links provide greater income-earning opportunities for small producers and landless workers.

Intensifying input-based production

Intensifying input-based production, centred on seed varieties with higher productive potential and the fertilisers and pesticides to realise these potentials, was the focal point of the Green Revolution in Asia. Similar efforts, expanded to include livestock breeds and associated veterinary drugs and compound feeds, hold great potential for rural households in Rural Worlds 1, 2 or 3. This is particularly true in areas with good agro-ecological resources, low climatic risks, good access to input suppliers and to markets.

Most of the opportunities for intensifying input-based production have already been exploited, however, and new opportunities will require much improved dissemination of existing intensification technologies, significant investments in infrastructure programmes and functioning input markets. Input-based production intensification can

also degrade land, which over time limits the yield responses. Furthermore, in Africa far fewer producers have irrigation, resource endowments are often too poor, and risks are too high for input-based intensification to be relevant to more than a few producers in Rural Worlds 1 and 2.

Producers and processors in Rural World 1, also in some cases in Rural World 2, already benefit from advanced technologies based on the recent discoveries of molecular biology and genetic manipulation. However, much of this technology remains primarily aimed at users in developed countries and has been financed by multinational companies. For the originators of the technology, research and development geared to the needs of the rural poor in developing countries are not considered high return investments. Application of some of the principles of these advanced technologies to the needs of poorer producers in Rural Worlds 2, 3 and 4 could nevertheless do much to raise their productivity and reduce risks. For instance, tissue culture can generate virus-free, and hence more productive, stocks of perennial crops that are important to the survival strategies of poor households.

Managing natural resources better

Natural resource management practices typically raise the productivity of household labour through changes in agricultural practices, such as managing water, soils and crop residues to augment *in situ* capture and retention of rainfall and raise land productivity or controlling pests and weeds by exploiting natural biological processes. Approaches such as dry-land cultivation, water harvesting and flood recession farming as well as dissemination of demand management techniques such as irrigation water conservation and waste water reuse can help address the needs of poor agricultural households while promoting sustainable use of water. Genetic improvements can play an important part in these efforts, but often do more to reduce risks by stabilising and diversifying production rather than maximising yield.

This category of technology is knowledge-intensive and often location-specific. With less stress on maximising yields, it seeks to lower risks and unit costs of output. It can be a first technology for many agricultural households in Rural World 3 that retain some usable land and labour but have no financial reserves, as well as for the financially vulnerable in Rural World 2. It can help women, the old and households with labour forces depleted by migration or HIV/AIDS to increase household food production on the small parcels of land they have retained. Developing the needed natural resource management technologies will require investments in science and technology, and disseminating existing technology will require widely distributed and skilled technical support on the ground.

Integrated water resource management can support the sustainable and equitable use of water. An integrated water policy relies on improved planning and legal frameworks, analysis of supply and demand, improved education and sector co-ordination. Co-ordination and arbitration are essential in conflicts arising due to increasing water scarcity, especially for cross-border resources where only supra-national or external bodies can provide a structure for dialogue. Co-ordination also improves water governance by enhancing decision makers' accountability for resource development and management (*Promoting Pro-poor Growth: Infrastructure*, 2006).

Policy must be tailored to increase the efficiency of natural resource management by incorporating knowledge from women and promoting greater participation of women stakeholders. Erosion, drought, floods, desertification and pollution mean that women find it harder to collect food, fuel and water. Poor sanitation has implications for health and the schooling of girls and women. In addition, women often have more knowledge about the ecosystems, but are often not included in natural resource management and environmental protection.

Diversifying outputs

The diversification of outputs involves a change in primary production or household post-harvest processing to capture more value added. This category spans a wide range of technological options from household processing of cassava roots – to making milk products to sell to passers by – to organic farming and the production of fruits or poultry to supply global supermarket chains. Often market demands make this category of technology better suited to well-resourced producers in Rural Worlds 1 and 2, who can more easily meet demands for volume, quality and timeliness of deliveries. Others in Rural World 2 as well as in Rural World 3 are likely to need finance and extensive institutional support to diversify, organise marketing and maintain technical quality.

Risks and financing needs for diversification will tend to be higher than those for merely upgrading production technology for existing staples. Careful prior assessments of markets and their needs, good information systems and ready rural access are other prerequisites for successful diversification. But for many small producers for whom the returns from staple crop production are no longer sufficient to earn a living, diversifying outputs may be the only technical strategy that will allow them to stay on the land.

Improving market access

Productivity gains can mean little without expanded access to markets. Market structures in many rural regions of the developing world are very weak, so the allocative efficiencies that markets achieve in fast-growing sectors of their economies do not materialise. Instead, undeveloped market demand for outputs discourages producers from raising production, while the consequent failures of incomes to rise in rural areas deters private traders and rural enterprises from entering and doing business. A vicious cycle. In the absence of functioning markets, rural areas remain trapped in a subsistence economy in which neither the narrow agricultural production sector nor the wider rural economy (both of which generate off-farm employment opportunities) can grow.

In the past many governments tried to address agricultural market failures in rural areas by creating state-managed organisations, such as marketing boards. Most of these interventions proved to be costly failures, often enabling widespread corruption to take hold to rural economies, and are becoming less and less common. The problems associated with weak markets remain, however, and new efforts are required if the agricultural sector is to spark sustained and rapid growth in poor countries. These efforts should focus on creating effective markets through improving the enabling conditions for wider private sector participation. Removing restrictions on the movement, sale and purchase of agricultural products is one example where changes are needed.

Box 13.2. **A new framework centred on the small producer for investment in science and technology**

The new framework for future investments in science and technology has as its primary aim the alleviation of rural poverty. The framework shifts the past emphasis on technology supply by scientists to a system that responds to user demands and needs. It also:

- Links the search for new technology much more closely to efforts to resolve non-technical impediments to change.
- Fosters equal partnerships between scientists and rural people in the search for technologies adapted to the needs of the different rural worlds.
- Recognises and provides for diversity between rural worlds in needs and solutions.
- Is multidisciplinary in its approach to constraint identification and alleviation; it widens stakeholder participation to engage the contributions of those concerned with the many non-technical constraints to poverty reduction.
- Favours the emergence of knowledge-based optimisation in the use of available resources.
- Allows for progressive technical change or upgrading based on experiment and learning by poor producers and workers themselves.
- Focuses the use of public funds on the generation and dissemination of public goods technologies, but with government agencies as facilitators rather than masters of development.

The new framework empowers rural communities by giving them access to public funds to hire those service providers best able to support participatory stakeholder efforts, and to form alliances that will draw in complementary funds from the voluntary and private sectors. The new framework has the empowerment of rural communities and specific common interest groups within communities as the centre and starting point of efforts to relieve rural poverty. Without investments to strengthen the capacity and opportunity for poor producers and workers to direct, manage and control their own circumstances, future investments in technology will be of no more value than those of the past.

Governments have a critical role in financing the support needed for small producers or rural communities to establish their own institutions – for example, Farmers' Field Schools for accessing and evaluating new agricultural technologies; village banks and rotating savings and credit associations for accessing financial services, and so building informal sector micro-enterprises; water users associations to manage irrigation infrastructure; or producer enterprise groups or associations to negotiate with market intermediaries. Empowerment needs to be central to all initiatives that seek to harness science and technology to alleviate poverty.

Insecure property rights, weak financial services and poor infrastructure are three of the most common barriers to more efficient rural markets, often to the notable disadvantage of women. There is mounting evidence for attention to all three areas to transform stagnating rural areas.

Extending secure property rights

For most of the rural poor in developing countries, land is the primary means for generating a livelihood and a main vehicle for investing, accumulating wealth and transferring it between generations. Because land makes up such a large share of the asset

portfolio of the poor, giving secure property rights to land they already possess can greatly increase the wealth of poor people who, unlike the rich, cannot afford the (official and unofficial) fees needed to deal with the formal system.

Unequal ownership of land is also a critical factor that creates and maintains differences between women and men, with consequences for the coming generations. In Kenya, for example, only 5% of the landowners are women, despite the fact that African women produce 60%-80% of the continent's food (Kameri-Mbote and Mubuu, 2002). A World Bank policy research report, "Land Policies for Growth and Poverty Reduction", concludes that the increased control by women over land titles could have "a strong and immediate effect on the welfare of the next generation and on the level and pace at which human and physical capital are accumulated" (World Bank, 2003). Ensuring that women have secure rights to land is thus critical in many respects, including the challenges arising in the context of the HIV/AIDS epidemic, where the absence of secure land tenure for women who have lost their husbands has been shown to be a key reason for costly conflict and additional hardship.

Secure title to land not only promotes wealth creation but can also enhance security. China illustrates that broad-based land access can provide a basic social safety net at a cost much below alternative government programmes, allowing government to spend scarce resources on productive infrastructure instead of safety nets. Having their basic subsistence ensured is likely to have allowed Chinese households to take on greater risks in non-agricultural businesses. With policies to foster lease markets for land, this also contributed significantly to a vibrant rural economy.

Box 13.3. **Protecting women's property and land rights**

Protecting the property and land tenure rights of women in AIDS-ravaged parts of Africa is vital to prevent rural households from slipping into a spiral of poverty. Losing land or property can unravel the whole fabric of a household, limiting access to safe, inexpensive and nutritious food and forcing children out of school and into work.

In Namibia and Uganda, where land law and property rights are made up of a complex system of overlapping official and traditional law, the rights of women to inherit, own and manage land can fall through the cracks. Widespread illiteracy and lack of access to formal court systems, lawyers and other legal resources can make matters worse. For many women in AIDS-affected households, losing a husband is the first of many losses she will face. She risks being thrown off her land, perhaps her only source of income and security, by relatives and robbed of her assets.

The Food and Agriculture Organization (FAO) is working with local authorities and communities to guarantee that women's rights are protected by ensuring they have access to sources that explain their rights and the means to defend them. They found that more than 40% of widows had lost cattle and tools, seized by relatives after the male head of household died.

When women lack title to land or housing, they have to face a narrower choice of economic options. They may have to deal with homelessness, poverty and violence, contributing to their impoverishment and that of their children. Poverty can also encourage high-risk behaviour such as engaging in unsafe sex in exchange for money, housing, food or education.

Source: FAO Newsroom (2004).

Box 13.4. **Pro-poor land administration**

It is now well recognised that, in many settings where land is rather abundant, full title may neither be needed nor be the most cost-effective way to secure the land rights of small producers. While a number of countries have started experimenting in this area, and interesting experience is accumulating, few models can be easily scaled up to deliver tenure security at sufficient speed and scale to be widely replicable.

Increasing the contribution of land rental markets

Even though land rental markets contribute to greater productivity in many countries, their potential to stimulate structural change has thus far been limited by the fact that most of the contracts have been short term. Various countries are now exploring measures – ranging from adjustments in the legal and regulatory framework to investment grants for long-term renters – that aim to maximise the contribution of land rental markets to enhancing structural change within the agricultural production sector while contributing to the emergence of a rural enterprise sector in the affected areas (China).

Exploring new mechanisms for land reform

New approaches to land reform recognise the importance of land as one among several different assets in households' portfolios, the importance of market and non-market mechanisms for accessing land, and the fact that land reform can be sustained in the long term only if the new landowners can make productive use of their new asset. In general, all the approaches are much more decentralised, relying on incentive-compatible mechanisms to complement, rather than substitute for, the operation of land markets.

Securing the possible equity and efficiency gains from past land reforms

Many reforms have left a legacy of legislation (land ceilings and tenancy regulation) that reduce the scope for land access by poor people. At the same time, the rights given to reform beneficiaries have often remained incomplete (rewarding only usufruct rights with the landowner or the government retaining ownership rights), thus limiting investment incentives and the ability of the beneficiaries to access credit markets. Clarifying the ownership of such plots may lead to significant gains in efficiency. Programmes to facilitate this in a more systematic manner could extend benefits to those not able to muster the necessary resources on their own and could thus combine the efficiency gains with significant equity benefits.

Institutional reform of the registry

Even where the ownership distribution of land is not an issue, institutional inefficiencies, such as a large number of unco-ordinated institutions, imply high cost of registering land that preclude realisation of the potential benefits from the land administration system. Best practice examples of institutional reform can be drawn on to learn lessons on this, including the use of technology as a means rather than as an end in itself.

Decentralising land administration institutions

Decentralisation of land administration services can help bring such services closer to the customers and thereby improve the ability of poor landowners to access services and thus reduce the transaction costs in dealing with the land administration system. At the same time, the rules to be followed in this process have to be clear to prevent local agents from using discretionary power to undermine the security of land rights.

Opening access to rural land by outside investors

Despite evidence on the productive efficiency of small producers, policy makers in many developing countries prefer large-scale production, often an excuse to give very generous land concessions at conditions very favourable to the awardees. There is a real issue, however, on how to provide access to the links, for marketing and processing, necessary for small producers to make the optimum use of their land and to choose a model for the organisation of production that helps to maximise economic efficiency, especially in very land-abundant settings, such as Mozambique or Cambodia. Models to do that exist but need to be developed further.

Source: Deininger (2004).

Increasing access to finance

One of the critical reasons that well-functioning land institutions and markets improve the environment for private sector investment is that the ability to use easily transferable land titles as collateral reduces the cost of credit for entrepreneurs and increases opportunities for gainful employment. It has the added advantage of developing rural financial systems.

Deepening rural financial markets is a high priority in an improved incentive framework that enables the agricultural sector to serve as a key driver for pro-poor growth. For the past two decades, however, most donors have provided very little funding for rural finance, and as part of structural adjustment programmes many partner countries have ended their substantial involvement in this area of activity. That has left a vacuum in the supply of seasonal credit for small producers. While private banks may still service the needs of large commercial enterprises, small producers and firms who want to finance the purchase of productivity-enhancing technologies or access new markets often have to rely on self-financing or household financing, sell livestock and other assets, borrow from local money lenders or use remittances from household members.

A return to the previous subsidised government credit schemes, with their artificially low interest rates and high rates of delinquency, is neither feasible nor desirable. Earlier government involvement in the management and implementation of rural financial systems was expensive and inefficient. The programmes were plagued by a poor repayment culture and the financial instability of the lending institutions.

In much of the developing world today, the inability of poor rural households, particularly female members, and enterprises to access credit on competitive terms to invest in new economic opportunities means that their incomes are lower than they need be. Moreover, without adequate access to risk-reduction instruments (such as weather-based crop or insurance for commodity market prices), rural households and enterprises may even retreat from profitable projects for which they have adequate liquidity. The absence of savings instruments also leads to less productive forms of savings, further reducing the scarce liquidity of poor rural households.

A number of factors thwart the development of vibrant financial markets in rural areas. The high transaction costs associated with dispersed populations and poor physical infrastructure, along with the particular needs and higher risk factors inherent in agriculture, result in the under-provision of financial services (USAID, 2003). It is critical that strategies for rural financial market development be put in place and that rural households have equitable access to financial services for their business and domestic needs.

Giving micro credits to poor women in rural areas has proved to be a strong concept. Taking into account the vulnerable livelihood situation of many women and, for the most part favourable results of, for example Grameen Bank, more micro credit facilities for women producers should be actively promoted.

Improving infrastructure

Improved infrastructure, including rural roads, rural electrification, irrigation and storage facilities links small producers to markets and reduces their risks and transaction costs. It saves time in transporting water, crops, wood and other products rural households produce. It increases the volume of marketable goods and reduces costs for inputs needed to produce these costs. And it gives them much greater access to social services, including

health and education, which can provide them with new livelihood opportunities. It is important to encourage the participation of beneficiaries in planning, construction and operation, and maintenance of the infrastructure in order to strengthen their ownership and sustainability.

Several recent studies highlight the link between weak infrastructure and rural poverty. Jalan and Ravallion (2002) find that road density has a significant positive effect on consumption expenditure in agricultural households in poor regions of China. Research in Vietnam indicates that poor households have a much greater probability of escaping poverty if they live in communities with access to paved roads (Glewwe *et al.*, 2000). Fan (2004) has also demonstrated that investments in rural infrastructure significantly contribute to agriculture growth and to poverty reduction. Improved infrastructure not only expands opportunities for growth but also ensures that growth is more diffused and equitable.

Despite infrastructure's recognised importance, many governments and donors have slashed their infrastructure investments in rural areas in recent years. Many developing countries, especially in Africa, still have inadequate infrastructure. Achieving pro-poor growth through agriculture will require much greater attention to this critical area of investment.

Improving institutions for higher productivity and greater market access

The challenge for many developing countries is to find more effective ways to pay for additional public investments, and to develop suitable institutional arrangements for their delivery. Effective public institutions require an adequate supply of trained people, including policy advisors, agricultural researchers and extension workers, business managers and financial and computer experts. Past investments in training did increase the supply of some types of key personnel, despite the fact that many did not return from overseas training. But HIV/AIDS, ageing, and low salaries and morale within public institutions have contributed to chronic staff shortages in many countries.

Strengthening public institutions that provide public goods and services can reduce costs while improving the quality of services. New innovations may be needed for this. Increased donor support of key public sector investments could be provided through new financing arrangements (vouchers, user fees and some co-financing mechanisms) that empower the users of public services and through appropriate institutional reforms to improve mandates and performance. And new partnerships need to be formed by the public, private and NGO sectors for the provision of public services.

Even though government must pay for many goods and services, it does not have to deliver them. Recent years have seen considerable success in using non-governmental and community-based organisations to deliver targeted assistance to the poor, and private firms can be contracted to build and maintain schools, health centres, roads and the like. Contracting arrangements can be very cost-effective and may offer better possibilities for involving local people and communities. The types of partnerships desired will vary by sector and function, with many more opportunities to diversify supply arrangements for education and health services than for rural roads and market regulation.

Organising small producers for marketing

Small producers have always been at a disadvantage in the marketplace, and in some places these disadvantages are increasing. Small producers typically trade only in small

volumes, often have variable and sub-standard quality products to sell and lack market information and links with buyers in the marketing chain. These inefficiencies can all too easily offset the efficiency advantages of small production units.

Many small producers must now also compete in ever more integrated and consumer driven markets where quality and price are everything. In the new and rapidly expanding global value chains, the private sector is emerging as a key player in linking larger-scale commercial producers with markets (contract farming and supermarkets), but they have less interest and ability in dealing with small-scale producers on an individual basis. Those small-scale producers will need to organise themselves to overcome these problems and to exploit the new opportunities that these market changes offer. Otherwise, they risk losing market access (Vorley and Fox, 2004).

Box 13.5. **Smart transfers**

Widespread and pervasive market failures, particularly in countries at the earliest stages of economic development, may provide some justification for a more direct role for the state, through using subsidies to create or build markets aimed to kick-start productivity gains. Fertiliser and irrigation subsidies had a powerful effect on development during the Green Revolution in Asia. But they can also distort markets and deliver decreasing returns as productivity and overall levels of development rise; they demand levels of state capacity and governance that may be lacking. Furthermore, subsidy systems are highly politicised and can be difficult to dismantle once set up – as current experience in India shows. Thus subsidies present governments with dilemmas when it comes to justifying their use to overcome initial perceptions of commercial risk or the high costs of working in thin and weak markets.

Subsidies or guarantees should generally be temporary measures to tackle specific barriers to private participation in markets. Persistent use may add to rather than solve underlying problems. Subsidies should not be used to provide a market for all producers or to provide general support to producers' incomes, since this will tend to benefit disproportionately the larger and more successful producers.

Many now believe that improved market access for small producers can best be promoted as one plank in the platforms of well-structured producer federations that can defend the interests of the small producers in a range of policy and programme negotiations and to ensure that the necessary services are put into place. Unlike former state co-operatives, widely discredited because of their poor performance and high cost, the new producer organisations should be voluntary, economically viable, self-sustaining, self-governed, transparent and responsive to their members. The functions of these associations should include establishing information systems and connections to domestic and global markets, creating good governance practices, and creating the infrastructure to connect small holders to finance and input supply systems. The associations can also have a role in establishing new forms of production insurance, hedging price "fluctuations" and developing new forms of public and private partnerships.

Policy implications

Agricultural sector productivity gains – combined with increased access to domestic, regional and international markets – are key elements of a pro-poor growth strategy that

can deliver sustainable improvements in the livelihoods of poor households. But policies and investments to unlock the productive potential of poor households are often ill-informed about the constraints and fail to address the range of interlinked environmental, physical, institutional, social and political factors that trap them in a stagnant growth setting. Appropriate policy responses must thus be based on sound diagnosis of rural poverty, an understanding of local realities in the different rural worlds and on the dynamics of occupational diversification and geographic mobility.

Enhancing agricultural sector productivity requires a stable and supportive policy and regulatory framework to remove market distortions, provide an enabling environment for market participation and entrepreneurship and stimulate innovation. Some basic requirements include reforming the property system and irrigation sector, fostering investments in productivity-enhancing technologies, recognising female as well as male producers, improving transport services, strengthening integrated water resource management and other infrastructure to link markets and reduce transactions costs, broadening access to information and finance, and strengthening the capacity of agricultural households and their associations to voice their needs and share knowledge and to improve the sustainability of infrastructure assets.

New policy and legal frameworks should give a high priority to establishing poor peoples' security of access to assets like land and water resources – for all rural producers, including those who need to diversify out of agriculture and migrate away from rural areas – developing natural resource management technologies and administrative frameworks, and strengthening institutions that facilitate informal property rights. Associations dedicated to land use, water management, irrigation or forest use can work with policy makers to oversee natural resource management.

Many countries have, in the last decade, enacted innovative pieces of land legislation and initiated institutional reforms to increase the security of land tenure and the ease of transferring it between users. Countries as diverse as Brazil, Guatemala, Honduras, India, Mexico and South Africa, have started to implement programmes to expand, complement or "complete" past efforts towards land reform. It is now recognised that, unless land inequality is attended to in an appropriate way, it can easily escalate into much bigger conflicts. In many contexts, from Afghanistan to Colombia, East Timor and Sudan, land issues are emerging as central elements to a peaceful resolution of conflicts. Similar efforts are underway to improve laws and systems governing water use and to strengthen enforcement.

Weak capacity of the vast majority of agricultural households to access, analyse and utilise new knowledge on improved practices hinders the extent to which productivity can be increased. Policy can strengthen links between research and extension, enable the participation of producers in setting research needs and priorities and enhance the ability of households to adopt and adapt appropriate practices that enhance productivity. A mix of public, NGO and private extension services can be exploited to respond better to the needs of rural households.

Support for producer organisations is also important, particularly for delivering client-focused services, improving the quality and timeliness of production and linking small producers to food processors, supermarkets and other food outlets. Reinforcing producer organisations can also be important to sustain and strengthen local development and decentralisation.

A gender lens

Women operate at a distinct disadvantage in increasing their productivity and improving their market access. Several studies have documented how women have poor access to the resources to respond to market signals. Secure land rights are perhaps the most important for the interventions proposed here. In addition, women generally enter labour markets on inferior terms and use their scarce time in easy-entry, low-return activities.

There is now a significant body of evidence that gender inequality limits economic growth directly and indirectly, particularly in Africa, and diminishes the effectiveness of poverty reduction efforts. Gelb (2001) describes this as "Africa's missed potential". Improving the circumstances of women producers and raising their productivity are critical to an agriculture-led, pro-poor growth strategy in sub-Saharan Africa. Critical elements include security of land tenure and control over other productive assets and increased access to financial services, technologies, fertilisers and extension services. Concurrent investments are required in domestic labour-saving technology and infrastructural investments that enable women to participate in higher productivity activities and to access markets. All of that needs to be underpinned by continuing to focus on girls' educational achievement and investing in improved health services that meet women's needs.

Removing gender-based barriers to growth will make a substantial contribution to realising Africa's growth potential. Reducing gender inequalities in access to and control of key resources is a concrete means of accelerating and diversifying growth, making growth more sustainable and ensuring that the poor both contribute to, and benefit from, that growth (Blackden and Canagarajah, 2003).

Spotlight on sub-Saharan Africa

Increasing sector productivity and expanding market opportunities

For most sub-Saharan African countries, agricultural growth clearly offers the most promising avenue to pro-poor growth. The continent has abundant natural resources, and agriculture is the primary source of livelihood for 60% of the population, much higher than in Asia and in Latin America. Female producers are also more dominant in sub-Saharan Africa than in any other continent. sub-Saharan Africa is rapidly urbanising, and by 2020 almost half the African population will live in urban areas (Rosegrant *et al.*, 2001). This offers important new opportunities for agricultural diversification into agro-industry, food wholesaling, and higher value products for African producers and entrepreneurs.

But the focus on staple food production should not be lost. Most poor Africans relying on agriculture are trapped in the low yields and high risks connected with staple food production, especially maize and cassava. To make a dent on poverty, a pro-poor growth strategy must emphasise higher land and labour productivity for such crops, while recognising the dynamics of increased production for local, national and regional markets.

Agricultural growth in sub-Saharan Africa has been disappointing over the past 30 years. Since 1990 food availability per capita in sub-Saharan Africa has declined by 3%, a stark contrast with increases of more than 30% in Asia and 20% in Latin America.

Several factors help explain Africa's poor performance in recent decades. Inappropriate policies, weak institutions and inadequate infrastructure are major contributors as are the spread of HIV/AIDS and worsening terms of trade. The gains that have occurred are primarily the result of an expansion of areas under cultivation rather than increasing yields, not too surprising given the very low rate of fertiliser use and the very small amount of land that is irrigated (Kydd, 2004).

Enabling agriculture to serve as a main driver of pro-poor growth in sub-Saharan Africa will require a major shift in current policies and practices, including a more gender-sensitive approach – and must be viewed as a long-term endeavour. Increasing sector productivity and expanding market opportunities will be the twin engines of this effort. Emphasis thus needs to go to technology options that can make a difference for both land and labour productivity as well as policies and programmes that improve market access and lower transaction costs.

Increasing sector productivity

Farming systems in sub-Saharan Africa are particularly diverse, reflecting both the huge range of agro-ecological conditions and socio-economic diversity. In many areas, also, pressure on resources has risen sharply: with fallows, rangeland and forest recovery periods much reduced, productivity of traditional systems is declining, soil nutrients are being "mined" unsustainably and land cover is being destroyed. Yet paradoxically, as FAO

and the World Bank (2001) note, considerable areas of underexploited potential remain in sub-Saharan Africa, with opportunities both to enhance the productivity of rain fed land and expand irrigation. For several of the major crops also – maize, cassava and rice especially – improved varieties on which to base such exploitation are already available.

Attempts to unlock these potentials for greater productivity must, however, above all respond to Africa's diversity. One-size-fit-all recommendations for intensification technology of the sort that spread the Green Revolution to great swaths of the rice/wheat lands of South Asia tend to find only scattered adopters in sub-Saharan Africa – often only those, predominantly in Rural Worlds 1 and 2, who are well connected to markets and with ready access to finance. For many years to come the main way ahead for the poorer producers and workers in Rural Worlds 2, 3 and 4, and the basis for any further technical upgrading, is more likely to start with improved management of natural resources already in hand. New forms of sustainable use need to be evolved which can replace the systems of bush fallow and transhumant grazing that sustained people in a less crowded past. Because of the diversity of systems and the wide spread of current problems and their origins, technical solutions will be far more specific to locations and clients that in other regions.

Government policies to initiate these forms of change need to concentrate on three main issues: security of access to resources; drawing resource users themselves into devising and spreading new production systems; and sharing with resource users the costs of transition.

To initiate a spiral of rising productivity and enhanced sustainability that exploits biological processes – for example, conservation agriculture that controls erosion and builds fertility through mulching and reduced tillage, Integrated Pest Management or Integrated Soil Fertility Management – takes time. Policies must assure potential adopters of reliable access to their land, whether as private owners, longer-term tenants or under customary law.

Given the diversity of potential changes in practices that may be needed, it is not possible to rely solely on organisational models that use external technical expertise to drive change. Producers themselves know most about local resources and risks, and which technical changes are, or are not, compatible with local livelihoods. Participatory methods are needed to communicate demands on the ground to those providing research and extension support. Producers themselves should evaluate, help refine and disseminate locally adapted technologies. To support these participatory approaches new types of research and extension organisations are needed, with staff prepared through training and reformed agricultural education systems to accept as partners, members or representatives of local communities, and co-operate with them.

On their own, however, mere policies to secure access to resources and participatory R&D will mean little to the poor of Africa, forced into daily resource depredation to survive. To have any impact such policies will need to be linked to incentives for technology change.

Expanding market opportunities

New, more input-intensive agricultural technologies can succeed only when small production units produce for the accessible market. With transaction costs as high as they are in much of sub-Saharan Africa, producing for the market can have high risks. But when markets eventually develop, transport and transaction costs usually decline substantially, which makes production for the market more attractive.

Market reforms in Africa aimed at reducing risk and increasing efficiency have for some time been considered necessary to stimulate agriculture-led growth. Too often however, these reforms have not generated the expected supply response. Nor have they removed many of the price distortions embedded in these markets. So, the reforms have done little to benefit small producers, especially those in more isolated and underserved areas. The yields of major staple crops fall considerably and the use of agricultural inputs declines sharply as one moves farther from markets. Without access to new markets, successes in increasing production frequently result in large price drops because of inelastic local demand.

The absence of markets reflects perhaps more than anything else the lack of infrastructure in many rural areas of sub-Saharan Africa. The road system in Africa today, only a fraction of what India had decades ago (Spencer, 1994), leaves about 70% of its producers poorly connected to markets. Many producers can neither procure fertilisers and other inputs at affordable prices nor market their own products effectively. Poor telecommunications infrastructure also keeps producers in isolation. Similarly, low investments in such key services as health and education diminish agricultural sector productivity.

Africa's low population densities make investments in infrastructure and key services difficult to finance. Achieving realistic levels of infrastructure will require substantial increases in public investment. Such investment in rural areas has fallen in many African countries over the past few decades due to the fiscal pressures imposed through structural adjustment programmes and a decline in donor support for infrastructure investments (Fan and Rao, 2003).

This needs to be reversed. The overzealous downsizing of the public institutions that provide essential public goods and services like agricultural research and extension will also need to be reversed. These institutions have key roles and need to be revamped and strengthened to fulfil their functions in cost-effective and demand-responsive ways.

Expanding trade

Africa currently imports 25% of its food grains. This offers scope for better integration of domestic and intraregional food-grain markets within Africa and expanded intra-African trade. Such integration is constrained by poor regional infrastructure, institutions, market co-ordination and competition from low-cost and often subsidised imports from OECD countries. To take advantage of expanding trade opportunities African producers must be able to meet more stringent demands for grading and food quality and safety standards. This will require strengthening market-support services, especially financial services, and improving rural infrastructure, especially roads, information and communications technology and telecommunications. It will also require attention to strengthening institutions responsible for standards and quality control, for enforcing contracts and for providing market information. Donors recognise that the potential effects of food aid on domestic agricultural production is extensively discussed in other forums (FAO, OECD, WFP) and have not thought it useful to add to these discussions in the present document.

Diversifying livelihoods

Many households in rural areas of sub-Saharan Africa, particularly poor households, obtain a significant share of their income and devote a large part of their assets (especially labour) to other activities. The most recent studies of this phenomenon (Deshingkar, 2005; Tacoli, 2004) find an increasing dependency on alternative sources of income, with contribution to total income well more than 50% in some areas.

Agriculture sector growth, with its strong upstream and downstream linkages to the local economy, can provide many new income opportunities for households that will rely increasingly on other sources of income. But other measures can assist households in gaining higher returns from other activities. Skill development is perhaps most critical for many poorer households. Also important are access to finance to start a business and a regulatory environment that facilitates starting up a business and doing business.

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PART III

Chapter 14

Promoting Diversified Livelihoods

While enhanced productivity is essential to achieve pro-poor growth through agriculture, poor rural households also depend on a range of non-farm economic activities as part of their livelihood strategies. This diversification of livelihoods by members of agricultural households augments and provides alternatives to earnings from agricultural production – alternatives that are critical pathways to poverty reduction.

Agricultural households benefit from mobility and growth in both the agricultural and non-agricultural sectors. They benefit from rising demands for diversified and higher value foods, from income and employment opportunities in an expanding rural-based agribusiness sector, from remittance income that can be invested in better practices, from the increased skills and market awareness of returnees and from the potential for reversing farm fragmentation by renting or buying land.

Diversifying livelihoods is partly predicated on, and itself increases, human capital in the skills, experience and willingness to innovate. It generates earnings and remittances that alter the options open to the household by providing cash resources that can be flexibly deployed. It ameliorates risk and reduces the adverse consumption effects of seasonality. Diversification thus generally improves livelihoods.

While rural or urban-based "off-farm" economic diversification is relevant to Rural Worlds 1-4, the main attention of this chapter is on Rural Worlds 3 and 4. Surplus labour and low stocks of assets both push and pull them towards non-farm livelihood opportunities.

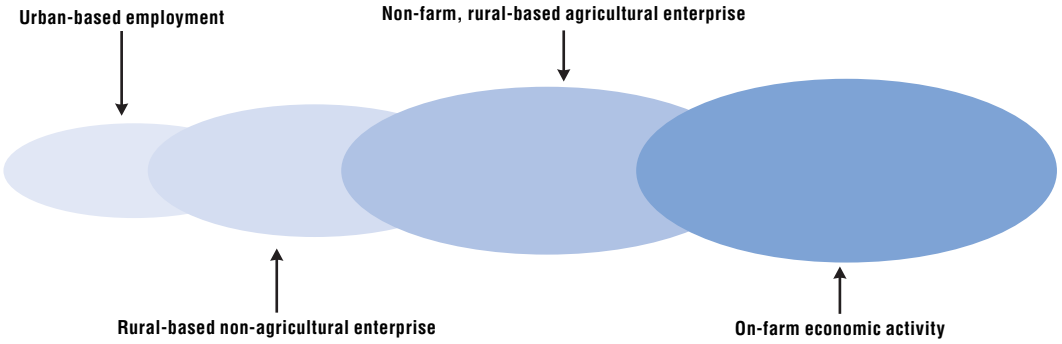
Sources of livelihood diversification

The core economic activity for agricultural households in developing countries takes place at the site of their agricultural production (on the farm) and can be enhanced by increasing productivity and access to markets (Chapter 2). Outside their own agricultural production activities (off the farm) three broad spheres of economic activity provide livelihood diversification opportunities for agricultural households (Figure 14.1):

- Non-farm, rural-based agricultural enterprise.
- Rural-based, non-agricultural enterprise.
- Urban-based employment.

Non-farm, rural-based agricultural enterprise, generally located in rural towns, includes agricultural processing and marketing, input supply and services and related industries. It represents the backward and forward linkages with agro-industry, the services and trade sectors and the rest of the economy. And it has traditionally been undervalued when assessing agriculture's contribution to economic development, since agriculture is measured using information about harvests and the sale of raw materials. Research in eight Latin American countries showed that official statistics, based on traditional measurements, indicated that agriculture contributed just 7% to GDP in 1997 while "extended" agriculture (which incorporates farm and non-farm agricultural enterprises) contributed about 30% of GDP (IICA, 2004). Most of these enterprises in

Figure 14.1. **Spheres of diversified livelihood opportunities for agricultural households**



developing countries are small and intensive in labour, providing important income and employment opportunities for rural people. In India, for instance, agro-based enterprises accounted for 22 million of the 33 million workers in the manufacturing sector in the early 1990s (Chadha and Gulati, 2002).

Rural-based, non-agricultural enterprise is found mainly in the informal economy. It provides a degree of income through a vast number of enterprises that are adaptable and easy to enter and exit and that have low transaction costs. It is an important source of livelihoods, particularly for women (Sida, 2003). Many of the activities require limited capital and skills, operate in highly localised markets and are based on self-employment. Rural-based, non-agricultural enterprise is usually the bridge between commodity-based agricultural production and livelihoods earned in the modern industrial and service sectors in urban centres (Timmer, 2005). Sida (2004) estimates that the rural poor in sub-Saharan Africa and Asia acquire 30%-50% of household income from non-agricultural activities (which may be rural or urban based).

Urban-based employment from temporary migration and commuting has become a routine part of the livelihood strategies of the rural poor. The mobility of labour between rural and urban areas has increased with better roads and communication networks. While the majority are employed in the informal and unorganised urban sector, they can earn more than they would be able to in traditional agricultural labouring or marginal agricultural production (Deshingkar, 2004). The contribution of remittances from this form of employment varies depending on proximity to urban centres. A review of 25 cases in Africa indicated migration earnings (both within rural areas and to urban centres) were as low as 20% of the total non-farming income in villages far from major cities – while this rose to 75% in villages near major cities (Reardon, 1997). Evidence from India suggests that, in unirrigated and forested villages of Madhya Pradesh, migration earnings accounted for half the annual household earnings (Deshingkar and Start, 2003).

The connections between the agricultural and non-agricultural rural economies in rural areas should not be underestimated. A thriving agriculture underpinned by improved sector productivity and markets will drive and expand the non-farm rural economy and influence real wages and food security (Dorward *et al.*, 2004). This underscores an important relationship between Rural Worlds 1 and 2 with Rural Worlds 3 and 4, whereby commercial producers create demands and opportunities for labour. Small traders do much to connect the farm and non-farm rural economies.

Combining rural and urban livelihoods provides a dual advantage to the poor; agricultural labouring and marginal agricultural production are important safety nets when urban employment is mainly in the informal sector (Deshingkar, 2004).

Empirical studies across Asia, Africa and Latin America have established that occupational diversification levels are higher and more complex than official statistics indicate. According to Ellis (2004), the contribution of non-farm income sources was, on average, roughly 60% of rural household income in South Asia, 50% in sub-Saharan Africa and 40% in Latin America.

The nature of diversification in rural areas

Diversifying livelihoods is a continual adaptive process for households to add new activities and to continue existing ones or drop others, thus maintaining diverse and changing livelihood portfolios. This diversity of income sources prevails across different income classes, but the nature differs between better-off and poorer households. The better off tend to diversify in non-farm business activities (trade, transport, shop keeping, brick making) or salaried employment. The poor tend to diversify in casual wage work, especially on other agricultural production units, while remaining heavily reliant on subsistence crop production. Diversification by the poor thus tends to leave them highly reliant on agriculture; that by the better off reduces this reliance.

The way diversification patterns change across the income ranges is illustrated for a case-study of agricultural households in Tanzania (Figure 14.2). The relative dependence on agriculture declines across the income ranges from 68% for the poorest quartile to 43% for the richest. Analysis within agricultural income showed that the share of livestock in the income portfolio of the top quartile is more than twice that of the bottom quartile. The share of non-farm business income quadruples from 11% to 44% of the income portfolio. This provides strong evidence that diversification in and outside agricultural production reduces poverty for agricultural households.

Figure 14.2. **Total income portfolio by income profile: Tanzania**



Source: Ellis and Mdoe (2003).

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It might be thought that the attention that better-off households pay to non-farm activities would result in the neglect and poor performance of their agricultural production activities. Not so. Evidence from four sub-Saharan African countries indicates that agricultural productivity per hectare rises steeply across the income ranges. Compared with the lowest income quartile, net farm output per hectare for the top income quartile of households was between three and six times higher (Ellis and Freeman, 2004).

The opportunities for poor men and women to diversify their livelihoods vary considerably across locations, religions and ethnic groups. But cultural barriers to women's participation in labour markets should not be seen as fixed and immutable – they evolve and sometimes collapse rather suddenly. In sub-Saharan Africa, women, the elderly and children tend to stay at the agricultural residence while men circulate for varying periods. Elsewhere, the rising demand for domestic labour long dominated migration in Latin America, as it does today in migration from Bangladesh, the Philippines and Sri Lanka to the Persian Gulf.

Women dominate many of the off-farm economic activities that grow most rapidly during structural transformation – activities such as food processing and preparation, trading and many other services. So women are key actors in the economic transition of the broader rural economy (Sida, 2004).

Why people diversify

Diversification helps to reduce risks, especially those related to seasonality in rain-fed agriculture. It can also be part of a strategy of combining (sequentially or in parallel) activities that contribute to the accumulation of wealth at different points in the household life cycle.

Becoming less dependent on agricultural production is part of becoming better off. The poor and the better off may diversify to the same degree, but the absolute non-farm income of the better off is several times that of the poor. Perceptions in South Asia have been rather more mixed. Some studies note that non-farm incomes are lower and less reliable than farm incomes, particularly in marginal areas – and that agricultural development is an important prerequisite for more remunerative kinds of rural non-farm sector employment (Deshingkar, 2004).

Diversification overcomes risk and seasonality in natural resource – based livelihoods, but it also reflects the failure of agricultural production to deliver better livelihoods in the post-liberalisation era. Poverty and vulnerability are often associated with undue reliance on agricultural production rather than the converse. Farms achieving yield growth often do so thanks to cash resources generated from non-farm activities, rather than being the origin of growth in such activities, as is the conventional wisdom. Migration, mobility, flexibility and adaptability are downplayed, ignored and sometimes blocked by policy and institutions. But these are the very attributes of occupational diversification that can strengthen livelihoods – and improve rather than degrade natural resources.

Diversification has always played a role in overcoming the "consumption-smoothing" problem created by the seasonality of agricultural output patterns (Morduch, 1995). The degree to which it is necessary to diversify for this reason varies according to the robustness of the underlying agricultural basis of people's livelihoods, the degree to which they can realise cash income from market sales and their confidence in the ability of markets to provide food supplies at reasonable prices in the agricultural production lean season.

For food-insecure households, out-migration of household members in the peak food deficit season may be essential for the survival of the resident group that stays behind, by reducing the number of people to feed (Toulmin, 1992; Devereux, 1993).

Similar considerations apply to the risk reasons for diversifying. For rural households, risks are particularly related to natural shocks (floods, droughts). For urban households, risks tend to be related to job insecurity. All households, whether rural or urban, are prone to the personal shocks of chronic illness, accidents and death. Risks are reduced by diversifying livelihoods, and mobility is the main but not the only means for doing this.

Urbanisation is an important driving force in migration and commuting because urban areas can offer economic opportunities to rural people through better paid jobs, new skills and cultural changes. These may be particularly beneficial to the historically disadvantaged, such as tribal groups, lower castes (in South Asia) and women. Contrary to conventional wisdom on urbanisation and migration, high rates of migration into urbanised areas (permanent and temporary) have continued despite the fact that many migrants live in appalling conditions and work in the informal sector, which offers uncertain and underpaid work. Why? Because urban labour markets offer unmatched opportunities to switch jobs rapidly, diversify incomes and become upwardly mobile with a very low asset base and skills.

According to the "de-agrarianisation" argument, agriculture cannot provide a sufficient livelihood for a substantial and growing proportion of rural dwellers, so agricultural production becomes a part-time, residual or fall-back activity (Bryceson and Bank, 2001; Bryceson, 2002). Some of the factors implicated here are long-term demographic and economic trends while others are associated with economic policies:

- Decreasing farm size caused by subdivision at inheritance.
- Increasing inability of young people to access enough land to take up farming full time.
- Poor farm performance and declining yields due to declining soil fertility and degrading natural environments.
- Increased climatic variation, causing greater extremes across seasons and years.
- Declining returns to farming.
- The impact of HIV/AIDS, superimposed on the other disadvantages.

These widely observed rural livelihood patterns shed light on the dynamics of rural vulnerability (Chapter 4). In sub-Saharan Africa the poorest and most vulnerable are those most heavily reliant on agricultural production and most strongly locked into subsistence within agriculture. The same category of the rural poor also tend to depend on work on other agricultural production units to cover the deficit in their household food balance. This heightens rather than diminishes their vulnerability for two reasons. First, labour on other agricultural production units can mean neglect of good cultivation practices on own units (Alwang and Siegel, 1999). Second, work on other agricultural production units proves an unreliable buffer when adverse natural events affect all agricultural production in a geographical zone.

Mobility of labour

The flow of money, goods and services between rural and urban areas can create a virtuous circle of local economic development by increasing demand for local agricultural produce, stimulating the broader rural economy and absorbing surplus labour

(Tacoli, 2004). But this depends on access to infrastructure, on trading relations and markets and on market information.

The returns to infrastructure investment in poverty reduction are undisputed (Fan, 2004). But for the other prerequisites it is more challenging to offer easy policy solutions because of widespread market imperfections, such as interlocked markets for credit, agricultural produce and inputs. These imperfections tend to work against the rural poor, especially in marginal areas, so that they buy expensively and sell cheaply. Access to market information is equally problematic, suffering from elite capture in the same way as other assets and resources essential for diversification. The poor are thus adversely incorporated in the market – not the free, rational players that neoclassical theories would assume. The challenge for donors and governments is to ensure that markets work for the rural poor (Chapter 2).

Patterns of mobility reveal much about the labour markets that stimulate them. In agrarian settings, a considerable proportion of economic activity is seasonal, having to do with the cultivation and harvesting peaks of different crops in different locations. This can create truly massive seasonal movements of labour, as exemplified by the travel of harvesting labour from poorer Indian states to West Bengal for the rice harvest (Rogaly and Rafique, 2003).

But just as peak labour demand in agriculture stimulates both rural and urban workers to move to the locations of these peaks, so the agricultural slack season creates conditions for rural workers to seek temporary jobs in the urban, industrial or service economies. Circular migration of this type is well documented for many parts of the world. Examples are movements in West Africa from the interior to the coastal zones in the agricultural off-season (David, 1995) and migration of poor workers with their families to Delhi's brick kilns (Gupta, 2003).

Mobility reflects the spatial and temporal mismatch between the residential location of individuals and households and the location and dynamics of labour markets. In predominantly agrarian societies, seasonality on its own helps explain a considerable proportion of such mobility, as does risk mitigation (Chapter 4). An emerging view marshals an overwhelming array of arguments in favour of mobility – and emphasises facilitating migration and improving the social conditions under which it occurs, rather than placing barriers in its way. This view runs counter to earlier orthodoxies in development policy that were opposed to migration, and that tend to resurface in strategic documents like poverty reduction strategies (PRSs), revealing unhelpful stances for poverty reduction.

Secure land tenure facilitates engagement by members of agricultural households in the non-agricultural production rural and urban economies. Without secure rights, landowners are less willing to rent out their land, something that impedes their ability and willingness to engage in non-agricultural production employment or rural-urban migration (Deininger, 2004).

Migration and commuting to urban areas

Temporary migration and commuting are now a routine part of the livelihood strategies of the rural poor across a wide range of developing country contexts. While past determinants of migration (such as drought) are still valid and important, there are new driving forces underlying the increase in population mobility. These forces are specific to

location and include improved communications and roads, new economic opportunities arising from urbanisation as well as changing market contexts as economies become more globalised and liberalised (Deshingkar, 2004).

The Global Donor Platform for Rural Development (2005) highlights the "mixed results" from migration. In general the rural poor are driven by a stagnant agricultural and rural environment, while the productivity of the urban sector can often be characterised as low as well. This "migration of despair" seldom reduces chronic poverty and may contribute to the rising social costs of urban poverty. If, however, migration follows industrialisation, it can be seen as an indicator of economic growth and structural transformation. Encouraging rural-urban migration may be helpful when there are meaningful urban jobs (Box 14.1), but the costs of human misery on the periphery of major cities must be weighed against the costs of investing in better living conditions in rural areas.

In theory it might be useful to separate circular and temporary movements of people from those occurring permanently due to structural economic change. But neither the data nor the realities of migration correspond to such a neat dichotomy. For one thing, at the individual or household level, successive temporary movements may lead to eventual more permanent relocation. For another, at the sector level, the establishment of rapidly growing manufacturing sub-sectors can also be dependent on circular migrant labour – for example, the textile mills of Mumbai and Shanghai (Davin, 1999) or Mexico's export-processing zones.

Box 14.1. **Chinese men choose the cities, women are still on the farms**

With China's rapidly growing economy, the demand for workers has sky-rocketed. And many male agriculture producers are migrating to the urban industrial areas.

The current status of rural households makes it difficult for all household members to migrate because of the near impossibility of getting a permanent residence permit in the cities. So most male migrants become temporary labourers in cities, with agriculture a kind of insurance and retreat.

The gender division of labour in the households has shifted, from "the men till and the women weave" to "the women till and the men work in industry". This new model can be described as "men control the outside world, women the inner". What's also new is that women's "inner world" is extending to agriculture.

The new gender division of labour has led to a feminisation of agriculture: about 80% of the rural labour force is female. In the poorer and more marginal south-western provinces of Guangxi, Yunnan and Guizhou, women make up more than 85% of the agricultural labour force – and in some remote mountainous areas, about 90%.

Source: Song (1999).

There is growing evidence of the importance of remittances in supporting the livelihoods of those who stay behind when some households' members migrate. In sub-Saharan Africa remittances account on average for 15% of rural incomes. The circular migration to the Persian Gulf from rural Sri Lanka has accounted for 25% of rural incomes (von Braun and Pandya-Lorch, 1991).

Long-distance commuting has become characteristic of Asia's largest cities, especially by buses and trains. For many, commuting and seasonal migration offer the chance to combine the best of a rural village – based existence with urban opportunities (Box 14.2). In these cases, better communication for migrants back to their families can sustain social capital and make temporary migration more manageable for households.

Box 14.2. **Why people may prefer temporary mobility**

Seasonal migration and commuting provide a route to diversification into work outside agricultural production rarely available in smaller, more remote villages. And this helps to spread risks. But employment in the urban unorganised sector is insecure, and many prefer to keep rural options open. So agricultural labour and marginal agricultural production remain important safety nets for the poor and vulnerable.

Supporting a household in the village is cheaper, especially if the bread-winner is earning in a town or city. In areas with good roads and transport services people can travel back home easily for peak agricultural seasons, festivals and ceremonies.

Impediments to diversification

Widespread failures of services and institutions – combined with low levels of human, physical, natural and social capital – create mutually reinforcing disadvantages, described as "interlocking logjams of disadvantage" (de Haan and Lipton, 1998). This seriously constrains efforts to improve agricultural incomes and promote diversification into occupations outside agricultural production. This may also explain why the poor living in marginal areas pursue occupations in urban areas.

Many barriers, characterised as thresholds associated with "poverty traps" (Barrett and Swallow, 2005), prevent the poor from engaging in more remunerative labour markets. At the lowest income levels, immense efforts are required to sieze the opportunities and return to labour that enable a household to climb out of poverty. But at somewhat higher incomes just above the poverty line, it becomes much less difficult to achieve a virtuous spiral that can lead to higher income levels and a more secure livelihood. The key to these traps and thresholds lies in the asset status of households, and especially in human capital (education and skills) and flexible assets that can be quite quickly converted into cash or other assets (money, credit, livestock).

The poorer a person is, the more difficult it is to navigate the barriers that the public sector places in the path emerging from poverty (Wood, 2003). Local institutional environments can be disabling in low-income countries, and it is not clear that local government decentralisation, promoted with enthusiasm by donors over the past decade, has improved matters in this regard. The reverse may be so. Some commonly observed practices:

- *Dense thickets of local taxes*. Almost all engagement in markets results in taxation of one kind or another (transit dues, market fees, commodity taxes, movement permits, bicycle taxes), discouraging engagement in the monetary economy and reducing overall trade and exchange (Fjeldstad, 2001; 2002).
- *Business licenses*. Typically all businesses, even the smallest one-person bicycle repair workshops, are subject to licenses, form filling, turn-over taxes and so on. Business registration is seen almost everywhere as a revenue-raising opportunity, not as a way of creating environments for enterprises to flourish.

- *Multiple shake-downs*. The "informal" predatory relationship between public official and subject can involve numerous fees, fines and prohibitions (Freeman *et al.*, 2004).
- *Migration barriers*. Migration may be inhibited by residence permits, harassment in transit, loss of rights to services at destination locations, loss of recourse to law in the event of injustice, active discouragement by city authorities, enforced returns by slum clearances and so on.

Policy issues

In general, decisions about what and where to produce are best left to private actors. What governments, donors and NGOs can do is to contribute to the overall climate of facilitation that surrounds individual decisions. This means supporting and encouraging domestic policies that improve exchange, mobility, communication, information and infrastructure – and discouraging domestic policies that have the reverse effects. Policies that create a more enabling environment for private sector development for rural households include:

- Neutral or progressive local taxation designed to exclude those living at or below the poverty line from the tax net.
- Business registration designed to provide support services to enterprise startups rather than penalise them with taxes and other costs.
- Encouragement of mobility to broaden spatial options and encourage growth processes.
- The general removal of spurious obstacles put in the way of people going about the business of making a living by those who derive their power from public office.

A major barrier to beneficial economic change in agriculture is often the historical and prevailing land tenure system. Tenure systems that fail to allow for a purchase or rental market in land reduce mobility, slow rural-urban transitions and rigidify uneconomic agricultural production unit sizes. Equity considerations often underpin traditional and state-owned tenure systems, but in densely settled zones exhibiting extremes of land subdivision, it is doubtful that anyone gains much from the absence of a land market – or from the lack of security of ownership or tenure. And many existing tenure systems are deeply gender biased against women in custom and in law, causing serious dysfunctions between the control, decision-making and use of land as a resource.

The prevailing land rights of women provide an additional reason for promoting active government interventions. Even though women play a substantial role in agriculture in most countries around the world, they are often discriminated against by the prevailing land tenure system. In many societies women are excluded from owning property (including land), or they do not enjoy the same rights as men. In marriage and in the family, women's right to property is often subject to the authority of the husband or father. Land titling, registration and the privatisation of land under colonialism and after independence have often set women back, leaving them in a state of even greater insecurity, with poorer prospects for accessing land. The demise of the local elders and clans has made women's land tenure even less certain, leaving women with fewer possibilities of obtaining a livelihood for them and their children (Tripp, 2004).

Agro-industrial development, which generates employment for rural households and adds value to agricultural production, also has the potential to damage the natural environment through pollution. Policies and legislation to protect the natural environment are necessary in order to enable sustainable industrial development.

At the macro policy level, second generation PRSs should contain wide-ranging recognition of the importance of occupational diversification, mobility and cross-sectoral interdependencies:

- The current social sector emphasis of PRSs requires better balance in its support to the rural economy.
- Artificial and unnecessary blockages to people's making a living should be removed wherever they occur, either in central or local government, or in private organisations.
- The antagonistic view of migration expressed in many PRSs clearly needs to be replaced by an approach that supports personal economic mobility and choice. PRSs need to recognise that rapid urbanisation can create dynamic growth processes that benefit both urban and rural economies.

A key policy issue here is to provoke a change in thinking about mobility in order to improve the political and social environment of those on the move. At the moment, migrants, in passing between jurisdictions, are generally unable to call on support from public authorities. Local governments in source areas have no interest in – and little capacity for – tracking the outward movement of their citizens. And those in receiving areas too often regard in-migrants as a blight, to be resisted or expelled.

Accepting the complexity of diversifying rural livelihoods, agricultural and rural economic development programmes within PRSs need to be based on a comprehensive understanding of diversification's extent and nature, nationally and sub-nationally. This will require strengthening the data gathering and analytical capacities of the public institutions delivering on agricultural and rural development policies. Only with such an understanding can support be targeted to assist processes that sustain poverty reduction in rural areas.

Spotlight on Global Value Chains – Does it Mean Shutting out Small Producers?

Small-scale agriculture, presented as a growth-equity "win-win", has encouraged a resurgence of interest in agriculture in the poverty reduction debate. But the case for the efficiency of small-scale agricultural production may be breaking down as the superior labour and land productivity of the small production unit is trumped by the higher costs of dealing with global food chains with new forms of private sector governance. The associated risks are the polarisation between agribusiness and small-scale agricultural systems – and the reduction in benefits of liberalisation due to problems of market structure.

A close look at global food chains is an important part of any new agenda for agriculture for a number of reasons. Private sector strategies in the agrifood sector – especially in global retailing – are moving fast, under the radar of public policy. If policy is to anticipate the changes, then those changes – and their implications for rural producers – must be better understood. And although developing countries have so far failed to significantly penetrate agricultural markets of rich countries, big hopes are invested in the idea of small producers "upgrading" into global buyer-driven food chains to escape from the cost-price squeeze of commodity production.

Meanwhile, concern is growing that markets are distorted by excessive corporate concentration in trading, processing, manufacturing and retailing. Trade liberalisation will not bring the expected benefits when agricultural markets do not function competitively. And because corporate growth and consolidation is premised on expectations that larger buyers can extract more favourable terms from suppliers, there is a risk of declining shares of value for rural actors in the food chain – the workers in agriculture and processing and primary producers. This can compromise agriculture's potential to act as an effective route for small producers to exit poverty and benefit from broader economic growth, especially when food markets are already stagnant. And the ability of buyers to set product and process standards and their demands for traceability can exclude certain classes of producers from supply chains and thus worsen inequality (Vorley and Fox, 2004).

Value chains and the rural worlds

Global food chains reach into developing country markets, as well as stretch outwards. National and regional markets may be restructured to the extent that they are no longer a refuge for smaller producers and processors, as markets are flooded with cheap export-grade produce from more competitive economies.

Rural World 1 is changing in response to the liberalisation and deregulation of agriculture. For a group that has supported and benefited from state protection and subsidies, it now comprises more free market – oriented agribusinesses with high levels of collaboration and associative relationships with downstream processors and retailers. This

new minority of commercial producers and entrepreneurs is connected to the global food economy through contracts with a rapidly consolidating agricultural handling and processing industry, and even directly with food retailers. These producers have become a vital part of agribusiness, and the lines between Rural World 1 and agribusiness are becoming increasingly blurred.

Rural World 2 finds itself in the position of residual suppliers to retail, wholesale or least cost suppliers to bulk commodity markets, and often is increasingly reliant on off-farm income. It must compete with the lowest cost commodity producers, upgrade to higher value chains, experience decreasing returns and a move towards subsistence-level production – or get out of agricultural production.

Because only the most capitalised and tightly managed enterprises have been meeting the strict specifications of importing nations or processing and retail sectors, there is much attention on the organisation, technical and institutional arrangements for small producers in Rural World 3 to build economies of scale to deal with the requirements of "buyer-driven" chains and thereby create relationships with their downstream customers and add value with differentiated (de-commodified) products. Shifting Rural World 3 out of small-scale agriculture into the role of labour for Rural World 1 has also renewed popularity, for instance in Sahelian countries, in the debate about the "modernisation" and "competitiveness" of agriculture in an era of globalisation of agrifood chains.

Outsourcing primary production rather than owning production makes economic sense for agribusiness. In fact, major processors have been engaged in vertical disintegration, outsourcing primary production and its associated costs and risks. The exception is industrial livestock production where vertical integration and ownership of agrifood chains from "farm to fork" is quite common.

The reversal of the marketing chain can also benefit consumers; it is no coincidence that in the United Kingdom, where supermarket power is most ascendant, consumers' aversion to genetic modification technology was translated into retailer-driven programmes to purge own-brand supply chains of genetically modified ingredients.

Contract farming can also bring significant benefits to producers. A producer is assured of a buyer, price risk is reduced. Favourable credit terms may be available. And marketing costs are lower. Producers with these agreements often get more favourable terms than neighbouring producers growing a product of the same quality but without a contract. But in their worst form such as some poultry production contracts, contract farming deserves its reputation of turning producers into wage labourers on their own land.

Agricultural producers working outside these closed chains, such as those who do not have sufficient scale of production to be able to sell directly (the classic position of Rural World 2), can become relegated to the position of residual or top-up suppliers or suppliers to the shrinking wholesale market.

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PART III

Chapter 15

Reducing Risk and Vulnerability

Managing risks and reducing vulnerabilities are essential elements in sustainable pro-poor growth through agriculture, perhaps the riskiest sector in the economy, not only subject to the price risks facing many sectors but also highly dependent on nature, leaving it vulnerable to droughts, floods and pests. The risks vary in their nature and impact across the different rural worlds. Volatile international markets directly affect Rural World 1 producers and ultimately their need to employ workers from Rural Worlds 3 and 4. Generic risks such as weather conditions can position agricultural households in Rural Worlds 2 and 3 either above or below the thresholds of profit and food security.

For agricultural households to have more secure and prosperous livelihoods, they need more ability to cope with risk and address the attendant vulnerability. Poor rural households, particularly those relying on agricultural production as a primary source of well-being, face the inherent risks of agriculture together with such domestic risks as sickness, death and loss of property. Exposure to these risks can be heightened by inadequate or non-existent infrastructure, poorly performing markets and weak institutions.

Without strengthening the capability of poor rural households to cope with the many risks they are exposed to, they will be reluctant to take on new risks and innovate, and they will remain trapped in low-risk and low-yielding livelihood strategies. Strengthening risk-reduction methods will enable poor rural households to maintain a certain level of assets despite experiencing shocks of different kinds and magnitudes. It will also promote greater acceptance of innovation and greater willingness to assume prudent risks. Strategies include reducing actual risk or exposure to risk, together with mechanisms to mitigate or cope with shocks once they occur.

The discussion here focuses on agricultural producers in Rural Worlds 2 and 3 and the landless of Rural World 4 because they are affected through the labour markets influenced by Rural World 1 producers. The majority of people in Rural World 5 will be reached through social assistance programmes and therefore are largely outside the immediate reach and attention of agriculture-enabled economic growth policy.

In the 1970s and 1980s the risk exposure of many rural households was very different from that today. Risks were reduced by the government through marketing boards and similar institutions, which assured a price structure, input and output markets and access to improved technologies and training. Public investments in research and development resulted in higher yielding agricultural systems. And innovations were encouraged through public subsidies of one kind or another. In much of Asia and Latin America these innovations led many agricultural households to shift to more productive and higher return farming systems.

The changing pattern of risk and vulnerability

Today the dynamics of the world economy, including globalisation, mean that the nature and pattern of risk and vulnerability are also changing. Many national governments have withdrawn costly and often inefficient support for their domestic agriculture on the

premise that the private sector would step in. But the failure of government to invest in the infrastructure and institutions that support the private sector's engagement in agriculture has left many poor and small producers either with no market access for inputs – such as improved seeds, pesticides and fertilisers – or with limited markets, resulting in prices vastly in excess of world market prices. Where markets are more developed, prices for the products of agriculture and the necessary inputs are more volatile, with markets more linked in a global trading environment. The withdrawal of government means that this volatility is not absorbed through floor prices and input subsidies, leaving farmers exposed. The solution is not to revert to the general agricultural support systems of the past, which often produced few benefits for the poor. It is to ensure that the public investments support market development of appropriate risk management instruments – together with broad-based safety nets for risks that cannot be handled by poor people or the market.

For agricultural households to achieve more secure and prosperous livelihoods, they need greater ability to cope with risk and the associated vulnerability. Policies, institutions and investments that reduce actual risk, strengthen risk management options and increase the availability of safety nets will enable poor households to maintain a certain level of assets despite shocks of different kinds and magnitudes. They will also promote greater acceptance of innovation and greater willingness to assume prudent risks.

Who faces what risks in the five rural worlds

High levels of risk, whether in the productive or domestic spheres, and the resulting shocks and stresses compromise both economic growth and poverty reduction. Some risks are common to all rural worlds – such health risks as HIV/AIDS, malaria and tuberculosis, and such natural disasters as earthquakes, hurricanes, floods and droughts. Though the risks may be common, the impacts differ in each rural world, as does the vulnerability of households and people.

Rural Worlds 1, 2 and 3 all engage directly in agriculture as business entrepreneurs and producers face the same natural risks, such as pests, droughts and floods, and to some extent the same commercial risks depending on the level of market engagement and type of farming system. But the vulnerability to shocks differ. A drought may affect producers in Rural World 3 most profoundly, with some impact in Rural World 2 and possibly less in Rural World 1. Subsistence producers in Rural World 3 are least likely to have irrigation systems, and producers in Rural World 1 most likely to have advanced systems. So in a drought, Rural World 1 may benefit if some producers in Rural Worlds 2 and 3 join the agricultural labour force, driving down wages. A shock with the deepest impact in Rural World 1, such as commodity price declines, may reverberate through the other rural worlds, potentially reducing agriculture labour demand and hurting the landless in Rural World 4, who rely on supplying agricultural labour.

Agriculture can fail over a large area, affecting all rural worlds. Producers in Rural Worlds 1, 2 and 3 may have to sell productive assets and increase their indebtedness, reducing their ability to bounce back quickly when the shock has dissipated. This has impacts on Rural World 4, which relies on selling labour, in large part to larger agricultural production units, and on Rural World 5, which may depend on people in Rural Worlds 1-4 for informal transfers to help them survive in the absence of formal safety nets.

Households in all five rural worlds face risks. For those in Rural Worlds 3 and 4, the inability to cope even with small shocks, due to low asset holdings and lack of risk management instruments, may lead them to adopt livelihood choices with the lowest risk but also the lowest return. These livelihood choices might include informal arrangements, such as seeking the protection of a "patron" who will provide credit in times of need (and thereby provide a degree of social protection). But in return the patron may demand priority access to the household's labour, the sole right to market its output and the sole right to provide seasonal credit. This interlocking of labour, product, input and credit markets makes it extremely difficult for poor rural households to take up new economic opportunities of the kinds that market signals might indicate (Farrington, 2004).

The spotlight at the end of the chapter shows the problems facing households in their livelihood strategy. The lowest income profile varies least. Potential troughs in income are more muted than those for the upper profile. But these lower potential troughs in income come at the cost of a lower expected average income. The higher income profile yields a higher expected average income but the possible troughs are unacceptably deep for poor households that have no ability to insure against these risks either through public or privately available instruments or through their own savings. This inability to offset risks is perhaps most acute for agricultural households given the vagaries of climate and commodity prices and the lack of instruments to handle this type of risk in underdeveloped financial markets.

If poor agricultural households are to capitalise on their production potential and escape poverty, risk management instruments are essential. But the inter-linkage between productive and domestic risks means that strategies to address risk and associated vulnerability for rural households must incorporate a portfolio of risk management instruments, addressing risk in both productive and domestic arenas.

Social risk management

Taking a strategic approach to risk management, both productive and domestic, requires a comprehensive assessment of the nature of risks that populations are exposed to. The World Bank has developed a social risk management framework that encompasses both livelihood protection and livelihood promotion to assess the degree of vulnerability faced by people and different sectors of the economy to different risks (Box 15.1).

A comprehensive social risk assessment enables a policymaker to make informed choices on reducing or eliminating risk and fostering mechanisms that allow people to deal with the troughs in their livelihood profiles. The elimination of all risks in agriculture is impossible, so the coping mechanisms are particularly important for poor people to be able to participate in and drive economic growth through agriculture.

Operationalising the social risk management framework requires careful consideration of four dimensions (Farrington, 2004):

- Different categories of poor people.
- Interactions between productive agriculture sub-sectors and non-agricultural sectors (where entrepreneurial activity is focused) and between the productive and domestic spheres (since funds are fungible between the two).
- The interface between protection and promotion options within agriculture and the promotion options outside of agriculture.
- Location-specific socio-cultural and economic conditions.

Box 15.1. **The World Bank's social risk management framework**

The social risk management framework can be used to analyse the sources of vulnerability. It addresses how society manages risks and the relative costs and benefits of various public interventions on household welfare. It also addresses how vulnerable individuals and households can be helped to better manage risks and become less susceptible to damaging welfare losses.

Social risk management repositions the traditional areas of social protection (labour market intervention, social insurance and social safety nets) in a framework that includes:

- Three strategies to deal with risk (prevention, mitigation, coping).
- Three levels of formality of risk management (informal, market-based, publicly mandated).
- Many actors (individuals, households, communities, NGOs, governments at various levels and international organisations) against the background of asymmetric information and different types of risk.

This expanded view of social protection emphasises the double role of risk management instruments in protecting basic livelihoods and promoting risk taking. It focuses on the poor since they are the most vulnerable to risk and typically lack appropriate risk management instruments, constraining them from riskier but also higher return activities and thus from gradually moving out of chronic poverty.

Source: Adapted from Holzmann and Jørgensen (2000).

Segmenting the poor is important in identifying the types of risk they face and how they might be vulnerable to them. The policy interventions to address the risk and vulnerability profiles of people in the different rural worlds may extend far beyond agriculture. The result should be a set of investments in infrastructure and institutions to reduce actual risk where that is optimal, combined with the development of a comprehensive social protection strategy that provides the rural poor with the security they need to adopt prudent risks for agriculture to be their route out of poverty.

Protecting and promoting livelihoods

Risk management instruments that enable producers to address the risk in agricultural production protect basic livelihoods and promote improved livelihoods. This has often been overlooked. Public provision of safety nets has traditionally been viewed as a drain on investment resources that could be used to foster economic growth. But good risk management instruments – together with safety nets for those who cannot or have no access to these instruments – ensure that agricultural households do not face exposure to deep troughs in income. This enables the poor to take on prudent risk, supporting both growth and poverty reduction. Livelihood protection and promotion cover a potentially wide range of arrangements, where prevention and mitigation are strategies and coping is the response.

- *Prevention strategies* reduce the probability of an adverse shock occurring. In agriculture, these can be found in both infrastructure and technology solutions. Irrigation reduces the risk from droughts, as do soil and water conservation investments. Developments in agricultural science, such as breeding livestock resistant to disease and crops resistant to pests, diseases and drought can eliminate the impact of some pests and diseases.

Improving health service delivery, including public health measures, can reduce morbidity rates and reduce the spread of HIV/AIDS. Risk-reduction strategies minimise the downside variance in income profiles and increase the overall expected average income. Policies which increase land tenure security also reduce risk of loss of land.

- *Mitigation strategies* are implemented before a shock and reduce the impact once it occurs. Households diversify their livelihood strategies combining elements which are not all subject to the same type or degree of risk. Insurance instruments, such as health, commodity price, or weather insurance provide a payout for a household when the trigger point is reached. These strategies do not remove the troughs in the higher expected household income profile, but they reduce the impact on the household by providing a level of replacement income thus effectively minimising the depth of the worst shocks. Policies that increase the ability of household members to migrate are important to risk mitigation.
- *Coping strategies* relieve the impact on households of shocks that they are unable to protect themselves against, through mitigation or prevention, due to lack of assets, access to instruments or the magnitude of the shock. They include social assistance or welfare programmes as well as relief operations in response to natural disasters or civil disturbances. These measures prevent the troughs in income profiles that would reduce levels of well-being below accepted thresholds.

Reducing risk

Public infrastructure investments can do much to reduce the risk exposure of rural households. Rural feeder roads can do much to integrate market economies, reducing some market price volatility as well as diversifying market opportunities for the rural poor. Shorter transportation times can reduce the risk of deterioration in perishable crops. Improved flows of goods and services can enhance the information base of local people, along with investments in communications infrastructure. This enables households in Rural Worlds 1 and 2 to make more informed decisions on the sale of their crops and livestock. Similarly, investments in electrification also reduce the risk associated with the production of perishable crops, which are also often higher value crops. Public investment in local level grain storage banks are more effective for small-scale producers, such as those in Rural Worlds 2 and 3, who lack the economies of scale to make it worthwhile to invest at the individual level. They can be particularly important for women who often grow crops for their household food security and lack effective means to store their production without losses.

Private investment is also necessary to reduce risk, through such infrastructure as irrigation. But many investments in risk reduction for natural disasters need public institutional support. For example, water needs to be managed at the watershed level, which requires the co-operation of many water users, both for domestic and productive purposes. Tree planting to prevent soil erosion and landslides in the event of floods benefits the community as well as the individual producer. But agricultural producers will not invest in their land if they lack secure property rights. So institutional development in appropriate land tenure arrangements, and land registries is critical for investments in land – to reduce the exposure to such risks as droughts and floods. Intensified efforts are required in many countries to formalise women's access to and control over land and other natural resources.

Similarly, investments in agricultural research and development are critical to maintaining yield growth, increasing agricultural productivity and maintaining performance in the face of drought, soil nutrient deficiencies and pest outbreaks. New models are needed today to foster such research. It should be producer-driven, recognising both male and female producers and their different needs. Many newer technologies incur considerable expense in research and development, and the investment by the public sector pales in insignificance with investments by the private sector. Effective public-private partnerships can release some new technological developments in the private sector for use by public sector research institutions for crops, livestock, forestry and fisheries that would be regarded as non-viable from a commercial perspective.

Mitigating the effects of shocks and stresses

Public investment in early warning systems, made more efficient by advances in data collection, management and forecasting infrastructure, can mitigate risk by enabling faster response times. For example, disease outbreaks such as measles can be arrested through intense immunisation programmes.

Institutional development is also critical to the mitigation of risk. Most of the rural poor in developing countries lack the sophisticated instruments available to producers in the developed world geared to the management of price and weather risk (Box 15.2). They even lack the basic means to self-insure through financial savings. There is considerable need to invest in financial deepening in rural areas to enable individuals to save "for a rainy day" and enable them to generate working capital to engage in entrepreneurial activities.

In India just 13% of marginal producers, those typical of Rural Worlds 2 and 3, had access to formal finance mechanisms – whereas 50% of larger scale producers had access to credit and 87% had access to a savings account. Of marginal producers 44% borrow from moneylenders, often at interest rates of 50% a year. Evidence suggests that for marginal producers to access formal finance often requires payment of bribes, up to 20% of the loan amount, and the process can take up to 33 weeks. Institutional development, together with appropriate regulation, is one key to unlocking the development of financial services and the economic potential of many marginal producers.

New and innovative health care insurance systems and pension schemes to help mitigate risk in the domestic sphere have been piloted in some areas to provide coverage to the rural poor.

Box 15.2. **Weather-based insurance in Ethiopia**

The United Nations is seeking support for a novel financial-markets approach to alleviating famines: drought derivatives. According to the World Food Programme (WFP), such instruments – by serving as a sort of insurance policy based on rainfall measurements – would allow aid workers to speed the delivery of cash and food before widespread starvation sets in among the rural poor.

Currently, when rains fail in a developing nation, it typically can take as long as nine months for aid agencies to assess the damage, put out an appeal to donors, collect contributions and deliver them to the needy. By then, many poor producers are beyond help or are surviving by eating their seed grain and selling their livestock.

The hope is to test-run the concept in Ethiopia, perhaps as soon as the end of this year. In the Ethiopian pilot project, the idea would be for the WFP to buy a derivative from a reinsurance or other financial-services company that would pay out perhaps USD 100 million if the country's rainfall slip below a threshold – a level historically associated with a drought of once-a-decade severity. In the past 30 years, Ethiopia has experienced such droughts in 1984, 1987 and 2002. The 1984 drought was the worst, with the cost of food aid for the 23.4 million affected people reaching USD 1.65 billion in today's prices.

The derivative differs from a normal insurance policy in that there would be no need for an adjuster to calculate the damage done by the drought. The payout would be based on rainfall, not damage. Rainfall measures are taken almost uniformly throughout the world, and Ethiopia has reasonably reliable data that would allow financial markets to assess the likelihood of another dry spell.

If a drought occurred, the WFP would not have to round up donors during the crisis, just collect from the holder of the derivative. Famines still could arise from other causes, such as war or plagues, requiring a more traditional fund-raising appeal and response.

Similar financial products already are traded on the Chicago Mercantile Exchange. Energy companies, for instance, buy weather-based derivatives to protect themselves against unseasonable weather. Most of the derivatives are sold by reinsurers, investment banks and hedge funds.

Source: Wall Street Journal (13 May 2005).

Helping poor rural households cope

When all else fails, poor rural households need safety nets to help them cope with sudden shocks. These take the form of social transfers and emergency assistance, in cash or in kind. The programmes should be specific to the particular risks and attendant vulnerabilities that rural households face. While these programmes should in most cases have permanence in the social protection portfolio, their use will generally be temporary, with households accessing them as and when they are needed in line with the qualifying criteria. This fosters the programmes' livelihood promotion function, underpinning prudent risk taking and entrepreneurial activities by the rural poor. Guarantee schemes, such as public works programmes, can scale up and down based on need, and a pipeline of planned activities can be ready for implementation. Appropriate programmes should be designed for those in Rural World 5 to enable them to "graduate" to their place in other rural or urban worlds.

Table 15.1. **Risks in the five rural worlds**

Categories of rural households	Types of risk typically faced	Typical measures to prevent, mitigate or cope with risk
Rural World 1 Commercial producers, globally competitive with large-scale agriculture operations.	Generic risks (pests, diseases, weather); and new risks: input/output price fluctuations, possibly associated with international market changes; stricter quality controls on products; saturation of national markets; transport and storage failures for perishables.	Improved technology (irrigation, agrochemicals, new varieties) to reduce generic risks (pests, diseases, weather). Improved infrastructure services, including feeder roads and electricity. New financial instruments such as weather and commodity price insurance. Standardisation of grades and standards.
Rural World 2 Agricultural households that produce for the market but also to meet subsistence needs.	Generic risks (pests, diseases, weather); possibly problems of new market links, but most likely to be problems of local or seasonal market saturation, and imbalances of market power.	Improved technology (irrigation, agrochemicals, new varieties) to reduce generic risks (pests, diseases, weather). Information, institutional and infrastructure development needed to improve market functioning and accessibility. Investment in local crop storage and processing facilities can help to fulfil subsistence needs more effectively. Support for livelihood strategies that include diversification within and out of agricultural production.
Rural World 3 Subsistence producers with small landholdings.	Same as for Rural World 2, but also risk of landlords withdrawing land, dearth of off-farm jobs, vulnerability of agricultural jobs in Rural Worlds 1 and 2, tenure insecurity, non-enforceable contracts, dangerous working conditions on construction sites and so on.	Same as for Rural World 2, also support for diversified livelihoods, including strengthened institutions for tenure security, contract enforcement, health and safety. Social sector investments that strengthen human capital and enable households to cope with a wide range of shocks.
Rural World 4 Agricultural labourers, mainly dependent on casual, unskilled labour.	Vulnerability of agricultural jobs to shocks affecting Rural Worlds 1, 2 and 3, which affect demand for labour, lack of off-farm jobs, non-enforceable contracts, dangerous working conditions on construction sites, communicable diseases and so on.	Economic policies that encourage investment leading to job growth. Policies that support seasonal migration, commuting and personal insurance. Investment in health care infrastructure and institutions (including public health), which reduce morbidity and inability to supply labour. Adult training programmes that support creation of alternative livelihoods including self-employment and enterprise development.
Rural World 5 Those unable to engage in regular productive activity (very elderly, sick, disabled, very young), all of whom rely on informal transfers of food, shelter, clothing.	Any risks adversely affecting the agricultural and related rural economies are likely to have secondary effects on this group through reduced informal transfers to them.	Measures as above to strengthen and stabilise the household economy as well as measures to provide social protection (health, social pensions, child and widows' allowances) including the care of orphans and people living with HIV/AIDS.

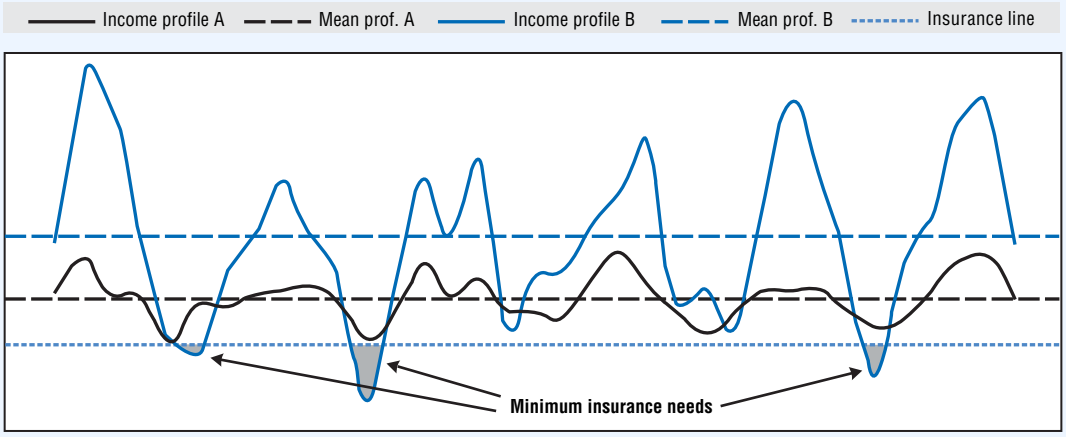
Source: Farrington (2005).

Spotlight on Higher-risk, Higher-return Strategies

Social protection, an integral part of economic policy, should consist of a wide array of programmes accessible to all. While some economists have argued that "welfare" payments to the poor are a drag on economic growth, a well designed social protection programme can be a springboard for economic growth. Many poor people's thoughts are dominated by where their next meal will come from. As a result they often adopt low-risk, low-return strategies as opposed to higher-risk, higher-return strategies.

Enabling poor rural households to adopt the higher-risk, higher-return strategies is an important dimension of increasing their opportunities for better livelihood strategies that lead to an escape from poverty. Good social protection programmes with clearly articulated, transparent, non-discriminatory eligibility and accessibility mechanisms are important in enabling the poor to adopt higher income livelihood strategies that may incur more risk.

Figure 15.1. **Two income profiles – one low, one higher**



Source: Brown and Gentilini (2005).

The figure shows two expected income profiles, A with a low mean but also a low variance, and B with a higher expected mean but a higher variance. A poor household will not adopt a livelihood strategy commensurate with profile B if it is unable to withstand the very low troughs in income that are possible.

A simple example may be a household with insecure land tenure living in an area prone to drought. Profile A may be represented by growing cassava, a food crop that is drought tolerant, with a fairly short maturation period and locally marketed or profile B by growing coffee, a long-gestation cash crop. The income from coffee is far higher but carries the risk of not being drought tolerant, or potentially losing the land before the coffee plants

reach maturity, or the harvest occurring at a trough in the international coffee price. Any one of these events or some combination could result in the very low troughs apparent in income profile B.

A variety of strategies and instruments, both public and private, could address these problems and enable a household to adopt profile B.

- Weather-based or commodity risk management instruments would provide protection against drought or the coffee being sold at a time of lows in the global price thus reducing the size of the troughs in income profile B, and increasing the average expected income.
- A land registration programme that was sensitive to traditional tenure patterns, also promoting access by women, as opposed to single right privatisation would reduce the downside variance of both income profiles increasing the average expected income.
- Investments in appropriate irrigation infrastructure would reduce the downside variance in the income profiles, particularly of B, due to drought.

The figure is, in essence, made up of a map of higher and higher income profiles where the goal is to enable households to steadily move to a higher profile – for example, from A to B and on to C, D, E – each having a mean income higher than the last. At some point the mean of the profile will be at the poverty line. In each part of the spectrum of income profiles some will have more inherent risk than others.

At the lowest income profiles, the instruments that reduce the likelihood of the risk materialising – or remove the troughs from the income profile either *ex ante* or *ex post* – are much more likely to be publicly provided. They may include public health programmes, investment in roads and institutions, as well as safety net, social assistance and welfare programmes. At the very lowest levels of expected income, and in location-specific circumstances, assistance may be provided in kind, such as direct food or housing assistance. At higher levels of income the protection measure may be privately provided such as commodity price or weather insurance or a mix of public and private provision, including contributory schemes, such as unemployment insurance, health insurance and old-age pension provision.

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PART III

Chapter 16

Advancing the New Agenda

In recent decades the context for developing and implementing policies for agriculture has changed fundamentally. Conditions in markets important for poor producers have deteriorated, partly as a result of protectionist measures in the developed world. The policy context guiding public investment in support of agriculture has been revamped. New health shocks and other forms of shock are changing the demographics in rural areas and having major impacts on productive capacity. And the natural resources supporting agriculture are coming under pressure from processes of environmental change.

The new conditions demand a new agenda, an agenda that includes many traditional approaches to agriculture – but that extends them to support pro-poor growth in agriculture. Some of the new agenda is about delivering on such neglected fundamentals as infrastructure and new technologies and the specific needs and contributions of women producers. Some is about looking at five rural worlds and coming up with policies, institutions and investments that increase the productivity of households in all five. Some is about supporting diversified livelihoods off the farm. And some is about reducing risk and vulnerability.

In advancing the new agenda, policy makers will need to broaden their understanding of poor rural households' livelihoods and work more closely with other sectors. They will need to identify and develop new institutional arrangements, using the best of both public and private sectors, to fill the gaps in markets important to the agriculture of the rural poor. And they will have to develop clear, ambitious visions for agriculture in their countries and ensure that they become central to national strategies. Donors can facilitate the involvement of rural stakeholders in shaping these policies, institutions and investments to ensure that they respond to livelihood needs and promote pro-poor growth processes.

Principles of the new agenda

Against this background, this chapter highlights the four key principles of engagement with developing country partners. These principles are essential in defining how the new agriculture agenda should be promoted, and how the investment and policy options proposed under the new agenda should be articulated. These principles are:

- Adapt approaches to diverse contexts.
- Build institutions and empower stakeholders.
- Support pro-poor international actions.
- Foster country-led partnerships.

Adapt approaches to diverse contexts

Current reality in rural areas is defined by a highly diverse range of stakeholders involved in agriculture – with considerable variation in their assets and access to markets and how institutions promote or constrain their interests. To address the needs of the rural poor, policy needs to be informed by the dynamics in these processes. That, in turn, must

be based on an understanding of the place of agriculture in the rural economy and in people's livelihood strategies, the productive potential of the land and labour involved in agricultural production as well as opportunities for agricultural enterprises.

The typology of five "rural worlds" can guide policy makers in understanding the diverse rural and agricultural systems and dynamics and respond with appropriate pro-poor policies. These rural world categories are not mutually exclusive. By using a more differentiated analysis based on people's livelihoods, it makes clear that poverty is located unevenly across and within rural populations, that policy in and for agriculture affects different groups in different ways and that the actions of one group of rural people can improve or impair the livelihoods of others. Indeed, the implication of such analyses is that policy should be primarily focused on facilitating, not prescribing, actions that will help people enhance their own strategies and improve their quality of life.

Local contexts vary in their agro-ecological potential and in the accompanying economic transformation – the contribution from agriculture is high in the early stages and declines as the economy diversifies and other sectors become more important. Public policy linked to agriculture should be tailored to a country's agro-ecological potential and the stage of transformation that it has attained. Policies need to be flexible enough to adapt to success and allow for resources to be transferred to other areas of the economy. Poverty will be reduced further if policy can promote productivity gains for small-scale, labour-intensive operations, recognising the gender division of labour in agriculture tasks. Other contexts could require an emphasis on generating employment from large-scale commercial operations.

Box 16.1. **Policies "for agriculture" and "in agriculture"**

Agricultural policies are about the direct promotion and regulation of the agricultural sector and include research, extension, producer education, inputs and credit, agricultural processing and markets. While these policies are at the heart of agricultural development, they are surrounded and supported by other policies that clearly affect, albeit indirectly, the agricultural sector. Such policies can be labelled as policies "for agriculture" – in contrast to policies "in agriculture". They include education, transport and communication infrastructure and private sector development. These policies "for agriculture" can ensure that the potential released through sound policies "in agriculture" are translated into effective and sustainable pro-poor growth. Without complementary and supportive policies "for agriculture", policies "in agriculture" will not deliver pro-poor development goals.

Build institutions and empower stakeholders

Much of the failure of agriculture to achieve its potential is essentially institutional. Support by the state has been widely discredited and unresponsive to the needs of producers and the poor. It has been inefficient in marketing producers' output, sometimes preventing the natural development of markets for producers. Public institutions need to be strengthened in their capacity to develop an appropriate blend of policy, regulatory frameworks and investments to re-launch and support the agricultural sector. At the same time, the role of private sector institutions in agriculture needs to be strengthened to help address a range of problems including limited access to financial services including credit and risk management instruments, to key inputs such as seed and fertiliser, and to output markets. These problems are often magnified for female producers.

A strategy to strengthen institutions must also develop the skills, the capacity, and organisation of poor rural producers to maximise their input in the policy processes and enable them to analyse and articulate key requirements for pro-poor growth through agriculture. In this way, the focus of policymaking may shift from the claims of competing vested interests, which frequently disadvantage the poor, to a more evidence-based dialogue. A stronger voice should also increase the accountability of the state to those representing the interests of the poor. There is clearly a need to develop innovative solutions that exploit the strengths of the public and private sectors and empower the rural poor through producers' organisations, associations and NGOs, including those that specifically represent the needs of female producers (Russo, 2005).

A major challenge, particularly in public extension and research services, is the capacity of the institutions themselves to deliver client-focused services for households in Rural Worlds 2 and 3. Years of under-funding and relative neglect have greatly weakened the capacity of these institutions to deliver in the new agricultural environment, which requires a demand-led rather than supply-led approach. Producers' associations can enhance agricultural household capacities, reinforcing the learning experience and promoting the dissemination of locally adapted technology.

Support pro-poor international actions

Three important processes can have major impacts on the successful implementation of the new agenda for agriculture. One is the **global trade negotiations** to reduce agricultural subsidies, a high priority for most developing countries. A second is the outlook, particularly since the G8 summit at Gleneagles, for a **major scaling up of aid** in response to the challenge of meeting the Millennium Development Goals. A third is the multi-donor commitment to **improve aid effectiveness**, as set out in the Paris Declaration at the Second High-Level Forum on Aid Effectiveness, 28 February – 2 March 2005. The way these processes play out in the short and medium terms will have an important bearing on conditions for enabling pro-poor growth through agriculture – and on the opportunities for achieving the Millennium Development Goal for reducing income poverty and hunger.

The 2005 WTO ministerial in Hong Kong achieved progress on agricultural subsidies and the provision of aid for trade but may fall short on providing effective market access for developing countries, particularly the least developed. Ministers reached agreement to eliminate, by the end of 2013, all agricultural export subsidies and export measures with equivalent effect such as food aid and other forms of export credits and state trading practices. Export subsidies for the cotton sub-sector will be dropped by the end of 2006, which may have significant benefits for poor West African producers. Domestic subsidy cuts will be deeper and faster than for other agricultural products. And the aid effort for the cotton industry will be further scaled up and better integrated under the special ongoing cotton consultation. The value and impact of these decisions for developing country agriculture however, will undoubtedly depend on a much wider range of factors, including domestic reforms and overcoming supply side capacity.

As noted at the G8 Gleneagles Summit, OECD members have committed to raising aid by nearly USD 50 billion a year by 2010 in order to step up the fight against hunger and poverty. Aid to Africa will be doubled in that period. For agriculture, G8 heads agreed to "support a comprehensive set of actions to raise agricultural productivity, strengthen urban-rural linkages and empower the poor", based on national initiatives and in co-operation with the African Union (AU)/NEPAD Comprehensive African Agriculture

Box 16.2. **The aid effectiveness agenda**

The aid effectiveness agenda and the commitments made in Rome and Marrakech in 2004 entail four broad areas: ownership, alignment, harmonisation and managing for results. Because these principles apply to aid management and aid delivery systems, they are as relevant for agriculture and pro-poor growth as they are for other sectors and for development co-operation more broadly.

Ownership

This refers to the degree by which partner countries exercise effective authority over their development policies, strategies and co-ordination. Locally owned country development strategies, according to DAC good practice principles, emerge from an open and collaborative dialogue by local authorities with civil society and with external partners about shared objectives and their respective contributions to the common enterprise. Each donor's programmes and activities should then operate within the framework of that locally owned strategy in ways that respect and encourage strong commitment, participation, capacity development and ownership.

Alignment

Donors agree to base their overall support on partner countries' national development strategies, institutions and procedures. Partner country strategies should be linked to multi-year expenditure frameworks and the national budget. Donor strategies, policy dialogue and co-operation should be based on partner strategies and annual progress reviews. Using a country's own institutions and systems, where these provide assurance that aid will be used for agreed purposes, increases aid effectiveness by strengthening the partner country's sustainable capacity to develop, implement and account for its policies to its citizens and parliament. Country systems and procedures typically include national arrangements and procedures for public financial management, accounting, auditing procurement, results frameworks and monitoring.

Harmonisation

Recognising that management of different donor procedures contributes to high transaction costs, donors are committed to implement, where feasible, common arrangements at the country level for planning, funding (such as joint financial arrangements), disbursement, monitoring, evaluating and reporting to government on donor activities and aid flows. One way to achieve harmonisation is to rely increasingly on sector and budget support and less on project approaches. Donors will also work towards a more pragmatic division of labour according to their comparative advantages to avoid fragmentation of aid and strengthen incentives for management and staff. These principles are particularly important in fragile states, which may draw large numbers of development actors and a proliferation of activities.

Managing for results

Managing for results focuses on strengthening performance and accountability in the use of development resources. Partner countries are to link their development strategies to realistic annual and medium-term budget processes and establish assessment frameworks. Donors are to rely as much as possible on partner country monitoring and evaluation systems. To strengthen accountability for development, partner country consultative processes and the role of parliament in approving development strategies and monitoring should be reinforced.

Development Programme (CAADP) and other African initiatives. Africans recognised the need to increase investments in sustainable agriculture as "the most important economic sector for most Africans" and committed to invest 10% of their budgets in agriculture.

Implementing the new agenda for agriculture is guided by, and anchored in, the aid effectiveness agenda agreed to by donors as good practice in the Paris Declaration which was endorsed at the Second High-Level Forum on Aid Effectiveness, 28 February – 2 March 2005. This agreement provides a well defined road map for increasing development effectiveness. It focuses on the need for a collective effort to enhance partnership commitments, align donor support to partner countries' development strategies, institutions and procedures, harmonise donors' actions around partners' development strategies to minimise transaction costs, manage resources with a focus on development results and improve mutual accountability for development results (Box 16.2).

Foster country-led partnerships

The aid effectiveness agenda, articulated in the Paris Declaration, calls for an ambitious reform in the way aid is managed and donors should be guided by those principles in helping countries unlock agriculture's potential contribution to pro-poor growth. National poverty reduction strategies (PRSs), the main point of reference for operationalising the aid effectiveness agenda in countries, are critical in implementing the new agenda for agriculture. But agriculture and rural development have been neglected in past PRSs, largely due to an inadequate understanding of the agricultural and rural dimensions of poverty. A key challenge is to redress the imbalance in the PRSs – to raise the profile of the productive sectors in general, and of agriculture in particular.

More attention must be given in particular to the role of effective monitoring frameworks in supporting improved decision making, flexible implementation, and increased accountability of the governments to all PRS stakeholders. Development processes are the outcomes of power, knowledge and information relationships: open monitoring frameworks can help promote the participation of all PRS stakeholders, including rural producers and their organisations, in the development of policies and investments with the aim of influencing and eventually re-orienting their implementation. In this context, donors need to find ways to work effectively with their partners to promote sustainable, country-driven and programme-based development that gives a higher profile to agriculture. More specifically, donors should:

- *Seek to identify and understand local processes relevant for agriculture,* such as PRSs, sector policy frameworks, sector-wide approaches (SWAps), territorial action plans and decentralisation processes and the links among them. Integrating priority areas of the new agenda for agriculture in PRSs will require active co-ordination and priority-setting at a country level, based on country analysis of bottlenecks and opportunities and a national strategy for pro-poor growth.
- *Help developing countries position agricultural and diversified livelihoods within the strategies for growth and poverty reduction*. This can be done by supporting local research capacity and improving mechanisms for the collection and dissemination of sex-disaggregated data and analyses of rural poverty. Better understanding of rural livelihoods is important for mainstreaming policy responses in growth and poverty reduction strategies. Agriculture policy makers must develop a vision and strategy for action and be accountable to their stakeholders.

- *Identify and engage the stakeholders and institutions that can engender change.* Mainstreaming is possible only if the new agenda for agriculture becomes a priority, and that will happen only with more knowledge, sensitisation and empowerment. The new approach needs to strengthen the rights and influence of the rural poor, especially women. The private sector, producers and their, associations and civil society must all take part in the policy making process and share accountability for results. Engaging the private sector will promote the buy-in to broader reforms and better co-ordination of investments in transport, market infrastructure, services and agricultural research and extension. Engaging small producers and civil society will improve understanding of the constraints and challenges of poor rural women and men.
- *Foster inter-ministerial dialogue and co-ordination mechanisms.* Addressing the challenges of the new agenda will require comprehensive approaches involving many parts of government. Beyond agriculture, the new agenda requires reform in macroeconomic, labour, land, gender equality, trade and tax policies and in science and education. Links to the ministry of economy or finance are key, but so are those to ministries responsible for social protection – to ensure that policies foster a sustained trajectory out of poverty.
- *Support local ownership through decentralisation and the integration of line ministry functions.* Agriculture policy has traditionally been highly centralised, with sector strategy determined and implemented by the line ministry. Decentralised structures of government and service provision provide poor people with a greater say in the design and implementation of policy. These structures, more responsive to local needs, can provide a forum for investment in the infrastructure and services to support agriculture and non-agriculture enterprises activities in rural areas.
- *Identify appropriate financing instruments that take the new agenda into account.* The agricultural sector is poorly represented in the political processes associated with budget negotiations, and the ministry of agriculture is frequently unable to ensure allocations consistent with the importance for poverty reduction. The decision on a financing modality should be pragmatic and impact-oriented, made in close consultation with the government. A variety of mechanisms are currently used to finance agricultural and rural development: SWAps, general budget support, basket or pooled funding to the sector and earmarked or project funding. In practice, none of these options is as distinct as it appears, and most agricultural and rural SWAps are financed through all these mechanisms. Once priorities have been established for financing, predictable and multi-year donor responses will contribute to effective use of aid.
- *Support local efforts to establish open, participatory monitoring frameworks* that enable the rural poor and their organisations to be active in monitoring the implementation of PRSs and SWAps. This will be critical in assessing whether interventions have been instrumental in responding to the livelihood needs of the rural population. The pattern so far with PRSs and agricultural and rural sector approaches is to give more attention to financial management systems and financial reporting than to qualitative reporting and impact monitoring.

Priorities for action in the new agenda

Actions to stimulate agriculture's role in pro-poor growth should, on the basis of the principles above, be used to guide renewed attention to three priority areas:

- Enhance agricultural sector productivity and market opportunities.

- Promote diversified livelihoods on and off the farm.
- Reduce risk and vulnerability.

Enhance agricultural sector productivity and market opportunities

Improving sector productivity and expanding market access is at the core of a more robust agricultural economy. Productivity gains will depend largely on a stable and supportive policy and regulatory framework to remove market distortions and provide an enabling environment for growth. It will depend on investments in new productivity-enhancing technologies and the dissemination of such technologies to the rural poor. Market access will depend on improved physical access and reduced transaction costs, particularly through appropriately targeted infrastructure and better transport services. And it will depend on improved market information through access to information and communications infrastructure and services. This may require interventions targeted towards women as they are the primary food producers and agricultural labourers in many developing countries. More specific actions that can enhance sector productivity and market opportunities would be to:

- *Tailor strategies to the development of expanded markets in food staples and the diversification into markets for higher value products*, according to local productive and market potential. Agriculture strategies have often been supply-driven, prescriptive and narrowly based, and so have failed to reflect local market and productive potential. Strategic support to agriculture needs to facilitate rather than prescribe pathways to growth and to be responsive to local potential, taking into account the diversity within the sector. It also needs to include strategies for both domestic and regional markets as well as for agriculture linked to international trade.
- *Develop institutions to help small-scale producers respond to changing market opportunities and participate in standard-setting processes*. The structure of domestic and international markets is changing rapidly, and small producers face more risk. On their own, they lack the market information and capacity to respond to many of the new opportunities emerging in these markets. Traditional forms of rural organisation have failed, and new, more effective organisational support is needed. Decentralised structures and more genuinely representative organisations will help provide stronger voice and better market access for these poorer producers. Governments should ensure that institutions exist to facilitate the flow of information to rural producers.
- *Develop effective and sustainable financial services for agricultural producers*. Financial services for agricultural producers, particularly small producers, have traditionally been very weak, and the lack of short-term credit has resulted in a failure to invest in such key inputs as seed and fertiliser. Realising the potential of agriculture to contribute to pro-poor growth will depend on financial services tailored to the needs of both women and men producers. Governments and donors will need to be innovative in their use of both public and private resources to develop models that can fill this gap.
- *Improve the functioning of land markets and generate greater incentives for investment by establishing more secure access to land*. Land policy has been a relatively neglected policy area, and the reforms that have occurred have tended to favour men and neglected women's land tenure and inheritance rights. A high priority should be to establish poor rural households' security of access to assets like land and water resources. This issue is also important for those rural producers who need to diversify out of agriculture and

migrate out of rural areas. This includes a focus on environmentally sustainable policies and institutions that facilitate informal property rights to water, land, forests and grazing land and good management of common natural resources.

- *Recognise the challenges posed by natural resources degradation to sustainable pro-poor growth,* especially where property rights are poorly defined and negative externalities and other market failures are frequent. New policy and legal frameworks should give a high priority to new natural resource management technologies that improve soil management and water productivity – and strengthen institutions that facilitate informal property rights. Adopting the Integrated Water Resource Management framework will be an important step in this direction. Associations dedicated to land use, water management, irrigation or forest use can work with policy makers to help oversee implementation of natural resource management.
- *Improve the functioning of national innovation systems*. National research and extension systems have been ineffective in addressing the needs of producers, especially poorer ones. They have too often had research agendas that reflected the capabilities and interests of researchers rather than the needs of producers. And they have tended to prescribe production strategies without due consideration of producers' productive potential or access to markets. Agricultural research that identifies low-risk and adaptable technologies for improved productivity is critical. Research and extension should always be strongly linked, with plural extension systems to fit the heterogeneous needs of poor producers. Policy needs to stimulate a broader approach to agricultural innovation – involving universities, civil society and the private sector and emphasising the participation of producers in research needs and priorities.
- *Strengthen the knowledge, skills and confidence of agricultural households to adopt and adapt appropriate practices that enhance productivity in a sustainable fashion*. The weak capacity of the vast majority of agricultural households to access, analyse and use new knowledge on improved practices hinders productivity increases on farms. Public, NGO and private agricultural extension services that provide information through an appropriate mix of channels can enhance agricultural household capacities, such as through irrigation and water conservation techniques, while producer organisations can reinforce the learning experiences. Broader education policy that increases literacy in rural areas has a major role in enabling agricultural households to use extension services. A major challenge, particularly in public extension and research services, is the capacity of the institutions themselves to deliver client-focused services for households in Rural Worlds 2 and 3. These services need to be designed to facilitate women producers' access, meet their needs and adapt to their specific situations. Years of chronic under-funding and neglect, relative to other sectors, has greatly weakened the capacity of these institutions to deliver in a new agricultural environment that requires a demand-led rather than supply-led approach.

Promote diversified livelihoods

The connections between the agricultural and non-agricultural rural economies are key drivers of diversified livelihoods. A thriving agriculture sector underpinned by improved sector productivity will expand the rural economy and influence wages and food security. Traditionally, agricultural policy has focused narrowly on increasing agricultural production, neglecting investment in non-agricultural assets for more diversified rural livelihoods while treating as socially undesirable those diversification strategies involving

movement out of rural areas. This has skewed policy to support larger, better-off producers, in the process marginalising poorer producers whose livelihoods depend more on markets outside agriculture and rural areas. This calls for government and external partners to:

- *Improve understanding of labour markets and migration patterns and incorporate that understanding in national policies.* Public policy needs to recognise the importance of enhancing people's capacity to access new markets in a diversified economy, establishing conditions for economic development of agricultural and non-agricultural enterprises and removing the political and regulatory barriers to movement out of agriculture and rural areas. This shift in policy would benefit both the landless poor and large-scale commercial producers who depend on workers for their operations.
- *Establish functioning land markets, including rental markets, with secure tenure so that people are more able to move to new forms of economic activity.* Lack of properly functioning land markets has undermined agricultural growth, and insecure access to land has made it more difficult for people to move to other forms of activity. Properly functioning land markets will provide the basis for a more diversified economy and for more secure livelihoods, making it easier for people to raise funds for investment and providing a safety net in periods of economic stress. Governments need to address land tenure to facilitate diversification.
- *Remove constraints to entrepreneurship.* The climate for investment in developing countries is typically clouded by excessively burdensome taxes and business licensing procedures and various forms of harassment of individuals and companies setting up and operating businesses – such as informal or illegal rents, fees and fines by public sector officials. The movement of people from one area or sector to another is often treated as an opportunity for officials to extract bribes. The landless rural poor who depend on selling their labour are most seriously affected by these constraints. Governments need to remove the impediments to create more equitable conditions in a growing and diversified economy with increased livelihood opportunities for the rural poor. There is evidence that technological change in agriculture frees up time for other income-generating activities and for individual and community development.
- *Tailor investments in infrastructure, education and health services to new livelihood patterns.* This means investing in transport and communication infrastructure and services to support enhanced access to markets. It also facilitates movement between rural and urban areas and makes migration easier. Migrants' needs are traditionally either ignored or even discriminated against by government, with poorly serviced urban ghettoes arising as a consequence. Infrastructure planning and implementation should pay attention to the specific needs of women producers and distributors. Policy makers should address these needs by providing services, including education and health, adapted to their livelihood patterns.

Reduce risk and vulnerability

Poor households whose livelihoods depend on agriculture face numerous setbacks, some potentially catastrophic. The general level of risk facing poor rural households has risen in recent decades with increased market exposure linked to globalisation and governments moving away from providing support to agriculture. The onset of the HIV/AIDS epidemic has further weakened the position of poor households, leaving them more

vulnerable and less able to engage in the productive economy at any level. Women's caring responsibilities for sick household members reduces the time available for food and other agricultural production.

Reducing these levels of risk and vulnerability has to be a central element of pro-poor agriculture policy, not least because it has important production and social protection impacts, but also because it enables poor rural people to engage more fully in markets. Strong synergies exist between social protection and agriculture policy, and many of the desirable public actions could increase the coherence between them.

Risk and vulnerability measures should be mainstreamed in broader infrastructure – fiscal and regional investment policies on the one hand, and in agriculture, migration and related policy spheres on the other. Sharing lessons of experience within and across countries could also be beneficial. Mainstreaming implies the need to:

- *Strengthen national analytical capacity to assess the wider risks and uncertainties*, identify the people most vulnerable to the resulting shocks and stresses and formulate measures to reduce, mitigate or cope with these potential shocks and stresses. Early warning systems should be made more efficient by advances in data collection, management and forecasting infrastructure to enable faster responses. New policies should also be examined through a risk and vulnerability lens to assess the trade-offs, when evident, between promoting growth and reducing risk. Policies increasing the risk of those most vulnerable should be tempered with stronger risk management instruments.
- *Identify infrastructure investments to reduce the exposure of rural households to risk* through climatic events, price volatility and high transport costs. This can include investing in improved transportation, electrification to reduce the risk associated with perishable crops, local grain storage banks to avoid losses, and land and water management to prevent soil erosion and landslides.
- *Invest in agricultural research and development* and promote effective public-private sector partnerships, recognising both male and female producers and their individual needs. Agricultural technology development projects should be aimed at ensuring more predictable and more productive yields and enable poor producers and workers access to existing technologies. Labour-intensive technologies, if competitive, can increase poor households' assets and so reduce their vulnerability to shocks and stresses.
- *Develop institutions to enable poor women and men to mitigate the effects of shocks and stresses and generate working capital to engage in entrepreneurial activities*. Together with appropriate regulation, institutions are keys to unlocking the development of financial services. There is scope to explore and innovate in the use of private market mechanisms, such as weather-based crop insurance, price hedging, and carefully managed buffer stocks. New forms of health care insurance and pension schemes have also been piloted in some areas to provide coverage to the rural poor.
- *When all else fails, develop social safety nets to help poor rural households cope with sudden shocks*. These take the form of predictable social transfers and emergency assistance, in cash or in kind, but their use should be temporary, as and when needed. Appropriate programmes should be designed specifically for Rural World 5 to enable them to "graduate" to more productive activities in other rural or urban worlds.

- *Assess and modify at the international level the numerous instruments affecting risk and vulnerability*, including international trade conventions, exchange rate policy and the policies controlling foreign direct investment and intellectual property rights. These instruments affect the introduction of new technologies and the degree of risk affecting all categories of farmers in developing countries.

Managing the change process

To sum up: in reality, the transformation from a system wholly dependent on low productivity agricultural production and a weak agricultural sector to one that is diverse and dynamic and that presents broader opportunities to poor rural people is not entirely virtuous. It is a process with serious imperfections. The main imperfection is that poverty persists in communities with poor market access, poor natural resource endowments and little political and social capital. Many households remain vulnerable to shocks of various kinds, and their livelihoods are exposed to high levels of risk.

In advancing the new agenda, policy makers will need to broaden their understanding of people's livelihoods and work more closely with other sectors. They will have to develop clear, ambitious visions for agriculture in their countries and ensure that they become central to national strategies. Pro poor policies must remove and relax the barriers and constraints faced by poor households as well as provide new incentives and support for their sustainable participation in more equal, market based relations and exchanges. Donors can facilitate this policy process by supporting capacity building efforts for the institutions that should lead this change process and re-launching of agriculture. Capacity building efforts can support, in particular, institutions:

- Promoting selective public investments, regulating markets, and designing regulatory frameworks in areas critical for the agricultural sector such as trade policy, tax policy, and land reform.
- Representative of poor rural populations, such as small producers' organisations, to analyse and articulate their key requirements for their development and promote their active participation in decision making processes.

So, for policy to be pro-poor, it should take account of the needs of poor rural households. This does not mean that policies in and for agriculture should become social policy. But it strongly suggests that economic policy, including agricultural policy, should be consistent with social objectives and, where possible, address them directly.

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Executive Summary

Reliable, efficient infrastructure is crucial to economic and social development that promotes pro-poor growth. By raising labour productivity and lowering production and transaction costs, economic infrastructure – transport, energy, information and communication technology, and drinking water, sanitation and irrigation – enhances economic activity and so contributes to growth, which is essential for poverty reduction. Thus a major goal for Development Assistance Committee (DAC) partner countries, with help from donors, is to develop sustainable infrastructure facilities and services that improve the livelihoods of poor people and enable them to participate in growth.

The important demand for infrastructure is not being met. Around the world more than 1 billion people lack access to roads, 1.2 billion do not have safe drinking water, 2.3 billion have no reliable sources of energy, 2.4 billion lack sanitation facilities and 4 billion are without modern communication services. In the absence of accessible, affordable infrastructure, poor people pay heavily in time, money and health. Recent estimates put annual investment needs for infrastructure (including rehabilitation and maintenance) at 5.5% of growth domestic product (GDP) in developing countries and 9% in the least developed countries (IMF and World Bank, 2005). Current spending falls far short, averaging 3.5% of GDP in developing countries. In sub-Saharan Africa, for example, annual infrastructure needs are USD 17-22 billion, while the annual spending (domestic and foreign, public and private) is about USD 10 billion. The region's infrastructure financing gap is thus USD 7-12 billion per year, or 4.7% of GDP.

Donors are working together to enhance infrastructure's contributions to economic growth and poverty reduction. Infrastructure's importance for growth, poverty and the Millennium Development Goals (MDGs) has been recognised at several major donor meetings, including the International Conference on Financing for Development (Monterrey, 2002) and World Summit on Sustainable Development (Johannesburg, 2002). Building on these efforts, in 2003, the DAC chose infrastructure as a major area of analysis for its Network on Poverty Reduction (POVNET). The Task Team on Infrastructure for Poverty Reduction (InfraPoor) was created to guide efforts by DAC members to enhance infrastructure's contribution to poverty reduction and economic growth. The team's conclusions, presented in Part IV, are summarised in four guiding principles.

The guiding principles offer a consensus framework for meeting infrastructure challenges. They are:

i) Use partner country-led framework as the basis for co-ordinated donor support.

ii) Enhance infrastructure's impact on poor people.

iii) Improve management of infrastructure investment, to achieve sustainable outcomes.

iv) Increase infrastructure financing and use all financial resources efficiently.

These principles apply generally, to all infrastructure investment, as well as specifically – to individual sectors and types of countries.

Applying the principles generally

The first principle, using a country-led approach, is central. Partner countries must develop comprehensive infrastructure strategies, linked to other economic and social sectors and plans. Developing such strategies requires responsive government entities, clear regulations and participation by accountable stakeholders. To support country-led infrastructure strategies, donors should:

i) Co-ordinate their assistance by establishing common approaches and methods (with explicit measures of their impact on poverty), agreeing on lead donors, sharing technical assistance and research data. Donors should continue to make progress on untying aid for infrastructure, as encouraged by the DAC's Recommendation on Untying Official Development Assistance to the Least Developed Countries (2001) and by the Paris Declaration on Aid Effectiveness – Ownership, Harmonisation, Alignment, Results and Mutual Accountability (2005b).

ii) Promote a programme-oriented approach in partner countries to foster coherent, network-wide strategies and develop the cross-sector synergies needed for pro-poor growth. This approach requires support for sector reforms, programmes and budgets. Support for sector programmes can also be provided through national budgets. If conditions prevent a programmatic approach at the national level, support should increasingly be co-ordinated within an agreed strategic framework.

iii) Exchange analyses of the viability and sustainability of proposed infrastructure investments in partner countries. Such analyses should include *ex ante* poverty impact assessments and joint monitoring of whether assistance strategies are contributing to sector development and poverty reduction.

iv) Co-ordinate training and technical assistance for planning, designing, managing, operating and regulating infrastructure – taking into account partner countries' administrative rules and avoiding use of donor-led project management units and similar structures. Donors should also encourage South-South sharing of expertise and good practices, as well as involvement by local and regional experts.

The second principle, focusing on poor people, should inspire all efforts to promote pro-poor growth. Partner countries, with donor support, should:

i) Develop infrastructure programmes and projects that use geographic targeting to improve livelihoods, incomes and social services for the greatest possible number of poor people.

ii) Promote synergies between economic and social infrastructure to amplify benefits for the poor and achieve the MDGs.

iii) Support involvement by poor people, women and men, vulnerable groups and those in chronic poverty (including the disabled, the elderly and minorities) in the entire process – from planning and implementation to management and maintenance – to ensure that infrastructure supplies reflect needs and prevent or mitigate negative impacts.

iv) Adopt technological and commercial options tailored to investment areas' long-term service needs and make services as affordable as possible for poor people.

v) Offer technical and financial incentives to promote involvement by the local private sector.

vi) Reduce gender inequities and include vulnerable groups when designing infrastructure strategies and programmes.

To help reach the poor and promote pro-poor growth, donors should support these efforts as well as specifically to:

i) Target infrastructure interventions to areas that enable the largest possible number of poor people to engage in productive activities and access social services, using a cross-sector approach linked to MDG outcomes.

ii) Encourage the involvement of poor communities through, for example, decentralised planning systems that incorporate explicit poverty reduction goals (such as universal coverage for basic services).

iii) Propose technological and commercial options tailored to investment areas' long-term service needs.

iv) Support tariff policies that poor users can afford – including smart subsidies and flexible payment structures – and ensure that users are consulted on needed tariff increases.

v) Provide technical and financial incentives (certification, risk insurance) for local private sector involvement.

vi) Promote employment creation in infrastructure construction, operation and maintenance.

vii) Systematically address gender-specific needs when designing infrastructure projects.

viii) Prevent or mitigate negative impacts on vulnerable groups and promote inclusion of the disabled, the elderly and minority groups.

The third principle, enhancing sustainability, is the priority for action. Driven by strong co-ordination among donors, actions under this principle seek to preserve infrastructure assets and increase service access and affordability – and, in so doing, encourage sustainable and ongoing investments that further expand access. To enhance the sustainability of infrastructure investments, donors should:

i) Emphasise the crucial role of infrastructure maintenance and sustainability in preserving the value of infrastructure assets. Strengthening such efforts in partner countries requires funding, technical assistance and capacity building.

ii) Help partner countries establish systems that recover costs and collect tariffs, while taking into account poor people's ability to pay.

iii) Support – before services are extended – improvement in the management of public service providers, to reduce commercial and technical losses and thus lower costs and make services more affordable.

iv) Foster public-private partnerships to enhance project efficiency and improve sector governance.

v) Strongly support initiatives that promote transparency and reduce corruption.

vi) Promote environmental and social impact assessments, and encourage sustainable resource management through price incentives.

The fourth guiding principle, increasing financing and using it well, follows from the other three. The first three principles indicate the need for a sharp increase in infrastructure investment – as well as the challenges involved for partner countries. At a minimum, countries must achieve macroeconomic stability and prioritise public spending. Moreover, countries cannot hope to fill the investment gap without mobilising private funds. To encourage broader and better involvement by the foreign and domestic private sector – as well as by central and local governments – in infrastructure financing, donors should:

i) Provide predictable, long-term official development assistance.

ii) Support a diverse mix of financial instruments, including credit enhancements (guarantees, co-financing, swaps from local to hard currencies) and investments in public-private partnerships.

iii) Provide technical assistance to build capacity in capital and financial markets and develop regional, national and subsovereign financing mechanisms for infrastructure.

Applying the principles by sector

Transport facilitates access to economic and social services and enhances the production and trade potential of local, national and regional economies. But transport costs are often high and maintenance inadequate, and sector activities can contribute to problems such as pollution and the spread of HIV/AIDS. To enhance the pro-poor growth and poverty reduction impacts of their support for transport infrastructure, donors should:

i) Strengthen co-ordination among administrative bodies and their public investment programmes to comprehensively and equitably address new investment, maintenance, services and urban mobility as well as to increase public and private investment.

ii) Promote comprehensive, economically, socially and environmentally justified networks, including cross-border networks.

iii) Encourage a service-oriented approach to optimise use of available resources, public and private.

iv) Strengthen institutional arrangements and capacity for maintenance by promoting the "user pays" principle.

v) Encourage local private provision of services and development of local industries for construction and maintenance of facilities.

vi) Address health, safety, environmental and social concerns, including impacts on and needs of vulnerable groups.

Reliable, modern energy services are essential for raising growth and productivity and improving the livelihoods of poor people. But most poverty reduction strategies have paid little attention to the sector. Donors' support for energy should:

i) Support investments in grid extensions and in areas where providing energy services is unattractive to private investors but necessary from a social perspective – as long as operation and maintenance costs are covered by tariffs or temporary subsidies.

ii) Support reforms and regulations that encourage efficient power use and result in tariff collection policies that attract private investment.

iii) Promote cross-border energy initiatives.

iv) Adapt energy supply technologies (including biomass) to productive uses, particularly among the poor.

v) Support efforts to improve poor households' access to safe energy, such as biomass, when modern energy cannot be provided cost-effectively.

vi) Provide accompanying measures, such as micro-finance schemes, to increase poor people's access to appropriate energy services.

vii) Strengthen the management capacity of all energy sector entities, including for transparency and accountability.

viii) Address concerns about environmental sustainability, energy security and access to modern energy in remote areas by promoting renewable energy sources and energy efficiency.

Information and communication technology (ICT) increases the efficiency of a wide range of efforts, from public administration to economic and social services to pro-poor growth. Yet partner countries and donors still have limited involvement in the sector – despite essential and unfulfilled public functions such as generalising new technology, strengthening regulation and financing backbone infrastructure. To increase ICT's contribution to pro-poor growth, donors should:

i) Support planning and investment in backbone infrastructure – particularly trunk and rural communication networks – and increased access through innovative financing facilities and network sharing arrangements.

ii) Link ICT programmes with activities in other sectors, particularly those that promote productive activities for poor people.

iii) Support ICT policy making and regulation, including regulation enforcement.

Despite the importance of water resources – including for drinking water, sanitation and irrigation – public bodies often fail to manage them correctly, with severe consequences for poor people. Water is directly linked to agriculture, food security and health as well as environmental, gender equality, social development and many other issues. Donor support for the water sector should:

i) Promote, using the integrated water resource management (IWRM) framework, better co-ordination between central and decentralised levels to rationalise water use for productive purposes. Donors should also help develop and implement water (and land use) laws, regulations and other sector reforms.

ii) Promote technical and economic assessments of and investments in irrigation, using common methodologies (particularly for investments covering multiple countries) and taking into account social and environmental issues.

iii) Favour participatory irrigation management, to facilitate recovery of operation and maintenance costs and improve environmental security.

iv) Strengthen public bodies responsible for water services and support their expansion only after their management has improved. Efforts can be made to stem technical and non-technical losses, encourage public-private partnerships, introduce demand management (such as metering, leakage control, conservation and reuse programmes) and support tariff policies that promote affordability (through smart subsidies, for instance), "polluter pays" principle and institutional sustainability.

v) Encourage peri-urban and rural access to regular, low-cost drinking water by involving the domestic private sector under decentralised public structures.

vi) Promote sanitation investment, capacity building and hygiene education.

Applying the principles in different types of countries

Fragile and post-conflict states suffer from weak governance and damaged core infrastructure facilities. Donor support for infrastructure in these states should:

i) Take the country context as the starting point.

ii) Restore core infrastructure – using a co-ordinated, long-term approach – and applying basic design standards to increase access.

iii) Rebuild governance and administrative capacity.

Many middle-income countries suffer from deep pockets of poverty. In these countries donor interventions should:

i) Focus on poverty-stricken areas and promote pilot approaches that include such areas in national pro-poor growth efforts.

ii) Engage the private sector and encourage public-private partnerships.

iii) Use innovative mechanisms to leverage additional financing – freeing up aid for low-income countries, particularly in Africa.

iv) Use decent country systems for procurement and social and environmental safeguards.

v) Focus on the environmental and governance-related strategic development goals identified in the Millennium Declaration, in addition to poverty reduction goals linked to the MDGs.

Regional and cross-border infrastructure can provide many benefits, including increasing trade, improving security, saving money, strengthening natural resource management, addressing the needs of landlocked countries and building on national and regional comparative advantages. To promote such infrastructure, donors should:

i) Support trade and transport facilitation, such as through efforts to reduce border crossing problems – including rationalisation of procedures and elimination of illegal or semi-legal checkpoints on roads – and increase the efficiency of multi-country operations in other network industries, such as railways and electricity.

ii) Assess potential benefits (for countries, regions and people) and ensure that designs and financing arrangements address concerns about equity.

iii) Contribute to capacity building and project preparation facilities in regional bodies.

iv) Ensure that their support promotes regional public goods such as pro-poor growth, poverty reduction and environmental protection.

Assessing the impact of infrastructure

Without measuring, it is impossible to know infrastructure's impact on poverty reduction. Moreover, comparability and consistency require common indicators and approaches to data collection, assessment and monitoring. To better assess how infrastructure investments affect pro-poor growth, donors should:

i) Strengthen country systems and capacity to generate relevant indicators and data. Support should be provided to strengthen the capacity of line ministries, other government agencies and local research institutes to collect and analyse data needed for pro-poor planning of infrastructure delivery.

ii) Encourage simple, harmonised, *ex ante* poverty impact assessments of infrastructure, aligned with poverty reduction strategies and the capacity of partner countries.

iii) Engage in joint monitoring and evaluation – involving donors, governments and other stakeholders – to build and share knowledge. Monitoring and evaluation should also aim to strengthen local research and analytical capacity, by involving government agencies, national and regional research institutions, civil society organisations and local consultants.

Monitoring the principles

Implementation of the principles must be monitored to ensure intended outcomes and generate lessons. Task team members have agreed to monitor implementation using DAC's framework for thematic peer review. In addition, implementation should be evaluated in collaboration with partner countries, facilitating co-ordinated follow-up at the country level.

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PART IV

Chapter 17

Scaling Up and Improving Infrastructure for Poverty Reduction

Because of insufficient investment, inadequate planning, poor maintenance and unsustainable sector governance, most DAC partner countries – especially low-income countries – suffer from huge gaps in infrastructure. Without major progress, it will be impossible for these countries to significantly reduce poverty and achieve the Millennium Development Goals (MDGs). Thus a better approach is needed to ensure substantial, sustained improvements in development of and access to infrastructure facilities and services, especially by poor people. The main challenge is to foster a dynamic growth process that develops infrastructure services and involves and benefits the poor.

Economic infrastructure – crucial to achieving growth and reducing poverty[1]

Defining infrastructure. In 2003 DAC's Network on Poverty Reduction (POVNET) began an ambitious programme to advance pro-poor growth. Reflecting the renewed international emphasis on infrastructure's role in such growth, POVNET assembled a Task Team on Infrastructure for Poverty Reduction (InfraPoor) to analyse recent strategies and needed actions in this area. Although the team recognises the importance of social infrastructure such as health, education and culture, Part IV focuses on economic infrastructure – transport, energy, information and communication technology, and irrigation, drinking water and sanitation – referred to hereafter as infrastructure. All such infrastructure involves both physical facilities (roads, energy generation, water connections) and services (transport services, energy and water supply). It also involves investment, management, maintenance, capacity building and policy making. In addition, it can span countries, borders and regions.

Infrastructure is important for pro-poor growth. In past decades donors supported infrastructure investment because they believed that it contributed to growth, trickle-down economic development and redistribution to poor people. Today the links between infrastructure development and pro-poor growth are better understood. Infrastructure supports pro-poor growth by:

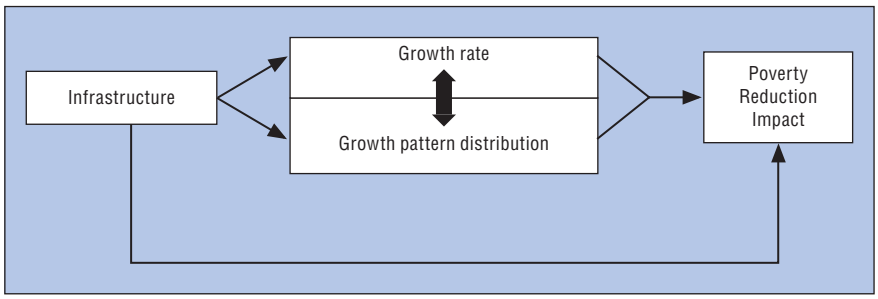
i) Enhancing economic activity and thus overall growth – for example, by reducing production and transaction costs, increasing private investment, and raising agricultural and industrial productivity (top arrow in Figure 17.1).

ii) Removing bottlenecks in the economy which hurt poor people by impeding asset accumulation, lowering asset values, imposing high transaction costs and creating market failures. Eliminating these bottlenecks allows the poor to contribute to growth directly through the employment and income opportunities created by the construction, maintenance and delivery of infrastructure services, and indirectly through better services (middle arrow in Figure 17.1).

iii) Generating distributional effects on growth and poverty reduction through poor people's increased participation in the growth process – for example, by increasing their access to factor and product markets, reducing risk and vulnerability, enhancing asset mobilisation and use, and promoting their empowerment (bottom arrow in Figure 17.1).

Infrastructure also affects non-income aspects of poverty, contributing to improvements in health, nutrition, education and social cohesion. Indeed, infrastructure makes valuable contributions to all the MDGs (bottom arrow in Figure 17.1), as described in a background paper prepared for the InfraPoor Task Team (Willoughby, 2004b) that is summarised in Annex IV.2. The many benefits of infrastructure have also been confirmed by the UN Millennium Project (2005), which advocates a major increase in basic infrastructure investments to help countries (especially in Africa) escape the poverty trap, and by the Commission for Africa (2005). But to be effective in reducing poverty, infrastructure development must be co-ordinated with other important concerns, such as agricultural, environmental and trade policies.

Figure 17.1. **Infrastructure can raise growth, improve its distribution and reduce poverty**

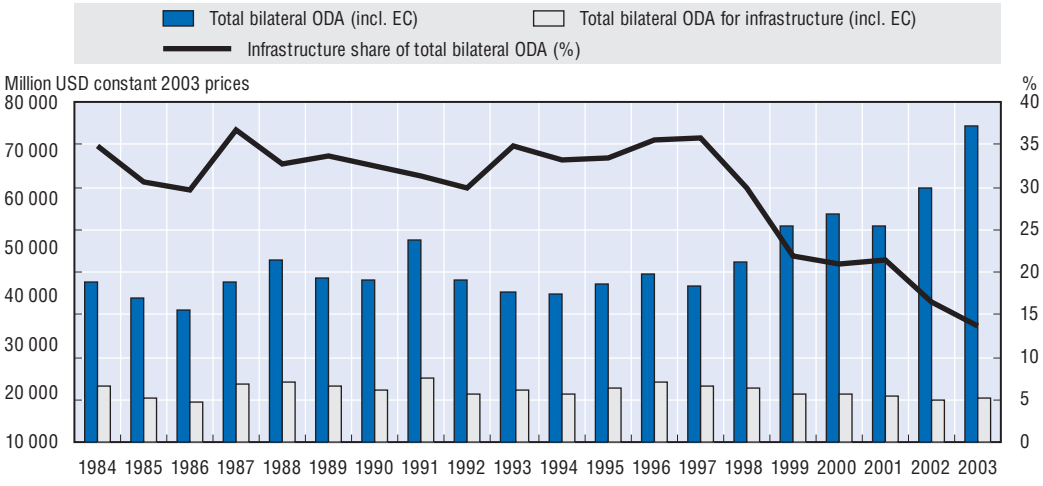


Recent trends in infrastructure – a widening gap[2]

The infrastructure gap is huge. Despite its clear benefits for growth and poverty reduction, infrastructure spending is far below what is needed. Moreover, that gap widens as country incomes fall. Globally, more than 1 billion people have no access to roads, 1.2 billion do not have safe drinking water, 2.3 billion lack reliable sources of energy, 2.4 billion have no sanitation facilities and 4 billion no modern communication services. In the absence of accessible transport, energy and water, the poor pay heavily in time, money and health.

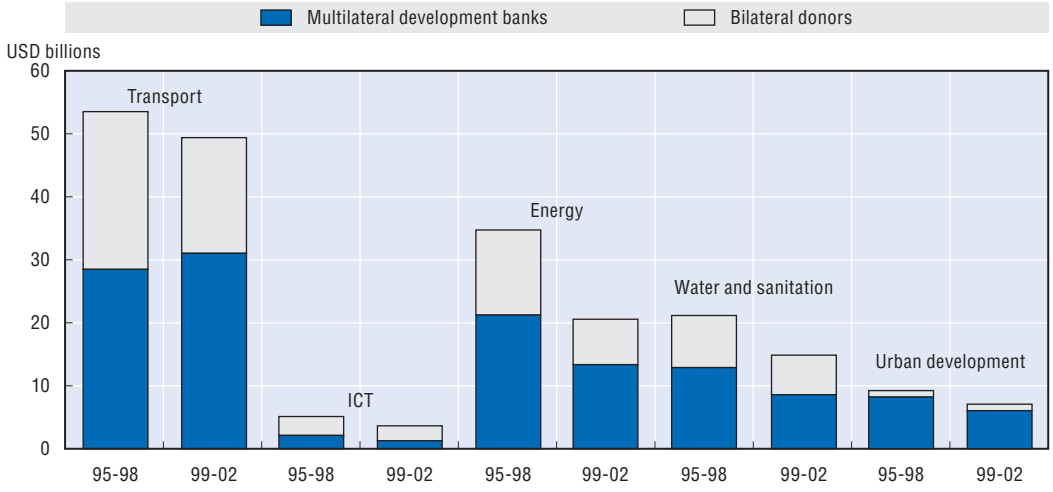
The drop in infrastructure investment was no accident. Spending on infrastructure (both capital and recurrent costs, including maintenance) in low- and lower-middle income countries has declined from 15% of GDP in the 1970s and 1980s to about 7% today (World Bank, 2003). Since the mid-1990s all sources of infrastructure funding have fallen dramatically: government funding (which accounts for about two-thirds of spending), official development assistance (with a 50% drop in multilateral and bilateral aid to infrastructure; see Figure 17.2 and World Bank, 2003) and private funding (which dropped from USD 128 million in 1997 to USD 58 million in 2002; World Bank, 2003). All sectors and regions have been affected by the decline (Figures 17.3 and 17.4). As a result many countries, especially in sub-Saharan Africa, suffer from a huge backlog of needed infrastructure investments.

Figure 17.2. **Bilateral aid for infrastructure has plummeted**



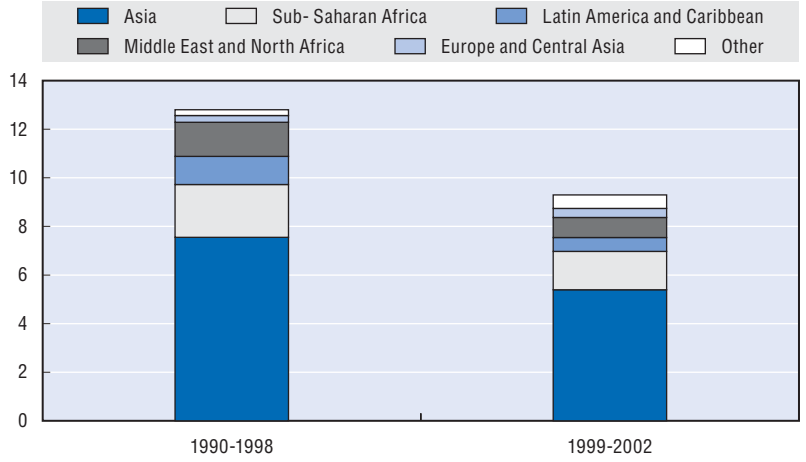
Source: OECD Creditor Reporting System (CRS); Commitments.[3]

Figure 17.3. **The drop in donors' infrastructure investment has hit all sectors**



Source: Hesselbarth (2004).

Figure 17.4. **All regions are hit by the decline of ODA to infrastructure**



Source: Hesselbarth (2004).

To reduce poverty, the decline in infrastructure investment must be reversed. A significant increase in national, cross-border and regional infrastructure investment is needed to advance growth and reduce poverty in partner countries. Even more is needed in extremely fragile countries and regions. The UN Millennium Project estimates that between 2005 and 2015, sub-Saharan Africa's annual needs for infrastructure investment and maintenance equal 13% of GDP. Maintenance is especially important: according to World Bank estimates, more than two-thirds of partner countries' infrastructure spending needs in 2005 – 10 are for maintenance.

Lessons from experience

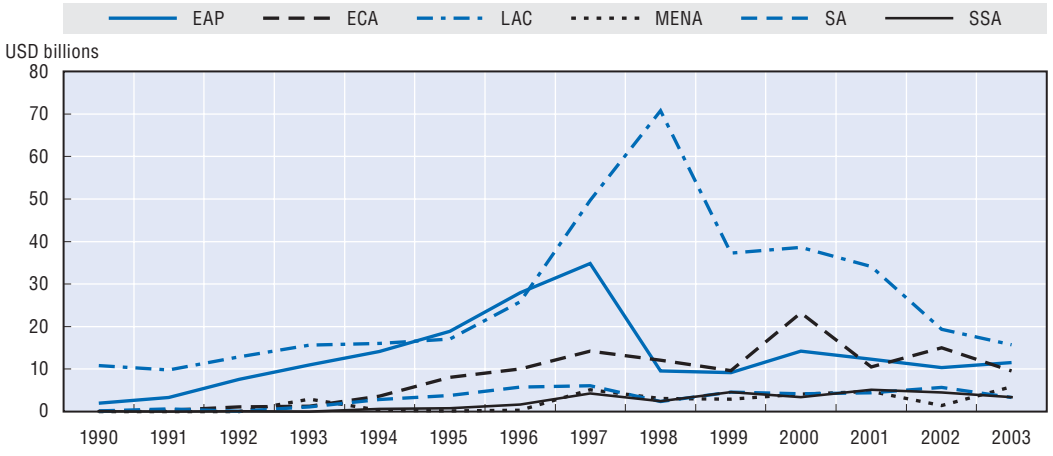
Against this background, four lessons are clear:

i) **Substantial improvements in infrastructure are needed to support pro-poor growth and the MDGs.** During the 1990s donors shifted from infrastructure to social

investments partly to compensate for the adverse effects of structural adjustment policies. But this move neglected infrastructure's importance in reducing poverty and supporting growth. Moreover, infrastructure projects were not designed to deliver maximum benefits to poor people, including through participation, targeting, and capacity building.

ii) **The public and private sectors both play important roles in providing infrastructure facilities and services.** But in the 1990s it was widely believed that private investment in infrastructure would increase as public investment and aid declined. This assumption proved incorrect, as shown in Figure 17.5. For various reasons, mainly involving investment climates and rates of return, private investment has been limited in terms of volume, sectors and countries – especially in sub-Saharan Africa but also in South Asia and the Middle East and North Africa. Thus, to achieve optimal management of infrastructure facilities (in line with private sector rules), make the best use of resources and extend services to the maximum number of people, governments should be active in planning, financing and regulating infrastructure investment. Africa's shortfall is partly due to shrinking public budgets for infrastructure – while spending has increased in other areas, including the social sector (Figure 17.6).

Figure 17.5. **Infrastructure investment with private participation has faltered everywhere and never took off in some regions**

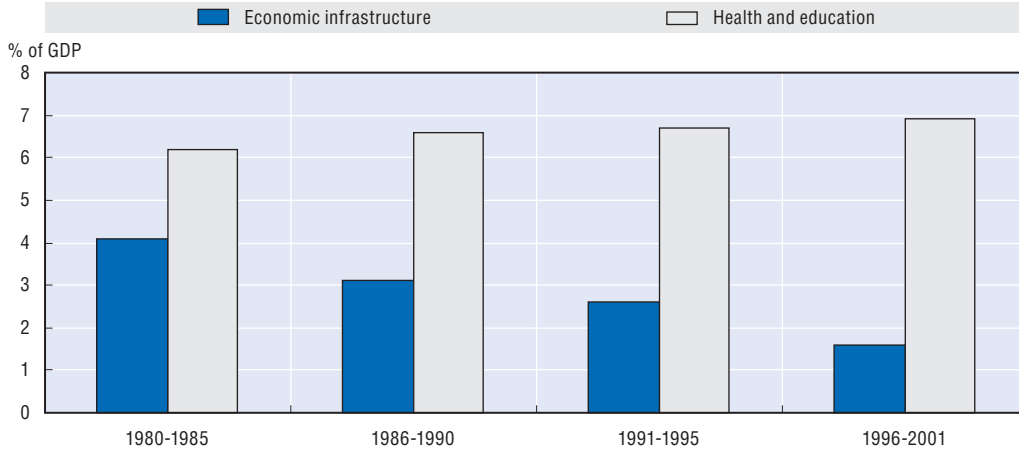


1. EAP: East Asia and Pacific; ECA: Europe and Central Asia; LAC: Latin America and Caribbean; MENA: Middle East and North Africa; SA: South Asia; SSA: Sub-Saharan Africa.

Source: World Bank Private Participation in Infrastructure database.

i) **Sustainable infrastructure services are a priority.** The drop in infrastructure investment has also been driven by poorly designed projects, many of which have been isolated, driven by donor demands and not tailored to the needs of local populations. For example, many investments have focused more on developing physical facilities than on delivering long-term services. Moreover, non-viable systems have caused asset losses for infrastructure providers and failed to provide benefits to poor people. Recent experiences show that a more systemic approach achieves better results when designing infrastructure projects. In addition, sustainable investments require maintaining services and developing and supporting the institutions responsible for managing infrastructure assets. Finally, infrastructure facilities should reflect the needs of local populations, especially the poor.

Figure 17.6. **Public spending on infrastructure has plunged in Africa**



Note: This figure was based on an 11-country sample.
Source: World Bank (2005a).

ii) **Optimal use should be made of available resources.** During the 1980s and 1990s infrastructure support was often spent poorly, reflecting insufficient co-ordination among donors on the needs of partner countries – often due to donors' own interests – as well as between donors and country stakeholders. Because infrastructure serves a wide range of sectors and groups, adequate co-ordination is needed when identifying needs, planning services and determining budget allocations. Resource use can be optimised by using sector-wide approaches and implementing the Paris Declaration on Aid Effectiveness (OECD, 2005b).

Notes

1. This section draws on, among other sources, Willoughby (2004a; b).
2. This section draws on, among other sources, Hesselbarth (2004).
3. The following sectors/activities have been included in "infrastructure": water supply and sanitation, transport and storage, communications, energy generation and supply, agricultural water resources, urban development and management, rural development.

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PART IV

Chapter 18

Four Guiding Principles for Using Infrastructure to Reduce Poverty

Part IV recommendations for donors and partner countries are based on four guiding principles:

- Use partner country-led frameworks as the basis for co-ordinated donor support.
- Enhance infrastructure's impact on poor people.
- Improve management of infrastructure investment, to achieve sustainable outcomes.
- Increase infrastructure financing and use all financial resources efficiently.

Principle 1: Use partner country-led frameworks as the basis for co-ordinated donor support

The first principle reflects the leading role of partner country governments in establishing solid frameworks for reliable aid flows. Partner governments should develop robust approaches for planning and managing pro-poor growth and infrastructure development, expressed in coherent poverty reduction strategies and sector strategies formulated in consultation with stakeholders – including donors and poor people. Donors can support this country-led, outcome-oriented approach by helping to build capacity and by co-ordinating and harmonising their support in line with country priorities for reducing poverty.

Developing consistent country strategies for infrastructure and pro-poor growth

Address infrastructure needs in poverty reduction and pro-poor growth strategies. A coherent national framework is essential for increasing infrastructure's contribution to pro-poor growth (Tedd, 2005). For partner countries not using poverty reduction strategies (PRSs), national development strategies should contain clear goals and plans for reducing poverty and inequality. Second generation PRSs are paying more attention to pro-poor growth, a trend that should continue. More thorough treatment of infrastructure in PRSs – including its impact on growth, poverty reduction and the MDGs – is also needed. Many PRSs treat infrastructure in a piecemeal way (addressing only rural roads, not the entire network, or physical infrastructure but not services) and are unclear about its links to other components of the strategy. It is not simply a matter of including planned infrastructure projects in PRSs, as doing so may compound the "wish list" problem. A PRS should clearly define infrastructure's expected contributions to the strategy's main targets and priorities, as well as to national MDG targets. In addition to facilitating pro-poor growth, such expectations include enhancing market access, mitigating environmental concerns, increasing gender equity and improving livelihoods and working conditions (including through increased gender equity).

Anchor infrastructure's contributions to poverty reduction and the MDGs in sound strategies. Infrastructure strategies – both for individual sectors and overall – must be country-owned, based on consultations with stakeholders and linked to the PRS. Strategies should express a vision for each sector and indicate how poor people's needs will be met. *Ex ante* impact assessments at the sector level can help define expected outcomes and specify (using indicators) how infrastructure will contribute to pro-poor growth, poverty reduction and the

MDGs.[1] Good infrastructure strategies address the entire network at the national and local levels, as well as regional and cross-border links. They include public sector responsibilities and interventions as well as the roles of the private sector and civil society in supplying, managing and maintaining facilities and services. Implementation plans must be politically and economically viable, addressing issues such as institutional capacity, sector management, and the adequacy and consistency of fiscal and donor commitments.

Link strategies to budgets. Functional links must be established between PRSs, sector strategies, and national and sector budgets, with clear connections between development priorities and programming of domestic and donor resources. Current weak links between strategies and budgets (including significant off-budget funding) impede co-ordinated infrastructure investment consistent with national poverty reduction priorities. Investments in infrastructure should be a component of a balanced and well resourced multi-sectoral expenditure programme implementing the PRS. To that end, it is useful to elaborate a medium-term expenditure framework (MTEF) aligned with the PRS. Operational sector strategies require budgets that reflect infrastructure needs, priorities and available resources, and that cover investment – including recurrent costs, with an emphasis on maintenance.

Develop better data on infrastructure needs and spending, including indicators of outcomes and impacts. Well-targeted infrastructure interventions require background data to prioritise investment and maintenance needs, then estimate (*ex ante*) and measure (during implementation and *ex post*) their impacts. In addition, sound country-led frameworks require data that quantify the links between infrastructure and poverty. Moreover, sector data are essential to effective management information systems in sector institutions and serve needs of other sectors, PRSs and donors. Yet partner countries often lack such data. Many national statistical offices do not have sufficient physical and financial capacity to collect basic data and conduct household surveys, while line ministries and agencies do not have enough incentives, capacity or resources. Sector data are often limited to physical output indicators, with no indication of outcomes, usefulness or impacts on the country's development goals. There are rarely systematic mechanisms for using basic data and surveys to inform policies and strategies; central planning agencies responsible for PRSs have little access to infrastructure data, and sector agencies are reluctant to establish frameworks and indicators for monitoring outcomes and impacts. Donors collect data, but often only for their projects or programmes. Such data may rarely be shared with the country or with other partners, and data are not always comparable across studies. Thus there is an enormous need to strengthen the capacity of line and oversight ministries, other agencies and local research institutes to collect and analyse data needed for planning infrastructure investments and sector reforms.

Improving frameworks for investment and management

Strengthen government's role. The 1990s saw an extreme weakening of government infrastructure planning, in some countries partly because of efforts to shift investment and management responsibilities to the private sector. But government has an indispensable role in planning infrastructure, and at much more detailed structural and systemic levels than in other industries. This is because of infrastructure's crucial role in supporting overall development and the need for co-ordination among the multiple entities involved, public or private. To ensure that partner governments act efficiently and effectively, the roles and responsibilities of the various actors involved in infrastructure – central and local

governments, domestic and foreign entrepreneurs, civil society, donors – must be optimised. This adjustment is needed to focus central governments on funding, regulation, and policy elaboration and implementation; to better balance the roles of national, provincial and local stakeholders; and to outsource, when possible, service provision to the private sector.

Involve stakeholders. Participation by stakeholders in infrastructure planning and decision making helps balance different interests and strengthens ownership and accountability. Stakeholder participation is important at all levels, from national to community strategies, and all stages, from designing to maintaining investments. All stakeholders – especially user groups and poor people – should be equitably represented.

Ensure transparency and accountability. Transparent processes should be established for public finance management, covering both the revenues and expenditures of government and para-statal bodies. Transparency involves independent audits, public display of tariffs and publication of annual activity reports, with specific mention of how services are being improved for the poor. Because infrastructure decisions can be affected by corruption and favouritism, a systemic approach should be used to ensure accountability, participatory planning, transparent monitoring and competitive implementation; and procurement reforms and transparent contracting arrangements promoted at the project and programme levels.

Regulation – a core government responsibility. Infrastructure with a public good character (such as most roads) is better provided by government, while infrastructure considered private goods (such as energy services) can potentially be transferred to private ownership or management – under regulation. Key issues for regulation include developing an orientation towards pro-poor growth, defining the level of government where regulation should occur and deciding on multi- or single-sector approaches. Responsiveness to the needs of poor customers may suggest placing regulatory responsibilities close to service provision, but financial and technical capacity and resources are generally greater at higher levels of government. Hence a multi-level solution may be appropriate. Regulation of private operators should establish rates of return and define good management and extension of infrastructure services. Achieving the latter may require providing subsidies to the private sector, in a transparent way, to promote investments that serve the poor.

Defining the role of donors: Support, co-ordinate and harmonise

To strengthen their support for country-led infrastructure, donors should:

i) Co-ordinate their assistance for infrastructure strategies agreed with partner countries. Such efforts require establishing common approaches and methods (with explicit measures of their impact on poverty), agreeing on lead donors, sharing technical assistance and research data. Donors should continue to make progress on untying aid for infrastructure, as encouraged by the DAC's Recommendation on Untying Official Development Assistance to the Least Developed Countries (2001) and by the Paris Declaration on Aid Effectiveness – Ownership, Harmonisation, Alignment, Results and Mutual Accountability (2005b).

ii) Promote a programme-oriented approach in partner countries to foster coherent, network-wide infrastructure strategies and develop the cross-sector synergies needed for pro-poor growth. This approach requires support for sector reforms, programmes and budgets. Support for sector programmes can also be provided through national

budgets. If conditions prevent a programmatic approach at the national level, support should increasingly be co-ordinated within an agreed strategic framework.

iii) Exchange analyses of the viability and sustainability of proposed infrastructure investments in partner countries. Such analyses should include *ex ante* poverty impact assessments and joint monitoring of whether assistance strategies are contributing to sector development and poverty reduction.

iv) Co-ordinate training and technical assistance for planning, designing, managing, operating and regulating infrastructure – taking into account partner countries' administrative rules and avoiding use of donor-led project management units and similar structures. Donors should also promote South-South sharing of expertise and good practices, as well as involvement by local and regional experts.

Principle 2: Enhance infrastructure's impact on poor people

The second principle reflects the need not only to increase the supply of infrastructure facilities and services in areas where poor people live, but also to ensure that infrastructure improvements benefit them. The latter goal will be achieved by promoting a dynamic process of inclusive growth and by strengthening infrastructure's social and economic effects on poverty reduction – perhaps the greatest challenge facing donors and partner countries. Infrastructure must do more than provide users with affordable, reliable facilities. It must also promote economic activities, particularly private sector involvement and employment, and ensure that women and marginalised groups gain more equal access to infrastructure resources and services.

Improving poor people's access to infrastructure services

Target bottlenecks to poverty reduction. In planning infrastructure and setting priorities for pro-poor growth, limited resources make it essential to identify and target the most serious infrastructure-related bottlenecks to such growth. (Examining characteristics of target areas – such as the proportion of lowest-income groups or vulnerability to natural disasters or famines – also helps make planning more pro-poor.) Better information is needed on such bottlenecks and on how to ensure that infrastructure planning accounts for it. For targeting to be more effective, partner and local governments must engage in a participatory process to increase its impact. At the same time, narrow targeting on the very poor is ineffective. An appropriate approach is to combine geographic targeting with other measures to extend services to the poor, such as adapted service standards, use of low-cost products, affordability-enhancing measures, and employment and income generation opportunities. The process of selecting target areas (rural or urban) must occur in the framework of an overall network approach, using harmonised methods for prioritising areas, conducting household surveys and assessing impacts.[2]

Strengthen decentralised planning with beneficiaries. Beneficiary participation in planning is needed not only to ensure that infrastructure facilities and services respond to the needs and priorities of the poor, but also to build local ownership and capacity to sustain them. Local planning should be connected to district planning structures and systems to further promote interest in maintaining assets once plans have been implemented.

Establish cross-sector synergies. Co-ordinated interventions involving more than one infrastructure sector do more for pro-poor growth than do single-sector interventions.

Benefits for the poor can also be increased by co-ordinating infrastructure interventions with activities in other sectors, particularly priority economic sectors and those that build human capital (education, health, food security). A major challenge for infrastructure policy makers and planners is to think well beyond their sectors and engage in dialogue and planning with other sectors and a broad range of stakeholders. For example, investments in electricity generation, transmission or distribution can be combined with financing schemes for the purchase of electrically powered machines and programmes to upgrade processing and production skills – enabling the poor to participate in local markets – while road rehabilitation projects can be combined with facilities and services to improve marketing of local goods.[3] Priority should be given to strengthening the contribution of infrastructure to the MDGs to exploit opportunities for joint initiatives and synergistic impacts (Annex IV.2).

Ensuring affordability for the poor

Take a demand-led approach. Infrastructure affordability can be significantly improved by taking a demand-led approach, defining appropriate service levels to raise low living standards. Sector planning must start with a clear understanding of the type, extent and quality of services involved – transport, energy, communications, water and sanitation – and needed by the poor, obtained through sound analyses of needs and capacities and systematic use of *ex ante* impact assessments.

Define appropriate levels of service. An appropriate service level is one that is low enough to make access as universal as possible but high enough to be efficient and protect health and the environment. Low service levels that appear cheaper in the short term may not be efficient or equitable. At the same time, infrastructure that relies on high-tech engineering standards may be too costly for the poor. Usually a middle ground of service provision – taking into account local conditions (urban/rural, geography, population density, average income) and infrastructure types – is most appropriate.

Make payment structures affordable to the poor. Many poor households pay large portions of their income for essential infrastructure services – often of low quality – provided by private vendors working in the informal sector, while government-subsidised services (particularly in water and irrigation, but also urban energy) are often captured by the rich. Appropriate tariff structures are an important tool for increasing poor people's access. More appropriate tariff collection systems and more flexible service provision (for example, in small amounts) helps the poor reduce their spending on such services. But such payment structures, together with the tariff and subsidy policies described below, are only possible when infrastructure spending is allocated appropriately.

Use smart and cross-subsidies to ensure affordability. Subsidies may be needed to ensure that services are accessible and affordable to the poor. Such subsidies must be "smart" – that is, targeted to increase access and affordability (not consumption), technically feasible and appropriate, and time-bound, with an exit strategy. Moreover, any tariff increase must be accompanied by visible improvements in service quality, quantity, or both, to increase users' ability and willingness to pay. In addition, concessional tariffs to households must not be at the expense of industrial and agricultural users. As part of smart subsidies, cross-subsidies through block tariffs – with tariffs rising in line with use, reflecting ability to pay – have proven particularly useful in extending access to energy and water services.[4] Application of smart and cross-subsidies is, of course, limited to those with access to infrastructure services. Thus other options are needed to increase access,

such as universal service funds, auctions for minimum subsidy concessions, output-based aid and community grants to develop infrastructure and connections.

Increase in-kind contributions by users and beneficiaries. In-kind contributions of labour and materials are invaluable for making infrastructure more affordable in cash-poor communities. Such contributions must be commensurate with benefits. Elite capture and reinforcement of inequalities must be avoided by pricing in-kind contributions according to local market rates or by using broad, non-discriminatory targeting methods, based on factors such as gender equity and geography for example.

Generating employment

Promote local enterprise development. Although infrastructure facilities are generally built by large domestic and international firms as well as governments, infrastructure services can be the domain of local private actors. To support poverty reduction, local contractors and service providers (including small and micro-businesses, community co-operatives and the like) should be encouraged to extend their services to remote rural areas and poor communities, where profit margins are lower and provision is more difficult. Partner countries and donors have not focused enough on such providers. Room exists to involve the local private sector in public-private partnerships, and measures to increase its access to service markets – such as promoting and regulating standards, providing certification and lowering contract amounts – should be promoted. Improving access to credit and risk insurance is an important complementary measure.

Create employment opportunities for the poor. Jobs created in the construction, operation and maintenance of infrastructure facilities, while often limited in scale and sustainability, can make a significant contribution to poor people's income. Thus labour-based methods for community works and maintenance activities should be used as much as possible. Governments should avoid using force account labour due to its often low standards and effectiveness, as well as the market distortions it creates. But this must not be work at any cost. Partner governments need to enforce basic labour, health and safety standards to reduce accidents, prevent exploitation and ensure fair payment for workers in infrastructure operations.

Improving gender equity, inclusion of the disabled and social safeguards

Plan infrastructure to reduce gender inequalities.[5] Gender equity and reduced inequality are crucial for poverty reduction. Pro-poor policies promote women and men's participation in infrastructure construction, operation and maintenance on fair terms, and ensure that both sexes can exploit infrastructure facilities and services to facilitate market access and income generation. Women may be more willing than men to pay for household services, but their ability to do so is often lower. Water fees, for example, are often based on a household's ability to pay – but it is often women who pay, resulting in gender inequities within the household. Infrastructure interventions should aim to significantly reduce the time that women spend on household tasks, particularly by improving access to water and sustainable energy sources. Well-designed infrastructure projects can bring significant positive benefits for women and girls by improving access to markets, schools, and health services or improving women's safety (OECD, 2005a). In addition, systematic analysis must be conducted on the needs and interests of both women and men when planning infrastructure, including who pays and who benefits. Because there are often practical and cultural obstacles to women's equal participation in

management and decision making, efforts are required to support women's involvement and to convince both women and men of the benefits. However, a recent study of the OECD's Creditor Reporting System concluded that while aid for transport, communications and energy infrastructure accounted for a third of bilateral aid, little was reported as focussed on gender equality (OECD, 2005a).

Include the vulnerable by planning social safeguards.[6] The disabled and their families account for a quarter of poor people in some partner countries – perhaps even more in countries suffering or emerging from conflicts or disasters (whether natural, such as *tsunamis*, or man-made). Infrastructure availability and design can have a major effect on the risk of disability and the participation of disabled and other vulnerable groups in economic activities. Without social safeguards, infrastructure investments can harm such groups by displacing or excluding them, reducing their access to resources and exploiting their labour. The risks and negative impacts of infrastructure interventions can be avoided through better, more accessible planning and design. Government policies on vulnerable groups and the views of representative organisations should be considered when designing infrastructure strategies and programmes. The needs and views of vulnerable groups should also be taken into account in reconstruction and development efforts following conflicts and disasters.

Defining the role of donors: Focus on the poor's involvement in growth

To better reach the poor women and men and promote pro-poor growth, donors should:

i) Target infrastructure interventions to areas that enable the largest possible number of poor people to engage in productive activities and access social services, using a cross-sector approach linked to MDG outcomes.

ii) Encourage the involvement of poor communities through, for example, decentralised planning systems that incorporate explicit poverty reduction goals (such as universal coverage for basic services).

iii) Propose technological and commercial options tailored to investment areas' long-term service needs.

iv) Support tariff policies that poor users can afford – including smart subsidies and flexible payment structures – and ensure that users are consulted on needed tariff increases.

v) Provide technical and financial incentives (certification, risk insurance) for local private sector involvement.

vi) Promote employment creation in infrastructure construction, operation and maintenance.

vii) Systematically address gender-specific needs when designing infrastructure projects.

viii) Prevent or mitigate negative impacts on vulnerable groups and promote inclusion of the disabled, the elderly and minority groups.

Principle 3: Improve management of infrastructure investment, to achieve sustainable outcomes[7]

Sustainability is a primary concern for infrastructure development. Well-maintained infrastructure has strong positive effects on growth and poverty reduction, and provides clear long-term fiscal and economic benefits. Thus emphasis must be placed on planning and budgeting for operation and maintenance. Maximising cost recovery and tariff

collection is also essential. In addition, infrastructure sustainability needs to be given greater attention in the context of natural and local resource management as well as effects on climate change.

Increasing maintenance to sustain impacts and benefits

Budget for operation and maintenance. The backlog of infrastructure investment in partner countries is particularly severe when it comes to maintenance. Many countries – and donors – prioritise rehabilitation and new construction over maintenance. But shifting funding from new infrastructure towards operation and maintenance can contribute to economic growth. Thus partner governments and donors must make decisive changes in maintenance practices and investment priorities, with a significant reallocation of resources. Operation and maintenance must be given greater priority in budgets as well as to be made more affordable through appropriate technical standards and optimal use of local resources.

Use appropriate standards and local resources. Costs of construction and of operation and maintenance can be cut by setting appropriate design and technical standards for infrastructure facilities, matched to locally available skills, technologies and supplies. Such standards can also enhance operation and maintenance. In the roads sector, for example, this might mean relying more on single-carriageway gravel roads and spot improvements rather than full rehabilitation. Low-cost operation and maintenance also implies making the greatest possible use of local expertise and resources, including locally manufactured equipment and materials and local contractors, consultants and experts. A local approach also strengthens sustainability.

Emphasising cost recovery to increase viability

Pursue cost recovery – essential for sustainability – but also take a more strategic approach. Long-term subsidies decrease resources for other uses and so may be anti-poor. At the same time, failure to recover operation and maintenance costs leads to a vicious circle of insufficient financial resources, service degradation, falling revenue, further deterioration of services and persistent donor dependence. Cost recovery is therefore essential both to enhance sustainability and promote a pro-poor approach to infrastructure. But cost recovery efforts must balance efficiency and sustainability with affordability and equity. Ideally, average tariffs should cover both recurrent and capital expenditures, but this is likely to be impossible in many sectors and countries. Still, operation and maintenance costs must be recovered – through tariffs and other sources – to ensure the financial viability of infrastructure operators and the sustainability of facilities and services.

Improve tariff collection. Cost recovery can be improved through appropriate methods of tariff collection, involving all users (including governments) based on their consumption and ability to pay. Because poor households often pay informal service providers a lot for water and energy, affordability may also be a function of how charges are paid. Community-based tariff collection systems can be effective for local infrastructure facilities and services, but they place considerable demands on social and human capital and require genuinely equitable community management and ownership. And because tariff levels for basic services, especially water and energy, are socially and politically sensitive – and increases are often strongly opposed – attention must be paid to educating users about the benefits of such services.

Provide subsidies if necessary for sustainability. Despite being pro-poor over the long run, cost recovery may imply prohibitive tariffs for some poor customers. In such cases smart subsidies (see above) can be used to promote access, affordability and sustainability.

Strengthening capacity and private sector management

Increase capacity to manage and maintain infrastructure facilities and services. Limited capacity for infrastructure management and maintenance is a major problem in partner countries, especially at local levels. Legal and regulatory frameworks should match local implementation capacity and local governance systems. But to improve outcomes for the poor and enhance efficiency, the best approach may be to establish strong service providers (public, private or public-private partnerships) that can meet agreed performance criteria, manage services following commercial principles and operate independently, transparently and accountably. Thus, over the long term, efforts should be made to strengthen the capacity of central and local agencies to manage procurement needs and operation and maintenance contracts.

Develop public-private partnerships. In the lack of reliable public services, the local private sector is the main provider of infrastructure services in remote rural areas (as with decentralised hydropower plants and telephone services based on the model used by Bangladesh's Grameen Bank), cities (urban and peri-urban transportation) and slums (water vendors). Although most private providers are efficient and effective in providing services to the poor, affordability and social equity are often compromised. Public-private partnerships can balance the need to increase access and affordability with the need to improve cost recovery and provide more appropriate payment procedures for poor customers. To date, however, there has been little experience with public-private partnerships for informal provision of infrastructure services. Pilot projects could be used to investigate this possibility.

Enhancing transparency and addressing corruption

Improve procurement and contract management. Well-designed infrastructure procurement can have significant direct effects on poverty reduction – for example, by creating employment through labour-based construction. Transparency is especially important in procurement. Good procurement practices include promoting open competition, setting and disclosing specific bid criteria, defining clear lines of authority, assigning specific responsibilities to individuals at each level, disseminating information on procurement performance, requiring regular reports and independent audits, and imposing sanctions for misconduct and malpractice. In addition, corruption can be addressed in contract implementation, monitoring and enforcement. Preventing petty corruption at lower administrative levels is also crucial in this context.

Promoting environmental sustainability

Environmental protection is key to fostering sustained growth and addressing climate change. Water contamination, air pollution and uncontrolled natural resource extraction harm the poor disproportionately and increase poverty. To improve environmental sustainability and address climate change, there is an urgent need to address the links between infrastructure and the environment. Of particular importance is enhancing the capacity of infrastructure bodies to integrate environmental (and social) concerns in their planning and better link this to pro-poor growth efforts. In addition, environmental impact assessments for small infrastructure projects have received less attention and should be required.

Encourage sustainable management of resources through price accounting for environmental externalities. Sustained growth requires sustainable resource management. Various steps can be taken to contribute to pro-poor growth and environmental sustainability, including measures that discourage waste and misuse, improve collection of taxes and tariffs, introduce use of the "polluter pays" principle, provide incentives for companies to adopt environmentally sound production mechanisms and include environmental safeguards in contracts. Partner governments often do not fully pursue these measures. Such measures can be implemented by adopting pricing strategies that take into account positive payoffs, such as improved health resulting from clean water or reduced accidents through safer public transport. Decentralisation, user participation and demand management are key elements of sustainable resource management. Integrated water resource management and integrated land use planning are examples of this approach.

Defining the role of donors: Enhance sustainability

To enhance the sustainability of infrastructure investments, donors should:

i) Emphasise the crucial role of maintenance and sustainability in preserving the value of infrastructure assets. Strengthening such efforts in partner countries requires funding, technical assistance and capacity building.

ii) Help partner countries establish systems that recover costs and collect tariffs, while taking into account poor people's ability to pay.

iii) Support – before services are extended – improvements in the management of public service providers, to reduce commercial and technical losses and thus lower costs and make services more affordable.

iv) Foster public-private partnerships to enhance project efficiency and improve sector governance.

v) Strongly support initiatives that promote transparency and reduce corruption.

vi) Promote environmental impact assessments and parallel measures linked to social concerns, and encourage sustainable resource management through price incentives.

Principle 4: Increase infrastructure financing and use all financial resources efficiently[8]

Increased infrastructure investment – particularly in maintaining and expanding services – is an essential element of a comprehensive PRS-based public expenditure programme and critical for achieving sustainable, pro-poor growth. Given the huge infrastructure backlog in partner countries and the limits of public finance, more innovative approaches are needed to tap possible resources. This includes improving public resource management at all levels, increasing private participation and strengthening local financial systems. The challenge for donors is to make infrastructure investment easier for governments and private actors.

Raising public investment and enhancing the effectiveness of sector investment

Reduce risks for infrastructure investments and minimise transaction costs. Improved macroeconomic and fiscal balance provides more fiscal space for publicly financed infrastructure. Two issues are especially important: the solvency of public infrastructure bodies and financial sustainability at subsovereign levels. First, payment

arrears and unpaid or uncontrolled consumption of infrastructure services (notably in water and electricity) strongly undermine economic and social development in many partner countries. Effects include poor service quality, insufficient maintenance and delays in extending needed investments – making them more expensive. Second, incomplete decentralisation leaves local governments with responsibilities but no funding and limited capacity to manage and maintain infrastructure facilities and services. For community-based and district infrastructure services, insufficient resources prevent user participation and in kind contributions of labour for construction and maintenance. To facilitate infrastructure investment, these constraints must be eased – with the help of donors.

Prioritise public spending. Partner governments must prioritise their spending on infrastructure (including for maintenance) to ensure the greatest impact on increased access by the poor and on pro-poor growth. A two-pronged approach is required. First, public resources should be used for investments (including maintenance) that may have inadequate financial rates of return but that have high social impacts, promote long-term sustainability and cannot be financed by private resources. Second, private resources should be mobilised for needed investments with higher rates of return. This approach requires partner country governments to conduct good economic and social assessments and to have the technical capacity to prioritise investments. In addition, innovative financing instruments can be used to facilitate increased public spending on infrastructure and better match sector needs.

Make financing predictable. Because infrastructure requires huge investments and careful planning – both at the outset and to ensure sustainable operation and maintenance – long-term predictability of public investment (including aid) in the sector is required. Increased clarity is also needed on private investments and credit enhancements to secure additional funding.

Leveraging private investment

Address constraints to private participation – domestic and international. Private investment in infrastructure is mainly long term and carries risks that must be adequately rewarded. It requires that investors have the ability to identify obstacles to market development, strong bargaining and management abilities to overcome them and solid financial capacities. It also requires a sound local financial system able to meet the long-term needs of investors and a strong and transparent regulatory environment. Finally, it requires that governments share the risks. Most partner countries fail to meet these requirements. To overcome these constraints, five issues must be addressed:

i) *Development of a sound institutional and financial environment.* Many countries require judicial reform to enforce laws and reduce corruption. Better legal and regulatory frameworks and transparent, accountable regulation and management are also needed at various levels, with significantly increased capacity and resources. Land market reforms – including modernisation of land registries and legalisation programmes – would significantly aid in the creation of domestic collateral and bankable credit. Such reforms should take into account the transaction costs involved, which must be affordable for the poor.

ii) *Promotion of private initiative through reinforcement of financial sector intermediaries.* Training and other technical assistance – for example, to improve credit analysis and monitoring – are needed to increase the capacity of domestic banks to provide loans for

private investments, including to small industries, and for municipalities and decentralised units. Assistance is also needed to develop domestic capital markets. In addition, more attention needs to be paid to neglected infrastructure service providers, because financing programmes and private sector promotion activities often do not reach this group.

iii) *Better management of public infrastructure bodies*. Four aspects are important: adopting management rules inspired by private sector practices, to be free from political influences; developing subcontracting to promote domestic private sector development; unbundling these public bodies to involve the private sector (domestic or foreign) in less risky activities; and supporting country units for public-private partnerships. A range of options is possible, including management contracts, leases, concessions, and build-lease-transfer (BLT), build-operate-transfer (BOT), and build-own-operate-transfer (BOOT) schemes. Governments may need assistance selecting suitable frameworks for private involvement, particularly to identify and resolve the trade-offs between costs and benefits in the context of poverty reduction.

iv) *Use of guarantee mechanisms to back up long-term contracts,* such as provision of guarantees by export credit agencies, multilateral and bilateral agencies or other official players, political risk insurance, co-financing and on-lending, equity or equity insurance, swaps from local to hard currency and advisory services. Such mechanisms have already been applied to private investment by multinational private companies.

v) *Regulation inspired by private sector practices.* Although involving the private sector can increase efficiency, it also imposes costs. Writing contracts, conducting international bidding, monitoring compliance and writing regulation are expensive because they usually involve hiring foreign advisers, investment banks and so on. Thus there is a minimum efficient scale under which some private approaches are impractical and other, cheaper ways of involving the private sector should be considered (for example, management contracts might be cheaper than BOT bids).

Defining the role of donors: Increase resources and improve their use

To encourage broader and better involvement by the foreign and domestic private sector – as well as central and local governments – in infrastructure financing, donors should:

i) Provide predictable, long-term official development assistance.

ii) Support a diverse mix of financial instruments, including credit enhancements (guarantees, co-financing, swaps from local to hard currencies) and investments in public-private partnerships.

iii) Provide technical assistance to build capacity in capital and financial markets and develop regional, national and subsovereign financing mechanisms for infrastructure.

Notes

1. DAC's POVNET is developing a methodology to harmonise poverty impact assessments for all donors.
2. Klump and Bonschab (2004) provide an interesting example in a study of Viet Nam, which took a determined approach to infrastructure planning – targeting a densely populated area (with a large majority of poor households) to maximise pro-poor growth and ensure redistribution to the poor through fiscal and other (non-infrastructure) measures. China's poverty reduction approach under its Go West strategy is another example.

3. The POVNET Task Team on Private Sector Development has produced related guidance on financial services and assistance as well as on business development services (2005a and 2005b). Refer also to the guidance by the Committee of Donor Agencies on business development services (2001), often referred to as the "Blue Book".
4. There is some empirical evidence challenging this assumption; a flat tariff combined with a lifeline tariff may be more beneficial for the poor.
5. This paragraph draws on, among other sources, GENDERNET (2004).
6. This paragraph draws on, among other sources, Wiman and Sandhu (2004) and the findings of the DAC POVNET working group on risks and vulnerability.
7. This section draws on, among other sources, Estache (2004a).
8. This section draws on, among other sources, Osius and Carlson (2004a; b) and Curtis (2004).

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PART IV

Chapter 19

Implementing the Guiding Principles in Sector Support

This chapter deals with the implications of the four guiding principles (Chapter 18) for the four infrastructure sectors that are the focus of this study: transport, energy, information and communication technology, and integrated water resource management, including irrigation, water and sanitation. It describes each sector's role in poverty reduction, then elaborates each principle's application to the sector.

Transport[1]

Transport infrastructure (roads, railways, sea, river and airports) enhances the production and trade potential of local, national and regional economies. It also facilitates access to economic and social services essential for reaching the MDGs. But transport costs are high – due to inadequate facilities and the weak services that result – in many regions, especially sub-Saharan Africa, posing a major obstacle to growth and poverty reduction. Urban areas in particular may suffer if their rapidly growing demand for transport is not met. Yet far too often, partner countries fail to address transport-related challenges:

i) Vast areas of rural hinterlands and urban slums are not served by adequate transport infrastructure.

ii) Maintenance, which involves high recurrent costs, is rarely performed due to weak sector management, irregular funding and the difficulty of recovering such costs from private users.

iii) Badly maintained transport networks exacerbate environmental and health problems such as pollution (including more greenhouse gas emissions), wasted energy resources and the spread of HIV/AIDS – all of which take a disproportionate toll on the poor.

iv) Responsibilities are often splintered among several ministries, impeding effective co-ordination and sector governance.

Principle 1: Use partner country-led frameworks as the basis for co-ordinated donor support

Strengthen transport planning and management. Because transport requires huge, long-term investments, effective planning is crucial. But in many partner countries sector responsibilities are spread among ministries (transport, public works, agriculture) and levels of governments, making co-ordination difficult. Thus an essential first task is to reorganise and co-ordinate the various public bodies involved in transport. Otherwise it will be extremely difficult to optimise investments, ensure that transport assets are maintained, fight corruption, collect regular and reliable data, and monitor and evaluate programmes. One important step, already taken by many partner countries, involves separating the policy functions of government from the planning functions of road management by creating road funds and autonomous, commercially oriented management agencies.

Establish coherent, economically viable core transport networks. A comprehensive network approach should be used to face the challenges of the transport sector – to open up the entire country, rural and urban, and facilitate its economic integration with the surrounding region. Accordingly, this approach should be tied to the country's poverty reduction strategy and overall infrastructure plan. A coherent, economically viable core transport network includes regional corridors, national trunk roads, feeder roads, and links between roads, railways, and sea, river and airports. Regional bodies and their member countries need to pay particular attention to enhancing international and regional trade through ports, railways and bridges – including by removing non-physical barriers such as

cargo handling delays at ports and informal user charges by local governments. The transport needs of landlocked countries also require extra attention, especially road corridors and transit arrangements.

Improve urban mobility to foster sustainable growth. In 2020 more than half of the world's population will live in urban areas, and most of the fastest-growing cities are in partner countries. Urban demand for transport is growing rapidly, spurred by population and economic growth. If this demand is not met, urban prosperity will be hindered. Integrated responses include promoting non-motorised transport, providing public transport (in line with considerations of affordability for the poor), and integrating spatial and transport planning. In addition, transport demand management based on economic instruments (such as tolls) and other measures can be used to relieve congestion.

Rationalise transport charges through regulation and private sector mobilisation. Getting service charges right is a key challenge. In many (mostly Asian) countries transport charges do not reflect internal costs of service provision, let alone external ones. Yet in other cases, charges are too high. Increased competition through service privatisation can lower transport charges, particularly in modes (such as railways) that have tended to be regulated by governments. Fair competition requires that independent regulators supervise all modes and handle cross-cutting issues. Because sector reforms are politically sensitive, interventions should focus on their smooth adoption and promote well-targeted interventions that benefit disadvantaged groups.

Principle 2: Enhance infrastructure's impact on poor people

Transport – essential for growth. Numerous studies have highlighted the importance of transport for growth (Willoughby, 2004a; works by the European Commission and others on the Sub-Saharan Africa Transport Program;[2] ADB, JBIC and World Bank, 2005). Many countries with access to sea ports have used their comparative advantages to become major exporters. (Countries have also increased trade by establishing appropriate regulations for its liberalisation.) Similarly, long-distance railway systems help deliver bulk goods to foreign markets. The elasticity of partner countries' international trade, relative to transport costs, is high. The median landlocked country faces transport costs about 50% higher than the median coastal country; as a result its trade volume is 60% smaller.

Link transport to social services. Transport difficulties inhibit poor people's access to health and education facilities. Accordingly, the social MDGs (2-6) indicate the need to improve transport services and facilities, and to link investments in transport with those in health and education. For example, reliable transport and communication services are a key reason maternal mortality rates have fallen in many countries, and health investments provide only additional benefits. Similarly, poor children's (mainly girls) school attendance – particularly in secondary education – is highly dependent on affordable transport services, with manageable distances and times from their homes. To strengthen the links between transport and poverty reduction, increasing use is being made of cross-sector accessibility planning at the district and community levels. Such planning takes into account all modes of passenger and freight transport, motorised and non-motorised. Community-driven development activities can help identify and ease bottlenecks.

Promote affordable, inclusive transport services. The issue of affordability has to be examined relative to poor people's income levels, existing infrastructure capacity and access, and supply and maintenance costs. Smart subsidies, such as cheap school

transport, allow services to be extended to poor users. In urban areas more comprehensive efforts to make transport accessible to all population groups involve promoting extensive and affordable rail- and road-based mass transit, and easier and safer non-motorised and informal transport services, particularly in slums. This approach implies taking into account the specific needs of poor women and men, children, the elderly and the disabled – that is, the needs of pedestrians and non-motorised transport – by installing basic accessibility mechanisms (such as ramps, rails, easily understood signs, pedestrian roads and accessible information). In rural areas intermediate modes of transport are more important, both motorised (such as small pick-ups) and non-motorised (such as bicycles, ox carts and wheelbarrows for fetching water). Thus making transport widely available in rural areas requires complementary measures such as providing financial assistance to acquire non-motorised vehicles and co-operating with private and farmer associations.[3]

Create employment and income opportunities. Transport can expand employment and income opportunities, up to a certain point, by involving poor women and men in the rehabilitation and maintenance of transport infrastructure and by promoting women's equal access to transport jobs (as engineers, planners, drivers and shopkeepers, for example). This approach requires choosing appropriate standards and designs, making optimal use of local resources (labour, equipment, materials), using local contractors and consultants, and supporting local construction industries.

Facilitate cross-border transport and regional trade. In many countries the core poor – often indigenous groups – live in remote areas, often bordering other countries. Such villages are not always accessible year round and are isolated from economic activities and social services. Improving transport facilities, such as community access roads and their connections to the main network, raises these people's productivity by providing access to markets and income opportunities and by stimulating economic activities. Indeed, in the poorest villages the presence of a road substantially increases a resident's chances of escaping poverty. Similarly, cross-border transport infrastructure – particularly roads, bridges and ferries – facilitates trade and social exchange among groups separated by borders. Geographic targeting of transport infrastructure is thus essential to making investments pro-poor.

Protect health and improve road safety. Protecting health in the transport sector has three dimensions: improving road safety, reducing local air pollution and containing the spread of HIV/AIDS. Poor people suffer more from such problems:

i) Traffic accidents injure 12-34 million people a year in less-motorised countries – an exceptionally high number given that the global total is 23-50 million – and sharply increase household poverty, particularly in urban areas. Globally such accidents kill 1.2 million people a year (often children and the poor), more than die from many communicable diseases. In addition, efforts are needed to improve the safety and security of transport users and pedestrians (Wiman and Sandhu, 2004). A priority is to strengthen institutions responsible for transport safety.[4]

ii) World-wide, local air pollution kills up to 3 million people a year. The transport sector generates a lot of this pollution. Comprehensive approaches for reducing pollution include promoting public and non-motorised transport, upgrading technical requirements (such as requiring the use of unleaded fuel) and implementing demand management measures such as local pricing schemes.

iii) Because transport is a major vector for the spread of HIV/AIDS – and high-risk groups include construction and transport workers and people living along roads and highways – transport interventions should include support for HIV/AIDS prevention. Examples include awareness campaigns for traders and the construction industry.

Principle 3: Improve management of infrastructure investment, to achieve sustainable outcomes

Enhance management arrangements for maintenance. Specialised central road agencies, supported by provincial and local agencies, have proven efficient for road management. These institutions often outsource tasks to independent performance-based road agencies, contract management agencies, private actors or communities. In addition, decentralised and privatised road management agencies have been created, and have been more effective at conducting road maintenance than public bodies. Financing of maintenance (usually in the form of road funds; see below) is based on the "user pays" principle. If central financial and technical support is required, decentralisation of maintenance supervision appears to be an appropriate solution to lower costs, fight corruption and promote the local private sector, by involving local stakeholders such as farmer and community associations and traditional local rulers. Provisions for the administration and financing of network maintenance are a core element.

Protect the global climate. The transport sector generates negative effects on health and the environment that harm the poor first. Major concerns include the sector's contributions to climate change, greenhouse gas emissions and rising energy consumption. Reducing these effects requires comprehensive approaches. Incentives for energy-efficient vehicles can help. In addition, environmental damage caused by road construction, such as soil degradation and forest destruction, can be mitigated when planning road network expansion. Prioritisation of transport modes should be based more on environmental criteria (for example, pursuing investments in "clean" rail before roads).

Build capacity to improve transport performance. Capacity building is a highly effective way of improving transport performance. At the individual level, it transfers knowledge and best practices to decision makers and professionals in partner countries. Capacity building that involves collaboration with private sector initiatives (such as vocational training) is also extremely effective. At the institutional level, capacity building helps partner countries analyse shortfalls in decentralisation of service provision and promotes regional co-operation among agencies. Examples include schemes related to inspections of axle loads, common road safety standards, creation of independent road authorities, and development of local construction industries.

Principle 4: Increase infrastructure financing and use all financial resources efficiently

Use careful planning to augment public financing with increased donor support. Between 2005 and 2010 annual investment needs in the roads sector alone total USD 90 billion, of which more than half is for maintenance (Fay and Yepes, 2003). More programme-based financing and sector-wide approaches are needed to fill this backlog. Although increased private and government investments are needed for transport infrastructure, particularly for roads in Africa, donors have a key role in scaling up financing over the next 10 years. Governments can attract increased donor funding by demonstrating commitment to regular sector dialogues and by adopting balanced and coherent sector strategies, carefully prioritised programmes and good sector governance.

Pursue private investment. Private involvement in the transport sector can scale up investments, free public funds for other sectors and increase efficiency. Although private provision of transport services and execution of infrastructure projects are common, private funding of infrastructure facilities is often limited by the size of such investments. However, public-private partnerships such as build-operate-transfer (BOT) schemes are being used for investments such as channel dredging, rail track construction and air navigation facilities. Public-private partnerships offer further possibilities (such as concessions, BOT and other modalities) for toll roads, container terminals and railways. And while in many cases it may not be possible to attract private investment in new infrastructure facilities, there are several examples of private investment in upgrading transport systems under long-term management and maintenance contracts.

Support road funds to improve maintenance funding and execution. Although nearly all partner countries have some sort of budgeting system for road maintenance, these budgets are often under-funded, vulnerable to interference or not respected. To address these shortcomings, since the late 1990s many partner countries have established road funds. Resources can be raised from users through improved tax collections and through charges such as licence fees, registration taxes, fuel taxes, axle overload fines and road tolls. If efficiently controlled (with monitoring and auditing of expenditures), these resources can cover the costs of maintenance needs. In addition, contracting of maintenance works to private enterprises (preferably local) has produced positive outcomes, especially where support has been provided to strengthen such enterprises. Performance-based maintenance contracting – where contractors are expected to maintain certain road conditions under periodic contract – has also been used with good results, and can be applied to all transport modes.

Strengthen financing of local roads. The transport sector must balance investments among the priority network of inter-state and inter-urban roads, the longer but less used secondary and unclassified networks, and urban networks. Local governments must receive regular funding to ensure maintenance of local roads. These funds can be provided by allocating road fund revenues to local authorities and by mobilising community resources, including municipal bonds and in-kind contributions. The share of road fund revenues (and other budgets) should be based on inventory and condition surveys, and tailored to local capacity to spend resources.

Defining the role of donors: Support public financing, including maintenance

In the transport sector, donors should:

i) Strengthen co-ordination among administrative bodies and their public investment programmes to comprehensively and equitably address new investment, maintenance, services and urban mobility as well as increase public and private investment.

ii) Promote comprehensive, economically, socially and environmentally justified networks, including cross-border networks.

iii) Encourage a service-oriented approach to optimise use of available resources, public and private.

iv) Strengthen institutional arrangements and capacity for maintenance by promoting the "user pays" principle.

v) Encourage local private provision of services and development of local industries for construction and maintenance of facilities.

vi) Address health, safety, environmental and social concerns, including impacts on and needs of vulnerable groups.

Energy[5]

Reliable, modern energy services are essential for inducing economic growth and improving the living conditions of the poor. Yet most poverty reduction strategies have paid little attention to energy. Large electricity generation, transmission and distribution projects primarily benefit industry, urban populations and agricultural users, while most rural and poor people depend on biomass for cooking and, in some countries, for heating. As a result the poor usually spend more time and money on energy services, and such services tend to be of low quality. In addition to its security and safety dimensions, energy has local and global environment dimensions, and can negatively affect human health – particularly through indoor pollution. Modern energy supplies strengthen poor people's productive prospects and social infrastructure such as health and education services, and are relevant to increasing gender equality and achieving the MDGs. Renewable sources can offer cost-effective ways to increase access to energy in remote areas, mitigate climate change and contribute to economic development. They also diversify energy supplies and hedge against spikes in fuel prices.

Principle 1: Use partner country-led frameworks as the basis for co-ordinated donor support

Recognise the essential role of government. During the past decade many partner countries introduced energy policies intended to shift financing and operational issues to the private sector. But private participation did not develop as expected. Thus governments continue to have an essential role where energy markets are weak and investments in medium- and long-term energy development are needed. Such governments should focus on the linkages between energy and social and economic priorities, the development of long-term energy security plans and the contribution of energy to job creation and income generation. Regulatory frameworks should be transparent, promote sustainable energy services and balance the interests of producers and users, including the poor. In addition, to provide a basis for donor involvement and co-ordination, national poverty reduction strategies (PRSs) and budgets – including MTEFs – should pay more attention to energy and related issues.

Use different approaches in different environments. In urban and industrial areas of many partner countries, well-managed electricity utilities and fuel distributors are able to deliver services on a commercial basis to meet the growing needs of industrial, public and household customers, including those in informal settlements. Where conditions are favourable – with sufficient population density, commercial development and potential electricity load – rural electrification programmes, developed in conjunction with other local development measures, are a viable option. In remote and poor rural areas where grid extension is too expensive, decentralised renewable energy systems (household solar systems, wind chargers, biogas digesters) can be deployed for basic electrification. Biomass (and its efficient use) and forestry management should be an integral part of energy supply strategies.

Promote pro-poor regulatory reform. Strong government commitment and a focus on protecting the interests of the poor through transparent policies are common features of reforms that have produced positive results for electrification of the poor. Pro-poor energy

reforms must enhance involvement by the private sector and by representatives of the poor. Reforms should be sequenced to ensure that structures and rules are in place before, or at least at the same time as, large-scale market-oriented reforms (such as privatisation) are initiated. Pro-poor impact and long-term sustainability must be taken into account when costing energy investments and services, while also ensuring that power providers are financially sustainable. Finally, government contracts with private operators should include incentives to provide sustainable, affordable services for the poor – for example, by awarding bonuses for connecting poor areas, leaving collection to the private operator and so on.

Support regional and cross-border initiatives. Energy resource reservoirs are location specific, and their capacity and viability vary based on their proximity to major consumption areas – which sometimes cross borders. Achieving economies of scale in energy supply and distribution requires regional and cross-border approaches, particularly for electricity and natural gas. This can be the case for large hydropower and geothermal sources as well as for interconnected national and regional distribution grids. Small cross-border hydropower schemes also have good potential, especially for remote and poor areas. To develop such potential, energy market mechanisms must be encouraged, based on strong political commitments to regional co-operation and to regulatory reforms in the countries concerned.

Principle 2: Enhance infrastructure's impact on poor people

Focus on productive energy uses and better services for social infrastructure. To establish cost-effective energy supply policies that foster pro-poor growth, better understanding is needed of the structure of demand for energy services. Energy development policies should take into account energy sources that meet the final forms of energy used by the poor – for example, for productive appliances, lighting, cooking and transport – rather than merely focus on provision of electricity supplies. Increasing productive uses of energy must be an integral part of development plans. To boost local income generation, energy services should be accompanied by business development services (such as financial services and access to markets).[6] Energy services for social sector activities, including power for health facilities, schools, water supplies and street lighting, should be considered public investments in human capacity development and well-being.

Increase poor households' access to safe, reliable energy by lowering the costs of cleaner, more sustainable energy sources. To facilitate such access, subsidies and other financing schemes can be used to reduce the upfront costs of connecting to local power grids (such as costs of electricity meters and other connection instruments) and of financing decentralised renewable energy systems. But for many poor women and men, especially in rural areas, biomass may continue to be the primary source of energy. Thus steps should be taken to help mitigate the significant safety and health risks (such as indoor pollution) – for example, by promoting the use of more efficient stoves.

Choose the most appropriate modern technology for the poor. Where grid electrification is not economically viable, decentralised renewable energy systems can offer cost-effective access to modern power for productive uses. Renewable energy options also reduce negative environmental externalities and increase energy security. Investment decisions and technology choices should be based on overall (life-cycle) least cost analyses.

Principle 3: Improve management of infrastructure investment, to achieve sustainable outcomes

Aim for effective cost recovery and tariff collection. Increasing the sustainability of energy services requires a range of efforts, including effective cost recovery and tariff collection, pro-poor regulatory reform, increased institutional capacity, greater energy efficiency and attention to environmental considerations. Where profits are not achieved and costs are not recovered – the implications are inefficient supply systems and eventually failing companies. Cost recovery requires appropriate tariffs and efficient mechanisms for collecting them. For social or development considerations, tariff structures may include cross-subsidies for basic services of poor customers. But financial losses due to non-payment, including by large consumers such as governments, must be addressed. One solution is to introduce meters, to help ensure payments based on consumption. Tariff collection can also be improved by introducing information and communication technology and by fostering the participation of beneficiaries in power distribution co-operatives and tariff collection efforts.

Increase energy efficiency. Inefficient energy generation, transmission, distribution and use result in financial losses, high production costs and environmental burdens. A precondition for increasing energy efficiency is that tariff structures provide incentives for saving energy and using it efficiently. Most energy suppliers fail to provide consumers with sufficient information on how to increase energy efficiency.

Strengthen management autonomy and institutional capacity. Regulators should protect the commercial operations of energy providers (public and private) from political intervention. When providers have weak institutional and technical capacity, it results in unreliable energy supplies and commercial failures – with strong negative impacts that harm the poor first. In such cases regulatory frameworks and incentives should aim to strengthen commercial principles and bolster institutional and technical capacity.

Address environmental concerns. Fossil fuel consumption causes local and global environmental damage that is generally not accounted for. Using more renewable energy sources and enhancing supply- and demand-side energy efficiency are general strategies that address cost-effectiveness as well as environmental concerns. Nevertheless, environmental impact assessments should be required not only for thermal power plants but also for systems using renewable energy sources, including hydro, wind and photo-voltaic.

Principle 4: Increase infrastructure financing and use all financial resources efficiently

Leverage more foreign private investment. The energy industry is highly capital-intensive. Where financial rates of return in the sector are positive, involvement by private actors (domestic and foreign) should be encouraged. To foster such investments, governments should share more risks for both large and small initiatives, using financial instruments such as guarantees. While foreign private investors tend to focus on large generation projects, domestic private actors – including co-operatives created by beneficiaries – are better suited to handling local distribution networks. Over the long term, well-designed public-private partnerships can increase private investments, enhancing efficiency and financial sustainability in the sector.

Improve regulation. The public sector can reduce risks for private investors by improving the regulatory environment and paying more attention to the accountability, transparency and monitoring of energy service providers. Further development of risk mitigating measures (such as guarantee funds), acceptable to both the public and private sectors, can deepen such efforts.

Defining the role of donors: Support government's role in planning, regulation and investment

To enhance the pro-poor growth and poverty reduction impacts of their support for energy infrastructure, donors should:

i) Support investments in grid extensions and in areas where providing energy services is unattractive to private investors but necessary from a social perspective – as long as operation and maintenance costs are covered whether by tariffs or temporary subsidies.

ii) Support reforms and regulations that encourage efficient power use and result in tariff collection policies that attract private investment.

iii) Promote cross-border energy initiatives.

iv) Adapt energy supply technologies (including biomass) to productive uses, particularly among the poor.

v) Support efforts to improve poor households' access to safe energy, such as biomass, when modern energy cannot be provided cost-effectively.

vi) Provide accompanying measures, such as micro-finance schemes, to increase poor people's access to appropriate energy services.

vii) Strengthen the management capacity, including for transparency and accountability, of all energy sector entities.

viii) Address concerns about environmental sustainability, energy security and access to modern energy in remote areas by promoting renewable energy sources and energy efficiency.

Information and communication technology[7]

Information and communication technology (ICT) is a powerful cross-sector tool for promoting pro-poor growth – by saving time and money through more efficient communication and by supplying strategic information on market prices, risk warnings, job and learning opportunities, service and product availability, and so on – as well as good governance and effective management. ICT also supports better planning and delivery of economic and social services. Although governments and donors have largely withdrawn from the sector, basic ICT network facilities and services remain public goods and require continued public support. And despite increased private involvement, ICT's potential is far from being fully exploited, let alone universally available – especially in rural areas of low-income partner countries, which private service providers avoid because of low profits and high investment risks. Rolling out telecommunications networks and providing affordable services, especially in remote areas, remain major challenges.

Principle 1: Use partner country-led frameworks as the basis for co-ordinated donor support

Emphasise the public sector's role. In many partner countries neither public nor private investment alone is sufficient to establish inclusive, universal communication

networks capable of serving needs for economic growth. Trunk telecommunications networks require huge upfront investments and cannot always be financed privately. In addition, such networks must be established to reduce regional disparities in growth. Similarly, network expansion to low-density areas usually must be financed by the public sector. Thus the public sector should play a major role in planning and investing in trunk and rural communication networks. To reduce initial investment costs, efforts should be made to create synergies between non-ICT infrastructure (rail networks, power transmission networks) and trunk network expansion.

Build links between ICT and other sectors. ICT increases the efficiency and effectiveness of all development interventions. When combined with other policy measures, ICT can provide innovative solutions to the challenges facing some poor households, such as remoteness and isolation. Thus ICT should be integrated with other sector strategies for infrastructure, both economic and social, and used during their planning and implementation.

Strengthen regulation and efforts to expand services. Well-designed regulation is critical to balancing efficiency and increased access to and affordability of ICT services, and to encouraging private investment. The public sector must ensure that regulation is transparent and free from political influence. It must also provide incentives for the private sector to expand services to less profitable areas. Small operators should be allowed to use networks owned by big ones, paying cost-based or, in remote or rural areas, preferential interconnection rates. Lessons in these areas are available from studies being conducted by InfoDev.[8]

Support regional co-operation. ICT development can be promoted using an area-based approach. Particularly with mobile phone interconnections and cross-border connectivity – whether through fibre optic cables or satellites – economies of scale cannot be achieved without regional and international integration and co-operation.

Principle 2: Enhance infrastructure's impact on poor people

Use ICT to support income-generating activities. Partner governments often heavily underestimate ICT's importance for poor people, despite many innovative uses that have contributed to their income potential. Examples include e-commerce activities, electronic cash systems in remote areas, weather forecasting systems for poor fishermen and electronic price systems allowing poor farmers to compare commodity prices in different markets.[9] Such initiatives, including limited financial support for equipment purchases, can be part of rural or commercial development programmes targeted at the poor.

Use ICT to promote gender equality. The Grameen Bank's village mobile phone programme has provided business opportunities for poor rural women in Bangladesh, helping them increase their incomes and enhance their status.

Principle 4: Increase infrastructure financing and use all financial resources efficiently*

Support universal access funds. Universal access funds aim to extend telecommunications services to rural and other poor populations. Such funds are often financed by telecommunications providers (through levies on revenues) and managed by regulators. Minimum subsidy auctions are a good way of awarding contracts for these funds to private operators.

* No comments have been made about Principle 3.

Defining the role of donors: Promote ICT in other sectors and invest in trunk and rural networks

To increase ICT's contribution to pro-poor growth, donors should:

i) Support planning and investment in backbone infrastructure – particularly trunk and rural communication networks – and increased access through innovative financing facilities and network sharing arrangements.

ii) Link ICT programmes with activities in other sectors, particularly those that promote productive activities for poor people.

iii) Support ICT policy making and regulation, including enforcement mechanisms.[10]

Water (integrated water resource management, drinking water, sanitation and irrigation)[11]

Water is a basic necessity, essential for life. Although this makes it highly sensitive politically, it does not confer it the status of a public good because its supply entails costs. It is directly linked to agriculture, food security and health as well as environmental, gender equality, social development and many other issues. In partner countries irrigation accounts for 85% of water consumption and the distribution of water-related services is extremely unequal, with urban consumers often receiving much more reliable drinking water and sanitation than their rural counterparts. Every year major water-related natural disasters – such as the recent floods in Bangladesh and China and the *tsunami* in south Asia – kill millions of poor people. Moreover, water scarcity and poor sector governance are causing severe tensions around the world – especially in the Middle East and Africa, where most water-stressed countries are located. Lack of clean water and adequate sanitation is the primary cause of disease and death in partner countries and severely undermines income generation. Achieving MDG 7 and its amendment calling for increased basic sanitation (adopted in 2002) is crucial. It has been estimated that funding for the water sector needs to double to meet needs (World Water Council, Secretariat of the 3rd World Water Forum and Global Water Partnership, 2003).

Principle 1: Use partner country-led frameworks as the basis for co-ordinated donor support

Link all water uses through integrated water resource management (IWRM). IWRM links all water issues – irrigation, drinking water, sanitation, power generation, water ways, floods and other disasters, industrial pollution – and stakeholders (including different countries, if international basins are involved).[12] IWRM also distinguishes between water values and tariffs: values reflect water uses and needs, while tariffs add an incentive aimed at achieving socially, financially and environmentally sustainable use. IWRM is thus an essential conceptual framework in the quest for the sustainable use of water for all and the control of flooding and pollution. National poverty reduction and other strategies must better recognise the importance of IWRM. There is considerable potential for improving integration of water-related policies and strengthening planning and co-ordination on IWRM.

Improve planning and facilitation of water uses and needs. Water policies and legal frameworks should arbitrate – through pricing and sharing – the social and productive uses of water and ensure adequate attention to water in strategies for other sectors. Responses to various water demands (for example, between urban and rural or household and industrial users) need to be well planned by central as well as local (subsovereign)

governments. In addition, national drinking water policies should follow IWRM agreements on water intake and outlet. Analyses of water supply and demand (such as water sources and means of provision, or users' willingness to pay) and of current and future needs provide a sound basis for evaluating water challenges (including land tenure, water rights and cultural or religious issues) and identifying ways to address them. Integrated initiatives are needed, comprising water supply and waste water collection, treatment and disposal, as well as education on hygiene and water use.

Use IWRM to improve sector co-ordination, management and governance. Few partner countries have a sole public authority in charge of the water sector. Instead responsibilities are split among ministries, agencies and levels of government. Water management is more effective when sector co-ordination occurs under a lead agency. In addition, such co-ordination is essential to arbitrate conflicts arising due to water resources' finite and depletable nature. Co-ordination and arbitration are especially important for cross-boundary resources (basins, rivers), where only supra-national or external bodies can provide a structure for dialogue. Co-ordination also improves water governance by enhancing decision makers' accountability for resource development and management.

Plan new investment, rehabilitation and renovation of irrigation schemes in line with poverty reduction strategies. Irrigation is crucial for increasing agricultural yields and incomes, thereby improving livelihood opportunities for the poor. But irrigation schemes involve high investment and recurrent costs and have serious environmental impacts, making government intervention essential. Yet irrigation rarely features prominently in poverty reduction strategies. Given its role in reducing poverty, irrigation should be part of country strategies and donor agendas, with priority given to rehabilitation and renovation.[13]

Principle 2: Enhance infrastructure's impact on poor people

Co-ordinate irrigation with other rural development initiatives. To raise productivity, irrigation schemes must be accompanied by measures such as provision of access roads, market information and extension services. For a pro-poor approach, partner governments should provide "service packages" – coordinating efforts among planning, agriculture, transport, energy and environment ministries as well as decentralised irrigation agencies.

Use innovative approaches to make irrigation more affordable and sustainable. Small, farmer managed irrigation schemes benefit poor farmers in areas with a tradition of irrigated agriculture and market access. Approaches such as dry-land farming, water harvesting and flood recession farming as well as dissemination of demand management techniques such as irrigation water conservation (drip irrigation, for example) and waste water reuse help them, too.[14]

Encourage decentralised, participatory approaches in irrigation, drinking water and sanitation to strengthen management, sustainability and pro-poor outcomes. Especially in rural areas, drinking water and irrigation are likely to be managed or maintained (or both) by communities. Decentralisation or devolution of service provision enables much greater ownership and accountability. To be effective, decentralisation must be accompanied by appropriate financing provisions (that is, budget decentralisation). In addition, participation by all concerned stakeholders ensures that poor people's interests are voiced.

Promote sanitation for the poor. Water supply and especially sanitation involve strong externalities due to their direct links with health (for example, through pathogens), gender specific needs (for example, through women's and girls' need for latrines) and education (for example, through sanitation deficiencies in schools). These externalities are especially apparent in urban areas, where higher population densities increase health dangers, make sanitation more difficult and pose risks for vulnerable groups. The externalities generate a mismatch between high social (welfare) benefits and low private ability or willingness to pay, and thus call for affordability-enhancing measures such as smart subsidies. It is also important to account for the gender dimensions of consumption and payment – within and across households – when designing facilities and services and setting and collecting tariffs. Finally, externalities call for integrated initiatives, addressing water supply and waste water treatment and disposal as well as education on hygiene and water use.

Use demand management to make piped water and sanitation more affordable. Technical and non-technical deficiencies of piped water and sanitation systems can hinder the application of metering and pricing mechanisms to such services, leading to water overuse, free-riding (for example, with illegal connections) and resource waste. Financially, environmentally and socially unsustainable water and sanitation services hurt poor people first. Demand management must be used to mitigate these problems, such as with pricing structures – for example, consumption charges (based on metering), pollution charges or both – restrictions, licenses, quotas or some combination. Adequate metering and demand management, ideally introduced with the participation and understanding of stakeholders, are pro-poor because they help make water and sanitation services affordable (by correcting deficiencies costly for society) and sustainable (by saving resources). Steps must also be taken to correct system deficiencies, such as unaccounted-for water and illegal connections.

Principle 3: Improve management of infrastructure investment, to achieve sustainable outcomes

Reduce price distortions to promote sustainability. There are wide gaps between the values and tariffs, as well as the private benefits and social costs, of drinking water, irrigation water and sanitation services. For example, pricing of (and demand for) irrigation water depends on its uses and particularly on international prices for agricultural commodities. In theory, pro-poor impacts of water investments can be maximised by charging tariffs as close as possible to "true" values – that is, values that reflect long-term social uses and costs. If found feasible, such tariff policy should be complemented by measures to increase affordability, such as smart subsidies, and mitigate negative externalities, such as environmental degradation.

Reform irrigation to improve management and sustainability. Top-down approaches to irrigation have resulted in low productivity or been unsustainable (or both). Partner governments are encouraged to introduce participatory irrigation management, which assigns operation and maintenance of irrigation facilities to user associations whose members are based on socio-cultural connections and norms.[15] Farmer involvement in planning, designing and managing farm-level irrigation canals, as well as main or secondary canals, creates ownership and so facilitates collection of water fees and maintenance of irrigation systems, increasing sustainability. Women's access to irrigated land promotes gender equality.

Encourage private involvement in drinking water and sanitation. Public water management often results in ineffective operation, unreliable supply, inadequate maintenance, red tape and favouritism towards certain groups of consumers. These deficiencies mainly hurt poor people because they have to pay more for water from individual sources or go without sanitation. More efficient, sustainable and equitable drinking water and sanitation supply has been achieved by combining private management with public oversight (as well as by decentralising service provision). Such arrangements – mostly public-private partnerships such as management or lease contracts or build-operate-transfer (BOT) schemes – increase efficiency and effectiveness, and public oversight and regulation ensure attention to issues such as law enforcement, quality standards, equitable participation (especially by women) and land tenure. Most public-private partnerships involve multi-national corporations from OECD countries; greater efforts should be made to involve small, local providers in providing water and sanitation services.[16]

Focus on rehabilitation and renovation. If not properly maintained, water infrastructure is prone to damage and can cause environmental degradation. Too often, investments develop new water sources (including for drinking water, irrigation and sanitation) – further draining resources – instead of rehabilitating existing ones. Introduction of demand management makes better use of existing resources without developing new ones. All water investments should include budgets for maintenance. Support for agencies to strengthen management of investments and regulation of irrigation infrastructure – through technical assistance and capacity building – should also be considered.

Limit environmental damage. Systematic efforts are needed to reduce the negative impacts of irrigation, water and sanitation interventions on health, ecosystems and biodiversity, and land use and rights. In addition, infrastructure investments, particularly long-lived infrastructure such as dams, hydropower facilities, water supply and road networks, need to be screened to determine how their performance could be affected by risks related to climate change. Special consideration should be given to mitigating flood and drought dangers, which will likely multiply as a result of expected climate change. To address such dangers, irrigation and hydropower investments should be complemented by water management measures that, for example, create observation networks to measure precipitation, track river flows to improve flood prediction and develop other disaster prediction systems, such as *tsunami* warnings.

Principle 4: Increase infrastructure financing and use all financial resources efficiently

Expand financing for irrigation. Investment in irrigation has fallen even more than for infrastructure in general, and reduced donor support has undermined the potential productivity of many existing schemes. New financing mechanisms such as rehabilitation funds – financed by users, donors and/or national budgets – should be promoted. Another approach is for beneficiaries and the private sector to construct and rehabilitate secondary and tertiary canals, while governments focus on main canals and other large facilities.

Increase funding for drinking water and sanitation. Given the scale of needs and the importance of achieving the MDGs, financing for drinking water and sanitation must be increased. To maximise efficiency, funds should go to projects with potential for scaling up, whether through larger-scale programmatic financing or, possibly, public-private

partnerships. In addition, innovative funding mechanisms for water and sanitation should be explored at local (subsovereign) levels. One possibility is revolving funds, which reduce the financial burden of connection costs by stretching repayments over longer periods while also using them to increase the number of beneficiaries (leverage effect). Financing constraints at local levels can also be overcome by promoting self-funding and by providing guarantees and risk sharing schemes. Guarantees provided by municipalities for other municipalities spread risks between local entities (a form of municipal solidarity and risk mutualisation).

Defining the role of donors: Adopt IWRM, increase irrigation investments, consider water tariffs and promote private involvement in water supply and sanitation

To enhance the poverty reduction and pro-poor growth effects of support for the water sector, donors should:

i) Promote, using the IWRM framework, better co-ordination between central and decentralised levels to rationalise water use for productive purposes. To that end, donors should help develop and implement water (and land use) laws, regulations and other sector reforms.

ii) Promote technical and economic assessments of and investments in irrigation, using common methodologies (particularly for investments covering multiple countries) and taking into account social and environmental issues.

iii) Favour participatory irrigation management, to facilitate collection of tariffs that cover operation and maintenance costs and improve environmental security.

iv) Strengthen public bodies responsible for water services and support their expansion only after their management has improved. Efforts should be made to stem technical and non-technical losses, encourage public-private partnerships, introduce demand management (such as metering, leakage control, conservation and reuse programmes) and support tariff policies that promote affordability (through smart subsidies, for instance), "polluter pays" principle and institutional sustainability.

v) Encourage peri-urban and rural access to regular, low-cost drinking water by involving the domestic private sector under decentralised public structures.

vi) Promote sanitation investment, capacity building and hygiene education.

Notes

1. This section draws on, among other sources, IDCJ (International Development Center of Japan) (2004).
2. The multi-donor funded sub-Saharan Africa Transport Policy Program (SSATP, at *www.worldbank.org/afr/ssatp/index.htm*) provides support to 26 African countries to conduct participatory processes in which national stakeholders (public, private, civil society) review the links and coherence between their national transport and poverty reduction strategies. The SSATP then helps countries revise their transport strategies to increase their contribution to poverty reduction.
3. The POVNET Task Team on Private Sector Development has produced related guidance on financial services and assistance as well as on business development services (2005a and 2005b). Refer also to the guidance by the Committee of Donor Agencies on business development services (2001), often referred to as the "Blue Book".
4. The Global Road Safety Partnership has developed strategies to address health concerns in the road sector; see *www/GRSProadsafety.org*.

5. This section draws on, among other sources, ECI (Environmental Change Institute) (2004), Oxford University.
6. See Note 3.
7. This section draws on, among other sources, Batchelor, Woolnough and Scott (2004).
8. InfoDev is a global grant programme, managed by the World Bank, that promotes innovative projects using ICT for pro-poor growth (*www.infodev.org*).
9. In East Africa and Asia e-commerce helps poor indigenous communities in remote areas link to high-potential specialised world markets, as with the connection where upland communities in Lao People's Democratic Republic sell herbal products to the Body Shop. Other examples of ICT benefiting the poor are Internet cafés located in road maintenance units in Bhutan, e-banking in Nepal and weather forecasts provided to fishermen in Tamil Nadu, India, and Tonle Sap, Cambodia.
10. See examples from the Public-Private Infrastructure Advisory Facility (PPIAF, at *www.ppiaf.org*), a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure through private sector involvement.
11. This section draws on, among other sources, Kraehenbuehl and Johner (2004) and Sakairi (2004).
12. At the World Summit on Sustainable Development (held in Johannesburg, South Africa, in 2002) the global community set targets for IWRM and water efficiency plans world wide.
13. Water and irrigation issues have also been analysed by the DAC POVNET Task Team on Agriculture.
14. See also the guidelines and examples of good practices on addressing vulnerability in the water sector in Wiman and Sandhu (2004).
15. Another method of reassigning management responsibility for irrigation systems is irrigation management transfer, where partial or complete management responsibility for subsystems or entire systems is transferred from governments to non-governmental organisations.
16. Moreover, the private sector has a rather chequered record on drinking water issues, as some projects in Latin America have shown. There is a need for better stakeholder information, stronger accountability and, as in irrigation, a definite role for user associations in implementing public-private partnerships for drinking water.

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PART IV

Chapter 20

Applying the Guiding Principles in Countries with Special Needs

Although these guiding principles have the same goals everywhere, they will need to be adapted to specific conditions in partner countries. This chapter explains how the principles should be applied in the most fragile low-income countries, including those suffering or emerging from conflicts or disasters, and in middle-income countries with deep pockets of poverty. It also addresses the role of regional and cross-border infrastructure, which is especially important for landlocked countries.

Addressing the needs of fragile and post-conflict states

Identify drivers of country conditions. Variously termed failing or failed states or low-income countries under stress, fragile states have governments that are unwilling or unable to provide their people with security, protection of property, basic public services and essential infrastructure. Countries suffering or emerging from conflicts or human made disasters face additional problems. They often have weak or non-existent governance structures and systems, and large portions of their populations experience profound poverty, vulnerability, insecurity, ill health and disability. Such weaknesses usually also impose burdens on the economies of neighbouring countries. All these factors provide reasons for prioritising investment in fragile and post-conflict states.

Providing co-ordinated support to improve governance and management

Support governance institutions. In such states the first infrastructure-related task is to rebuild governance and administrative capacity at the central level. Thus long-term technical support aimed at increasing central authorities' capacity to manage infrastructure resources and programmes is essential. Where government capacity is weak, infrastructure services can be delivered by non-state providers, including non-governmental organisations (NGOs) and the private sector. Regional initiatives should be supported because they can help re-establish national governance.

Promote inclusive sector strategies. Country-owned poverty reduction and sector strategies can help build consensus and unity, and contribute to more effective political leadership and resource management. Support should be given to country-owned, inclusive processes of sector strategy formulation involving stakeholders. Moreover, care should be taken to avoid activities – such as bypassing national budget processes or constraining recruitment in national organisations by setting high salaries for staff of project management units – that undermine local capacity and institution building.

Expanding access and improving security

Restore core infrastructure and basic services. Governments in fragile and post-conflict states should focus on rehabilitating core infrastructure facilities and basic services, especially trunk roads, energy, water and sanitation. Careful sequencing is needed to improve absorptive capacity. Where efficient management is difficult, small-scale rehabilitation may be more viable than large-scale interventions. Strengthening what already works and building on self-help initiatives can be particularly useful.

Strengthen security and reduce vulnerability. Infrastructure investments should take into account territorial security, aim to reduce risks and vulnerability, and promote the safety of marginal populations – for example, by enabling food production in former conflict zones and creating employment opportunities for high-risk groups. Conflict assessments and alternative performance measures (such as progress on building peace

and improving governance) should be included in programme assessments. Cross-border infrastructure may be a particular priority in post-conflict countries, to ease tensions and rebuild co-operation between previously warring countries.

Managing and sustaining infrastructure

Increase capacity to manage and maintain infrastructure. Infrastructure maintenance is essential in fragile states, but its financing and management must be adapted to evolving governance and administrative capacity. For small-scale facilities, priority should be given to supporting communities and, where possible, subsovereign authorities to manage and maintain local infrastructure, making the best possible use of local resources. Although donor or NGO financing for service providers may be needed in the short term in some countries or subsovereign territories, it should be provided as a last resort – when no government or other local bodies can provide such functions. Responsibilities of independent service providers should be transferred to domestic institutions at the earliest opportunity.

Increasing infrastructure financing

Provide more reliable, predictable, co-ordinated aid. Because aid to fragile states is highly volatile, more reliable and co-ordinated flows are needed to stabilise governance structures. In post-conflict countries priority should be given to establishing faster procurement modalities, including pooled funds, to provide rapid support and facilitate disbursements. Aid should be accompanied by diplomacy, security guarantees, conflict reduction programmes and technical assistance.

Provide grants and no- or low-interest loans. To expedite growth and rehabilitate central financial governance, infrastructure aid should be in the form of grants or low- or no-interest loans.

Defining the role of donors: Support core infrastructure to strengthen governance

Donor support for infrastructure in fragile and post-conflict states should:

i) Take the country context as the starting point.

ii) Restore core infrastructure – using a co-ordinated, long-term approach – and applying basic design standards to increase access.

iii) Rebuild governance and administrative capacity.

Reducing poverty in middle-income countries

Recognise the importance of middle-income countries for global achievement of the MDGs. Many middle-income countries have severe pockets of poverty in certain regions or among particular groups. Such poverty is often caused by high inequality (based on race, ethnicity, gender or other social grounds) and weak governance, including corruption, political exclusion and poor representation of citizen interests. These situations, which often result in political interference, may discourage involvement by the private sector and NGOs. Infrastructure support for middle-income countries must tackle poverty and inequality in an integrated way, involving all of society. Such countries receive more aid than is required to achieve MDG needs, but in many cases it does not help to reduce poverty. As a result some middle-income countries are reverting to low-income status.

Developing more comprehensive pro-poor strategies for infrastructure

Promote a pro-poor orientation in national development strategies. Donor dialogue with middle-income countries should focus more on strengthening government commitment to improve the pro-poor focus of national development strategies. Support should be given to strategies promoting growth in the poorest areas and to reforms improving governance and fostering private sector involvement through regulation. Technical support should aim at developing institutional capacity to reduce poverty and inequality in infrastructure policy and delivery and in fiscal, utility and sector reforms. Such capacity building could draw on South-South knowledge sharing as well as international expertise.

Build on country systems for environmental and social safeguards. Many middle-income countries have well-functioning procurement systems and well-developed social and environmental safeguards. Even if the standards used are not fully consistent with those advocated by donors, infrastructure provision under country-led approaches and systems can expedite implementation.

Reducing inequalities in access

Encourage integrated approaches while targeting marginal and excluded populations (such as indigenous groups and the disabled) when extending infrastructure networks and services. For example, an initiative could seek to increase financial sector support or enhance safety and health care in poor areas, particularly to address challenges such as HIV/AIDS, disaster recovery and environmental concerns.

Foster public-private partnerships. Local private actors should be involved as much as possible in managing and maintaining facilities and services in marginal areas. Public-private partnerships can extend services to poor areas at affordable prices and promote environmentally friendly development at central and decentralised levels.

Promote fair tariffs. Inequalities in middle-income countries are particularly high between groups and regions. Given that middle income countries can afford more social balancing, a pro-poor approach to extend infrastructure services should emphasise fair tariff collections, with cross-subsidies supporting vulnerable groups such as the disabled. Governments should ensure that tariff collections are free from political interference by bodies in charge of infrastructure services.

Leveraging more financing to tackle poverty

Ensure that investments in middle-income countries do not cut into support for low-income countries, particularly in Africa. Annual infrastructure investment needs for 2005-10 (for both new construction and maintenance) are estimated at USD 356 billion for middle-income countries, compared with USD 109 billion for low-income countries (Fay and Yepes, 2003). Sub-Saharan Africa alone needs USD 17-22 billion a year, more than half of which would be an incremental increase. While middle-income countries have more options and better access to financing, public spending including ODA continues to be the major source of investment in the poorest countries, especially sub-Saharan Africa. Thus there is a great need for donors to reallocate infrastructure aid towards poorer countries, while also developing innovative financing mechanisms in middle-income countries.

Develop innovative financial products. Lending should be combined with financial product innovations (guarantees, risk management products, local currency loans) to increase public and private financing for infrastructure facilities and services targeted at

the poor. Development banks, both bilateral and multilateral, have a comparative advantage in increasing capital market financing for infrastructure in middle-income countries. Such financing is also development oriented and so should be included as a memo item in DAC statistics.

Defining the role of donors: Focus on pockets of poverty using innovative loan-based support

Donor support for infrastructure in middle-income countries should:

i) Focus on poverty-stricken areas and promote pilot approaches that include such areas in national pro-poor growth efforts.

ii) Engage the private sector and encourage public-private partnerships.

iii) Use innovative mechanisms to leverage additional financing – freeing up aid for low-income countries, particularly in Africa.

iv) Use decent country systems for procurement and social and environmental safeguards.

v) Focus on the environmental and governance-related strategic development goals identified in the Millennium Declaration, in addition to poverty reduction goals linked to the MDGs.

Supporting regional and cross-border infrastructure*

Develop regional and cross-border infrastructure to support pro-poor growth. Regional and cross-border infrastructure can increase trade, improve security, save money, strengthen natural resource management, address the needs of landlocked countries and build on national and regional comparative advantages, among other benefits. Regional infrastructure projects can be implemented by sovereign governments or regional economic communities. Both approaches require well-designed strategic frameworks and agreements on trade and economic integration. Such projects usually combine infrastructure development with regulatory, institutional and technical harmonisation. Cross-border initiatives are implemented through agreements and contracts between two (or sometimes more) countries and usually have a specific focus, such as integrated water resource management (IWRM) or co-operation on energy supply. Because such arrangements involve several sovereign states, harmonising systems (regulatory, institutional, financial, technical and legal) and ensuring sufficient political support are often major challenges.

Strengthening national and regional policies and capacity

Link regional and cross-border infrastructure with national plans. Regional and cross-border infrastructure projects must be closely linked to national poverty reduction strategies and other development plans, to identify investments with the greatest potential for promoting pro-poor growth and to induce donor investment. National strategies should include careful analysis of trans-national obstacles and integrate the costs of constructing and maintaining regional and cross-border infrastructure in accompanying expenditure plans. Improved coherence and co-ordination between infrastructure improvements at different planning levels (regional, national, local) is vital, both within sectors (for example, linking road corridors with feeder roads) and between them (for example, linking water resource management and food security with rural electrification and health).

* This section draws on, among other sources, Stafford (2005).

Take an economic corridor approach. Many regional and cross-border infrastructure initiatives have indirect – and sometimes uncertain – effects on pro-poor growth. Taking an economic corridor approach helps focus attention on an area broader than the specific line of a road, railway or pipeline. But strategies for developing these economic corridors must address poverty reduction and growth. Complementary measures are needed to ensure that the poor benefit from such investments (or are compensated for any negative effects) and to achieve more direct contributions to pro-poor growth.

Conduct *ex ante* impact assessments and monitoring. Robust impact assessments and monitoring are needed for regional and cross-border infrastructure, particularly for large projects and investments in fragile areas. Such efforts must consider the potential impacts of infrastructure development and accompanying reforms on the poor and pro-poor growth, taking into account any environmental, social and economic risks in and around the economic corridors or geographic zones. The findings should feed into the design of measures to reduce risks and vulnerability. All affected stakeholders and groups should be consulted during assessment and monitoring.

Support regional economic communities. Regional economic communities are key in facilitating the harmonisation of regulatory, institutional, legal and other issues. Yet despite the importance of such communities in leading multi-state operations, accountability systems are often unclear. So, responsibilities during all programme or project phases, including implementation, must be formally assigned before any involvement by regional economic communities. If necessary, capacity building should be strengthened.

Getting funding frameworks right

Establish mechanisms for coordinating and sharing costs. Strong co-ordination among countries and donors is a prerequisite for any infrastructure project or programme involving multiple states. Clear funding arrangements and equitable cost-sharing agreements between the countries involved are needed to encourage the involvement of countries, donors and investors.

Use regional development banks to channel resources. Regional development banks can play a crucial role in facilitating and financing regional and cross-border initiatives, particularly since they often channel bilateral aid. Bilateral development banks can also support such initiatives.

Defining the role of donors: Support economic activities and trade across borders

To promote regional and cross-border infrastructure, donors should:

i) Support trade and transport facilitation, such as efforts to reduce border crossing problems – including rationalisation of procedures and elimination of illegal or semi-legal checkpoints on roads – and increase the efficiency of multi-country operations in other network industries, such as railways and electricity.

ii) Assess potential benefits (for countries, regions and people) and ensure that designs and financing arrangements address concerns about equity.

iii) Contribute to capacity building and project preparation facilities in regional bodies.

iv) Ensure that their support promotes regional public goods such as pro-poor growth, poverty reduction and environmental protection.

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PART IV

Chapter 21

Assessing the Effects of Infrastructure on Pro-poor Growth

The OECD is actively engaged in promoting donor harmonisation. Thus the InfraPoor Task Team recommends that donors promote the development of management information systems, ex ante *impact assessments, monitoring systems and the like for each infrastructure sector. Good data and indicators and robust assessment and monitoring are crucial to effective implementation of the guiding principles.* Ex ante *assessments help design projects that promote pro–poor growth, monitoring is vital to verifying that planned improvements are on course and to correcting design flaws, and evaluation informs future designs and ensures accountability to investors and stakeholders. The current situation is far from perfect: different methods and instruments are used to conduct similar tasks. Donors make multiple demands on partner countries. Finally, there is insufficient capacity to manage data and undertake analysis. This chapter offers guidance on overcoming these weaknesses.*

Improving data and indicators

Establish sector datasets. Available data on infrastructure are unreliable, incomplete and out of date. Most partner countries have limited central, local and sector capacity to generate and manage such data. More sector datasets are needed – ideally recognising the links between infrastructure, growth and poverty reduction – to allow international comparisons and support linkages between sector programming, country outcomes and global MDGs. These datasets should be linked to household information on poverty. To make data collection feasible and affordable, cost and capacity considerations must be taken into account. A way to provide support for infrastructure is to include measures and incentives for improving data collection and analysis, including research and academic initiatives in an infrastructure project; doing so would strengthen individual programmes (through baseline data and monitoring) and increase knowledge at the sector, national and local levels. Such efforts can also generate lessons that can, with caution, be applied in countries lacking the capacity to conduct their own research.

Use existing indicators. Optimal use should be made of existing indicators, especially those that monitor poverty reduction and pro-poor growth strategies, as well as general development. Infrastructure-specific initiatives such as the World Bank's proposed collaboration on cross-country infrastructure databases and the European Union's transport indicators are particularly relevant.

Disaggregate indicators and data. Specifying indicators and data based on location, target groups, poverty levels and differential gender impacts is essential to the effective design of infrastructure for pro-poor growth, and to monitoring its impacts on the poor and on poverty reduction. Indicators should allow monitoring of the impact of infrastructure investments on environmental sustainability, social inequalities such as gender and ethnicity that impede growth, and the situation of socially excluded groups. However, sector indicators may not be appropriate to monitor wider impacts on poverty, income distribution and the like, which need to be followed through indicators in national poverty reduction strategies.

Making systematic use of *ex ante* impact assessments[1]

Align *ex ante* assessments with poverty reduction strategies and targeting. *Ex ante* impact assessments should be aligned with national poverty reduction strategies and address the issues highlighted in the discussion of Part IV's guiding principles, including sustainability, governance, cross-sector synergies, the environment for private investment, and potential sources of and bottlenecks to pro-poor growth. To be effective, such assessments should be conducted well before decisions are made and in a transparent, participatory manner – involving stakeholders not only in the analyses, but also in identifying alternative options and mitigating identified problems.

Draw on existing methods and work. Infrastructure investments absorb huge amounts of public and donor funding. Hence their opportunity costs are high. At the same time, pure economic rate of return calculations do not provide sufficient information to

predict their poverty impacts and contributions to the MDGs and pro-poor growth. To increase such knowledge, existing methods and work should be made more operational, such as poverty and social impact assessments (PSIAS) by the World Bank, poverty impact assessments (DAC POVNET), infrastructure indicators developed by various donors and international sector networks, and infrastructure diagnostics used by the World Bank in its Recent Economic Developments in Infrastructure (REDI) studies. More important, further efforts should be made to develop and use simple, robust, affordable methods that take into account analytical capacity in partner countries.

Strengthening monitoring and evaluation

Improve participation and feedback. Participation and feedback mechanisms were almost non-existent in infrastructure project monitoring and evaluation until recently, and should be pursued as much as possible to build knowledge and capacity and influence policy (as in other poverty-relevant sectors such as agriculture, education and rural development). A more dynamic approach to monitoring and evaluation – using innovative, participatory approaches involving stakeholders and beneficiaries (with a broad range of private and civil society actors, including the media) – is required to foster policy making based on communication, learning and feedback. In addition, better indicators and data should be collected to support more efficient sector management.

Conduct sector- and country-wide evaluations. Sector- and country-wide evaluations provide a better means of assessing the poverty impact of infrastructure than do evaluations of individual interventions. To build knowledge, policy and programme interventions can also be clustered by country, region, sector (or multi-sector) or theme.

Defining the role of donors: improve data collection, ex ante *poverty impact assessments, and monitoring and evaluation*

To better assess how infrastructure investments affect pro-poor growth, donors should:

i) Strengthen country systems and capacity to generate relevant indicators and data, building on work such as Paris21.[2] Support should be provided to strengthen the capacity of line ministries, other government agencies and local research institutes to collect and analyse data needed for pro-poor planning of infrastructure delivery.

ii) Encourage simple, harmonised, *ex ante* poverty impact assessments of infrastructure, aligned with poverty reduction strategies and the capacity of partner countries.

iii) Engage in joint monitoring and evaluation – involving donors, governments and other stakeholders – to build and share knowledge. Monitoring and evaluation should also aim to strengthen local research and analytical capacity, by involving government agencies, national and regional research institutions, civil society organisations and local consultants.

Notes

1. This section draws on, among other sources, Jennings (2005). The DAC POVNET working group is conducting further work on a harmonised donor approach to *ex ante* poverty impact assessments.
2. The Partnership in Statistics for Development in the 21st Century (PARIS21, at *www.paris21.org*) is a consortium of policy makers, analysts and statisticians from around the world, formed to promote high-quality data, make these data meaningful, develop sound policies and facilitate dialogue on development data.

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PART IV

Chapter 22

Monitoring Implementation of the Guiding Principles

This section outlines the steps that donors should take to monitor implementation of Part IV's guiding principles, and the indicators they should use.

Monitor and evaluate implementation of the principles. Implementation of the guiding principles must be monitored to ensure intended outcomes and generate lessons. Donors have proposed using the DAC framework to conduct such monitoring, with peer reviews for specific issues, regions and countries. In addition, implementation of the principles should be evaluated in collaboration with partner countries, facilitating co-ordinated follow-up at the country level.

Develop indicators to gauge implementation of the principles. To support peer reviews, the InfraPoor Task Team has suggested indicators to assess implementation of the guiding principles by all donors that are members of the team (Table 22.1). Donors may wish to refine and deepen these indicators based on their institutional contexts and priorities. In addition, over time more measurable indicators will be developed and agreed.

Table 22.1. **Suggested indicators for monitoring implementation of the guiding principles**

Principle	Indicators
Use partner country – led frameworks as the basis for co-ordinated donor support	Percentage of on-budget donor infrastructure support. Percentage of donor funds in country sector programmes. Existence of medium-term joint assistance strategy developed by donors and the partner country, involving all donors and linked to the national poverty reduction strategy.
Enhance infrastructure's impact on poor people	Number of an *ex ante* impact assessments conducted by donors (country and sector studies as well as general surveys on poverty reduction strategies and the MDGs). Extent of capacity building for cross-sector planning and impact assessment.
Improve management of infrastructure investment, to achieve sustainable outcomes	Percentage of donor programme portfolio funding maintenance and capacity building. Number of donor investments taking into account recurrent maintenance and maintenance capacity. Alignment of donors with partner countries' sector plans, budgets and systems.
Increase infrastructure financing and use all financial resources efficiently	Percentage of non-official development assistance in infrastructure financing. Percentage of economic infrastructure in donor portfolios.

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ANNEX IV.1

The InfraPoor Task Team

Objectives

The DAC Task Team on Infrastructure for Poverty Reduction (InfraPoor) was established in November 2003 as part of efforts by the DAC Network on Poverty Reduction (POVNET) to identify how donors can be more effective in promoting growth that involves and benefits the poor, to contribute to the MDGs. POVNET started its work by focusing on three areas: agriculture, private sector development and infrastructure. For each area a task team was established.

The goal of the InfraPoor Task Team was to formulate – in the context of efforts to achieve the MDGs – a joint position of DAC members to enhance the impact of economic infrastructure on poverty reduction and economic growth. Such infrastructure was defined as transport, energy, information and communication technology, and irrigation, drinking water and sanitation.

Participants

The InfraPoor Task Team was led by a core group of donors: the European Commission, France (French Development Agency), Germany (German Agency for Technical Co-operation and KfW Development Bank), Ireland (Development Co-operation Ireland), Japan (Japan Bank for International Cooperation, chair), Switzerland (State Secretariat for Economic Affairs), the United Kingdom (Department for International Development) and the United States (US Agency for International Development).

Other DAC members involved in the InfraPoor Task Team's work included Australia, Austria, Belgium, Canada, Denmark, Finland, the Netherlands, Norway and Sweden.

Multilateral development agencies were also involved: World Bank, Asian Development Bank, African Development Bank and International Labour Organization.

Government, private sector and civil society representatives from partner countries also participated, feeding in their experiences and providing examples of good practice. Countries represented include Albania, Armenia, Bangladesh, Bolivia, Cambodia, Ghana, India, Indonesia, Morocco, Nicaragua, Pakistan, Peru, Tanzania, Uganda and Viet Nam.

Particular thanks go to the following core group members; Hitoshi Shoji (task team leader), Yasuhisa Ojima (JBIC, Japan), Armin Bauer and Nina Barmeier (KfW Development Bank and GTZ, Germany), Jean-Francis Benhamou (AFD, France), Alistair Wray and Leonard Tedd (DFID, United Kingdom), Olivier Bovet (Seco, Switzerland), Bryan Greey and Bruce Thompson (European Commission), Earnan O'Cleirigh and Gerry Cunningham (DCI, Ireland),

Mark Karns (USAID, USA) and Antonio Estache (World Bank). Technical support to the Task Team was provided by OECD staff, Bill Nicol and Annabel Mülder. Initial draft of this document was prepared by Mary Braithwaite. The final version was edited by Paul Holtz.

How the work was carried out

The InfraPoor Task Team's work involved intensive examination of the evidence and experiences accumulated by donors and partners over many years, across the four economic infrastructure sectors and all developing regions. The process included:

i) Two surveys of donors to identify issues, approaches, lessons and examples of good practices.

ii) Production of many expert working papers (References) covering the infrastructure sectors addressed and various cross-cutting themes, including financing, the MDGs, poverty reduction strategies (PRSs), gender equality, the impact on the disabled and on socially excluded groups, regional and cross-border infrastructure, impact assessment and targeting.

iii) Three important meetings (29-30 March 2004 in Paris, 27-29 October 2004 in Berlin and 22-24 March 2005 in Tokyo).

iv) Review of drafts of the guiding principles for infrastructure by the Task Team and sector networks.

v) Financial and logistical support from the core group of donors, who have met regularly to steer the process.

More information on the InfraPoor team's process and copies of all working papers are available at: *www.oecd.org/dac/poverty*.

ANNEX IV.2

Potential Contributions of Infrastructure to the Millennium Development Goals

	MDG 1: Reduce income poverty and hunger	**MDG 2:** Full primary education coverage	**MDG 3:** Gender equality in education
Transport – Local (Village to Township or Main Road)	+++ Improvements to low-volume local roads and associated networks of village tracks/paths can significantly reduce poor farmers' transaction costs and expand their production possibilities (incl. non-farm)	++ Village roads significantly affect school enrolment and attendance	++ Girls' attendance significantly increased by safer roads
Transport – Trunk (Beyond the Township)	+++ Availability of competitive transport services on adequately maintained trunk network is critical to the effective participation of an area in national and international markets	+ Quality of link to regional centre significantly affects quality of teacher who can be attracted and his/her attendance	+ Helps secure better quality of teacher
Modern energy	+++ Rural electrification often correlates with sharp increase in regional incomes and growth of non-farm activity. Reliability of modern energy supply strongly affects investment in, and competitiveness of, local enterprises	+ Availability of modern energy increases enrolment and attendance rates, and home electrification raises time devoted to study	++ Modern energy helps families release girls for school: less time collecting fuel-wood and water, and schools improved
Telecom	++ ICT significantly improves the efficiency of most service-sector activities (incl. government) and can in particular reach poorer people with information of direct use for improving their economic situation	+ ICT helps expand and improve teacher training, and can make classes more interesting	+ ICT can make school more worthwhile attending by strengthening students' exam performance
Household water	++ Convenient, good water can substantially reduce morbidity and mortality, time spent fetching water, and enterprise interruptions, and improve nutrition, with significant effects on poor people's productivity	++ Good home water supply increases school attendance (especially by children with literate mothers) and increases learning capacity	+ More convenient home water supply facilitates release of girls for school and reduces absences due to sickness
Sanitation	+ Adequate sanitation sharply reduces illness and expenditure on medical treatment (itself a significant factor in poverty)	+ Good sanitation/water helps attract good teacher	++ Good school sanitation and water facilities increase girls' attendance
Water management structures	+++ Irrigation and flood control structures can greatly increase incomes and nutrition levels of the poor if they are managed to maximise benefits to the community as a whole, and especially if they support production of labour-intensive crops		+ Less drudgery for women in obtaining water for household needs
Public markets	+ Reduce transaction costs for small producers and help ensure competitive prices for consumers	+ Make centre at which schools, etc. benefit from same good access	

MDG 4: Reduce < 5 mortality	**MDG 5:** Maternal mortality reduction	**MDG 6:** Communicable disease	**MDG 7:** Environmental protection	**MDG 8:** Framework for development.
+ Increases use of primary healthcare facilities and facilitates access to better water	+ Positively affects antenatal care and share of deliveries professionally attended		+ Care needed to maximise compatibility of engineering design with local environment	+ Work on local roads/ transport can generate much youth employment
++ Vaccines/drugs supply, visits by more skilled health personnel and emergency evacuations	+ Increases in-hospital deliveries and often critical when emergency obstetrics required	+ Important for drug supply and higher-level diagnostics Care needed to avoid stimulating AIDS spread	– Great care needed in fragile ecological environments to minimise risks and compensate people who suffer	+++ Essential facility to enable area to benefit from international trade opportunities
++ Sharply reduces indoor smoke pollution and impurities in water/food consumed, the two major mortality factors	+ Reduced stress of household chores, and lectricity improves medical services (hours, equipment, refrigeration)	+ Improved medical services, including from attraction of more qualified personnel	++ Reduces pressure on land resources (by moving water and reducing fuel-wood need), but care needed to avoid ill-effects of large dams	+ Small quantities of electricity essential for use of modern ICT
+ Can promote better health practices and ensure timely availability of life-critical diagnostic info. and drugs	+ ICT enables efficient arrangements for emergency treatment	+ Reduce drug stock-outs and make efficient referrals to higher medical institutions	+ Record-keeping and retrieval services of importance for environmental protection	++ Essential to target for ICTs' supply, and for participation in international economic opportunities
+++ Good home water supply greatly reduces child mortality, especially if mother is literate	+ Water improves general maternal health and deliveries	+ Clean water important for disease treatment, and for formula milk (HIV mothers)	+++ Crucial for meeting the household water target under this goal	+ Water improvement much needed in least developed countries
+ Improved sanitation decreases child mortality and improves nutrition	+ Improved sanitation reduces maternal illness	+ Effective water disposal reduces malaria mosquito breeding	++ Crucial for meeting the sanitation target and combating urban environmental degradation	+ Sanitation high priority in least developed countries
+ More ample supplies of water for household use		– Care needed to avoid adverse health consequences of man-made changes in water regimes	++ Sound planning, design and op. of water-related structures are key in protecting environmental resources and accommodating growing populations	
+ Help ensure clean food supplies				+ Makes centre for ICT-based Activities

Note: +, ++ and +++ indicate percentage improvements relative to initial levels of attainment. While the overall experience suggests that some types of infrastructure might have been more efficient in achieving specific MDGs, in specific projects that is not always the case. Hence the need for *ex ante* impact assessments at the project level derived from general sector-level analysis.

Source: Willoughby (2004b).

ANNEX IV.3

Projects and Good Practices Related to the Four Guiding Principles

Around the world, there are many examples of infrastructure projects that reflect the four guiding principles in their design, implementation, assessment and other areas. These projects include:

Principle 1: Use partner country-led frameworks as the basis for co-ordinated donor support

i) Adapting growth and infrastructure strategies to reduce poverty in Viet Nam.

ii) Targeting technical support to improve power sector management and reallocate resources in India.

iii) Promoting pro-poor growth in China.

Principle 2: Enhance infrastructure's impact on poor people

i) Recognising – and exploiting – the links between rural roads and poverty reduction in Africa.

ii) Using information and communication technology to expand opportunities for women in Bangladesh.

iii) Conducting an *ex ante* impact assessment of energy privatisation in Honduras.

iv) Expanding urban water supply in Bolivia.

v) Pursuing community-led total sanitation in Bangladesh.

vi) Rehabilitating water infrastructure and reforming land tenure in Cambodia.

vii) Using smart subsidies under public-private partnerships to expand power access in Tajikistan.

Principle 3: Improve management of infrastructure investment, to achieve sustainable outcomes

i) Ensuring effective road maintenance in Cameroon.

ii) Promoting effective regulation to develop urban water kiosks in Zambia.

iii) Forming a public-private partnership to support investment in El Salvador.

iv) Organising a co-operative network for rural electrification in Bangladesh.

v) Cleaning river basins, treating waste water and improving drinking water in Morocco.

Principle 4: Increase infrastructure financing and use all financial resources efficiently

i) Providing a guarantee for increased telecommunications investments in Uganda.

ii) The Emerging Africa Infrastructure Fund – drawing on a range of financing sources to develop private infrastructure.

These projects are summarised in the sections that follow.

Principle 1: Use partner country-led frameworks as the basis for co-ordinated donor support

Adapting growth and infrastructure strategies to reduce poverty in Viet Nam

After adopting its Comprehensive Poverty Reduction and Growth Strategy in May 2002, the Government of Viet Nam recognised that the strategy was not aligned with its Public Investment Plan. The initial version of the strategy failed to address the role of large-scale infrastructure, while the public investment programme (PIP) focused on such investment.

Several donors – the Australian Agency for International Development (AusAID), U.K. Department for International Development (DFID), Japan Bank for International Cooperation (JBIC), Asian Development Bank (ADB) and World Bank, led by Japan – helped a Vietnamese inter-ministerial working group analyse how large-scale infrastructure can contribute to sustainable growth and poverty reduction. The group sponsored a workshop to discuss the findings, which were later incorporated in the Comprehensive Poverty Reduction and Growth Strategy.

This collaboration also led to an agreement to focus the country's next PIP on making public investments more efficient, balancing economic and social investments between rich and poor areas, integrating capital and recurrent expenditures to ensure adequate maintenance of public infrastructure and optimal development impact of all public spending, recognising that operation and maintenance investments often yield higher returns than do new projects, improving poor people's access to infrastructure and observing environmental and social safeguards. These policy issues will also be addressed through reforms supported by the Poverty Reduction Support Credit, provided as co-financing between the World Bank and JBIC.

Targeting technical support to improve power sector management and reallocate resources in India

State-owned electricity utilities in India suffer heavy financial losses due to high levels of inefficiency, system losses, power theft and subsidies. State financing for subsidies is often provided through book transfers rather than actual cash transfers – and is frequently delayed, exacerbating the financial problems of utilities. Moreover, Indian power supply is highly politicised, particularly in rural areas, where the political strength of farmers has created a culture of free or heavily subsidised electricity for irrigation pumps. Most rural energy subsidies are badly targeted, captured by elites and do not encourage efficiency, leading to water resource depletion and oversized pumping sets.

To stem such losses, DFID has been working with various state governments to restructure and reform power utilities and increase efficiency. For example, DFID supported an intensive five-year, GBP 30 million (United Kingdom pounds) programme of technical assistance for power reform in Andhra Pradesh, complementing large-scale investment resources from the World Bank. Between 1999 and 2004 the programme helped reduce annual electricity subsidies by about GBP 200 million. In the neighbouring state of Madhya Pradesh a two-year, GBP 10 million programme helped slash losses by about GBP 220 million.

Lower subsidies helped Andhra Pradesh reallocate resources to spending on poverty reduction. The programme also provided higher-quality power services to support economic growth. In addition, government reforms have increased utility efficiency and service reliability, improved metering, billing and revenue collections, and better addressed the socio-economic issues involved in power provision.

Promoting pro-poor growth in China

China's impressive economic development – with *per capita* income quadrupling and poverty falling significantly since the 1980s – is the result of many factors, including promotion of private initiative, investment in infrastructure and opening to the outside world. Development has had the biggest impact on the country's coastal provinces. To reduce poverty in the hinterlands, China has embarked on a "go west" strategy, part of which involves construction of a 625 kilometre railway from Chongqing to Huaihua, thereby increasing access to the Red Basin and its 120 million inhabitants.

Supported by German Financial Cooperation, the new railway is a good example of a transport project that aims to reduce poverty by increasing transport efficiency and economic growth. The railway reduces the average distance travelled along the corridor by 275 kilometres, to 370 kilometres, saving money and time. The resulting growth effects – through increased trade, productivity and division of labour – will benefit the poor. Apart from impacts on the national economy, regional poverty impacts can be expected from the transport opportunities created in very poor areas. Residents of these areas should benefit from increased trade, market integration, urbanisation, mining, agricultural production and processing, tourism and new businesses.

The project design is pro-poor in several respects. Attention was paid to connecting a large number of poor townships and small cities to the railway, creating opportunities for manufacturing and services as an alternative to farming in mountainous areas. Moreover, infrastructure developed during railway construction (roads, bridges, buildings, drinking water stations, electricity lines) was designed for permanent use. Employment was generated for the local poor through labour contracts and procurement of local construction material. And by cutting transport distances and diverting road traffic to the more environment-friendly railway, the project has saved energy and reduced pollution.

Principle 2: Enhance infrastructure's impact on poor people

Recognising – and exploiting – the links between rural roads and poverty reduction in Africa

In a 1998 study of its aid for road projects in Ethiopia, Lesotho, Tanzania and Uganda, Development Cooperation Ireland found strong linkages between rural roads and poverty reduction:

i) Identifying and targeting poor populations are crucial to reducing poverty. Road projects can use various types of targeting, including based on geography or sector, wages, season or gender. With international geographic targeting, support is based on country classifications such as least developed, rankings such as the United Nations Development Programme's human development index or progress towards the MDGs. Within countries, remote districts and poor urban areas can be targeted in line with the scope of proposed interventions. At the village level, formal transport networks are used infrequently – mostly for peak seasonal market access or emergencies. Indeed,

70% of transport activities are conducted at the household level (using paths and tracks), involving collection of firewood and water and travel to the farm. Wage targeting can be used by setting daily payments at a rate that mainly attracts the most needy community members, not the better off. Where communities are predominantly poor, workers can be rotated on 3-6 month contracts to ensure that everyone has an opportunity to work. With seasonal targeting, it is important to consider how the timing of projects will affect the availability of labour at peak agricultural times, to ensure household security. Finally, gender targeting is essential for projects designed to support poverty reduction. Quotas for women are especially effective – including female-headed households, with an emphasis on serving their domestic needs (child care, water provision). In Development Cooperation Ireland programmes, women's participation in the workforce ranges from 15-50% depending on time of year, migrant male employment elsewhere (such as in mining), social customs, proximity of works and commitment by the implementing agents.

ii) Roads do not guarantee increased prosperity. They have the most impact in areas with potential (such as in agriculture) for a significant economic response and where improved access is being provided for the first time. In all cases, communities should participate in decision making.

iii) For low-volume rural roads, "basic access" standards are likely to be just as cost-effective and often more sustainable than higher design standards. Spot improvement approaches are often the best way to extend services to the maximum number of beneficiaries.

iv) In areas with weak economic activity, the main benefit for the poor is the short-term cash injection provided by employment. Without wage employment, such as labour-based road projects, poor communities will not have sufficient economic capital to exploit the business opportunities created by improved access. Expectations of reduced transport costs or increased market prices are often not realised in the short to medium term because they usually depend on external market forces.

v) Wages paid to women are more likely to be channelled to social and productive priorities.

vi) In Uganda better infrastructure increases use of emergency health care but not necessarily routine care. In Ethiopia and Lesotho the construction of footbridges (for both people and livestock) was particularly cost-effective in increasing year-round access for local communities, especially for schooling and emergency medical treatment.

vii) In most cases improved infrastructure has made government employees more willing to work in remote districts.

The Kibaale District programme in Uganda represents a best-case scenario in terms of social and economic impact. Even with basic access standards, car taxis have replaced traditional pick-up and four-wheel-drive versions, resulting in increased service at lower cost. Improved road surfaces and wages from the works have significantly increased the use of bicycles, mainly among men, though there is evidence that men are using the bicycles for tasks such as water collection, previously a female burden. Parents used wages to pay schooling costs, and attendance rose 119% between 1991 and 1996. There is significant evidence of higher housing standards and a proliferation of small business activities, increasing local council revenue.

Using information and communication technology to expand opportunities for women in Bangladesh

GrameenPhone's Village Phone Programme is administered by one of its shareholders: the non-profit Grameen Telecom, created by the Grameen Bank. The model is simple. A person, usually a woman, buys a telephone handset and a subscription from Grameen Telecom with a loan secured from the Grameen Bank's micro-credit facility. By selling phone services to her fellow villagers, she gradually pays off the loan while making a living. To cover the programme's administrative costs and provide an income to subscribers, Grameen Telecom buys airtime in bulk at a discounted rate from GrameenPhone.

Studies conducted during the programme's early years found widespread demand for telephone services in rural villages. Phones are used for a variety of purposes: keeping in touch with family members who have gone abroad to work, organising remittance transfers, inquiring about market prices in neighbouring towns, consulting doctors and so on. Rapid expansion in the number of village operators shows that the programme is profitable for operators and provides socio-economic benefits for communities.

One of the explanations for the programme's success is the 1 800 kilometre fibre optic backbone network infrastructure, spread across the country along Bangladesh Railway's lines, which Norway financed in the 1980s. This huge initial investment was a sunk cost for the programme. In addition to financing infrastructure expansion, donors such as Canadian International Development Agency (CIDA) and Norwegian Agency for Development (NORAD) have financed socio-economic studies for the programme.

The programme makes effective use of a multi-stakeholder approach to create business models for expanding infrastructure to unprofitable areas, including the following measures:

i) *Provision of micro-credit* to give purchasing power to the poor.

ii) *Reliance on a special purpose organisation*. Grameen Telecom is responsible for programme management, training of operators and all service-related issues, drawing on substantial support provided by the Grameen Bank's national community network and the bank's family of organisations.

iii) *Use of a tariff discount system beneficial to all actors*. For GrameenPhone, the programme's benefits include guaranteed revenue without any bill collection cost and the lack of need for investment in a sales and billing network in rural areas. For Grameen Telecom, its administrative cost for the programme is covered without any subsidy. For village phone operators, the system provides a business opportunity. For users, there is no need to travel to cities for telephone services, and they pay the market rate (rather than an add-on premium rate) for services.

iv) *Consistent programme management policies*. The programme has strict rules, including criteria for selecting operators and no misuse of programme benefits. In addition, it takes a sequential approach: every operator is initially granted a monopoly on village services, and competition is introduced slowly and carefully.

v) *Extensive coverage*. GrameenPhone is able to reach villages because of its fibre optic network and growth in the number of its base stations.

Conducting an ex ante *impact assessment of energy privatisation in Honduras*

Poverty and social impact assessment (PSIA) is an approach to impact analysis that informs policy formulation and choice, rather than being a specific tool or method. It draws

on a host of tools from many disciplines, depending on what is appropriate. PSIA considers the intended and unintended consequences of policy interventions on the well-being of different social groups – with a focus on poor and vulnerable people, and including both the income and non-income dimensions of poverty.

In 2002 a PSIA study was conducted of possible electricity privatisation in Honduras. Carried out by the UK Department for International Development (DFID) in co-operation with the government's Poverty Reduction Strategy Unit, the study aimed to examine the impact on poverty of different privatisation scenarios and outcomes. The study showed that the effect of the increases in electricity price would have the greatest negative effect on very poor rural households. The findings were shared with the donor community and civil society.

PSIA is innovative in that it calls for *ex ante* (as well as *ex post*) assessment of a policy change's impact on poverty. Ideally the process should have a central role in the policy process, take a disaggregated view of poverty, facilitate broad stakeholder engagement, be multi-disciplinary and part of national processes, and support capacity development – while always remembering the need to be pragmatic and appropriate to its purpose. Since the pilot studies in 2002, DFID has identified 134 PSIAs completed or under way by various donors, 38 of which have involved infrastructure. (For more information on PSIA pilot studies, visit: *www.prspsynthesis.org/psia.html*.)

The Honduras PSIA consulted government, civil society and the international community. The study adopted a methodology combining qualitative work and quantitative assessment, drawing on various sources of information – including data from the national electricity supply company, national household surveys and case studies of utility privatisation. The study concluded that any privatisation of electricity should proceed with caution. If efficiency gains do not counterbalance the need to raise prices to cover costs, the net impact on poverty could be dramatic, especially in very poor rural households.

PSIA uses a wide range of tools and methods, including econometric, risk and vulnerability assessment, social impact assessment, monitoring, participatory approaches and political economy. These tools help identify direct impacts in the short term and indirect impacts over the long term. The framework and tools used in PSIA are summarised in the PSIA User's Guide (*http://lnweb18.worldbank.org/ESSD/sdvext.nsf/81ByDocName/PSIAintheWorldBank*) and the Sourcebook of Tools for Institutional, Political and Social Analysis (soon to be posted on the World Bank and DFID Web sites). Because of its history, PSIA emphasises policies. But this framework and its many tools are also applicable for sector plans, programmes and large projects. Given that PSIA can cover the range from simple and quick reports to complex and long-term studies, it provides an ideal framework for improving understanding and assessing the *ex ante* impact of initiatives to address poverty.

Expanding urban water supply in Bolivia

In the city of El Alto, Bolivia, the densely populated and particularly poor District 7 lacks a public water supply and sanitation system. In 1997 a concession agreement (public-private partnership) was concluded between the municipality of El Alto and the private utility Aguas del Illimani (AdI). The agreement foresees expansion of the city's water and sanitation network to poorer areas of the city, but makes no provision for District 7 and its surrounding peri-urban districts. Due to the population's limited purchasing power, connecting the area to the network is not profitable for AdI.

Expanding the network to District 7 requires state subsidies. Switzerland's State Secretariat for Economic Affairs (Seco) contributed by financing the main pipelines and sewage treatment tanks and pre-financing connection charges with a non-reimbursable grant. The district's population can reduce individual connection charges by contributing their labour. The reduced charges are paid into a revolving fund that is used to finance further connections in the surrounding districts. While the initial funding from Seco enabled the construction of about 3 000 drinking water and 5 000 sewer connections, the revolving fund will ultimately lead to 12 000-14 500 new connections. The use of simple, appropriate, low-cost technology further lowers costs. In addition, the project is to be complemented by technical assistance on health and sanitation as well as training to develop local plumbing services. Ultimately about 60 000 people are expected to benefit directly from the project.

Major innovations under the project include:

i) The one-time subsidy through pre-financing of connection charges.

ii) In-kind contributions of the poor's labour, lowering connection charges.

iii) The multiplier effect resulting from the creation of a revolving fund, financed by connection charges, for further connections.

iv) Affordability through a "condominium" approach using simple, low-cost technology.

v) Sustainability through operation and maintenance by the private operator (part of the concession agreement) and technical assistance for users.

vi) Creation of opportunities for private business – and so income generation – through provision of training in plumbing construction and maintenance.

Pursuing community-led total sanitation in Bangladesh

Political commitment to sanitation has grown since the addition of an MDG target on sanitation at the 2002 World Summit on Sustainable Development in Johannesburg, South Africa. While urban sanitation and waste water treatment remain major challenges, new approaches to rural sanitation emerging from Bangladesh are being adopted by other countries with sanitation crises.

In recent years one of the most exciting developments in sanitation provision has been the emergence of the community-led total sanitation approach in Bangladesh – pioneered by various local non-governmental organisations (NGOs), guided by the international NGO WaterAid and supported by the UK Department for International Development (DFID). This model challenges established approaches to sanitation by promoting changes in hygiene behaviour at the community rather than the household level, achieving total sanitation (with an end to open defecation) and underscoring that direct subsidies are neither needed nor desirable. Progress in Bangladesh has been dramatic. The government has set a target of total sanitation by 2010, well in advance of the MDG target.

The community-led total sanitation approach involves numerous innovative mechanisms. In many traditional rural sanitation programmes, subsidies are provided for hardware and progress is measured by the number of new latrines. The community-led approach advocates that subsidies for hardware costs be provided by communities, made possible by the low costs involved. Programme implementation relies on participatory rural appraisal principles of community mobilisation and empowerment. However, recent research has found that the approach may have problems with sustainability and targeting of poor people.

India recently adopted aspects of the community-led total sanitation approach. Encouraged by promising pilot work in the state of Maharashtra, in June 2003 the Indian government announced the Nirmal Gram Puraskar scheme, which provides fiscal rewards for villages that become free of open defecation (in other words, a reward for sanitation outcomes) rather than subsidies for the construction of toilets (inputs). Furthermore, in November 2003 the Indian government announced it goal of moving towards a no-subsidy regime in sanitation.

Rehabilitating water infrastructure and reforming land tenure in Cambodia

The Prey Nup Project, supported by the French Development Agency (AFD), aims to reduce poverty through water infrastructure improvements and land tenure reform. When the project started in 1999, its contractual documents set five complementary objectives:

i) Rehabilitating hydraulic infrastructure to protect 11 000 hectares of rice-growing land.

ii) Transferring polder management to a polder users community to make infrastructure management more efficient and sustainable and lower recurrent costs.

iii) Establishing a polder land map to calculate user fees, and preparing for the regularisation of polder land ownership rights.

iv) Establishing agricultural production support mechanisms.

v) Establishing a sustainable rural credit service.

The project moved from experimental to pilot status after management of the hydro-agricultural scheme was transferred to users and the land registration method was established. Both of these local activities took on larger resonance because they were used as input for national policies being elaborated. These were not explicit goals when the project was launched.

The project has resulted in physical upgrading of infrastructure, including dikes, hydraulic works, and canals. In addition, topographical markers have been installed, and a detailed topographic survey of the six polders is available. The project's micro-credit component has been implemented, with a sustainable micro-credit institution (EMT) established in the region that offers solidarity and personal loans to village households. By late 2000 about 6 000 households has taken solidarity loans, and the outstanding balance totalled 1.35 billion riels.

The project's land tenure regularisation component is under way; nearly all cultivatable areas have been publicly registered, and 95% of the plots have been titled and received property deeds. The agricultural development component has replanted 1 500 hectares (about half of the total), resulting in higher average rice yields. In addition, cultivable areas have been extended and crops diversified, and actions have been taken to improve animals' health. Finally, management has been transferred to a representative Prey Nup polder users community with nearly 15 000 members. The community has been legally recognised by the supervising Ministry of Water Resources and Meteorology, and has specific tools and procedures for water management. A participatory maintenance plan has been prepared and discussed.

Using smart subsidies under public-private partnerships to expand power access in Tajikistan

Tajikistan's Pamir Private Power Project was developed by the International Finance Corporation (IFC), International Development Association (IDA) and Aga Khan Fund for

Economic Development (AKFED), with financial support from Switzerland's State Secretariat for Economic Affairs (Seco). The project aims to complete and rehabilitate the Pamir I hydropower plant, the power transmission system and management of the power utility in the Gorno-Badakshan oblast. Activities under the project are covered by a 25-year public-private concession agreement between the government and Pamir Energy. This company is owned by AKFED (70%) and IFC (30%), which will finance the largest portion of the project (USD 16.4 million). Additional financing will be provided through a USD 10 million IDA loan to the government.

Due to widespread poverty in the area, for the first 10 years of the project, consumers will receive subsidies for a baseline of services – that is, a lifeline tariff block – allowing lower levels and slower increases in tariffs. (Increases are needed for long-term cost recovery.) The subsidies will be financed by a USD 5 million grant from Seco and a spread resulting from on-lending of the IDA loan to Pamir Energy at a higher interest rate. These subsidies are considered "smart" because they are targeted, do not disrupt market forces and have a limited lifespan. In addition, steps have been taken to achieve longer-term affordability.

The concession agreement became effective in December 2002 and has operated successfully since then. The public-private partnership has ensured effective and efficient electricity provision, while the smart subsidies have ensured that basic services are affordable. In addition, the project's gradual tariff increases will support long-term cost recovery and enhance the project's sustainability.

Principle 3: Improve management of infrastructure investment, to achieve sustainable outcomes

Ensuring effective road maintenance in Cameroon

Implementation of the second Cameroon Road Maintenance Programme, jointly financed by the European Commission (EUR 54 million) and the Cameroon Road Fund (EUR 24 million), started in 2000 with the goal of supporting the government's sector reforms – particularly efforts to establish a sustainable, effective maintenance system for the priority road network. The four-year programme provided annual funding for routine maintenance on about 5 000 kilometres and periodic maintenance on 1 500 kilometres. It also helped build the capacity of the key players in the maintenance system, notably the Ministry of Public Works for programming and organisation, local consulting companies for designing and supervising works, small and medium-sized local contracting enterprises for executing works and road users for enhanced participation in road management. The programme was managed with the assistance of consultants.

A mid-term review in 2003 highlighted the sound management of the road fund (particularly its efficiency in paying contractors) but noted that its financing was still dependent on an annual budget allocation from the Ministry of Finance – an approach that did not ensure sustainability – and that the funding provided was below needs. Training was assessed as having clear positive impacts but needed to be sustained over a long period, and support given to establishing professional associations for local contractors and consultants, as well as internal structures for training within these associations and within government.

Promoting effective regulation to develop urban water kiosks in Zambia

In Zambia the German Agency for Technical Cooperation (GTZ) and KfW Development Bank have been helping reform the water sector and invest in local distribution points –

so-called water kiosks – since 1994. This support is designed to increase water supplies for the rural poor and residents of urban slums. The reform is being promoted as part of the EU Water Initiative and by the World Bank and other partners and donors, and focuses on regulating, decentralising and professionalising supply services. Increased financial sustainability in the water sector, coupled with more balanced rates and conditions, will help the poor gain access to water at stable, affordable rates.

Ten new utility companies have taken over and in some cases restored ramshackle facilities. Decisions in the water sector are no longer dominated by large users. Instead, a new, independent regulatory authority has given poor people a voice and strong lobby. Water watch groups arbitrate disputes between consumers and utilities. And the dedicated Devolution Trust Fund (DTF) provides investments that give poor users low-cost access to water. As a result of the 80 urban water kiosks set up in two provinces with support from GTZ and KfW Development Bank, more than 100 000 slum residents now have reliable access to water.

Commercialising the water supply does not, however, automatically benefit the poor. The pro-poor aspect must be given high priority even at the planning and implementation stages of reform. This requires strong political backing to ensure that reform remains on track. In an urban context special attention must be paid to the peripheries and slums where the poor live. Strong, autonomous regulation and specific pro-poor instruments such as the DTF are required to narrow service gaps, including a dedicated information system tailored to the water challenge that is user friendly and easy to maintain over the long term.

Forming a public-private partnership to support investment in El Salvador

The Government of El Salvador has chosen the gulf of Fonseca in La Union Province – a traditionally poor area where poverty grew even worse during the civil war of the 1980s – to develop international port facilities and complement the fully used Port of Acajutla. The project includes constructing access roads and general and bulk cargo, container and passenger quays, procuring cranes and tug boats, and dredging for the port access channel. The proposed port will also support the Puebla Panama Plan – which promotes regional integration in Central America – by connecting to the ports of Cortez (Honduras) and Barrios (Guatemala) for cargo trans-shipments between the Gulf of Mexico and the Pacific Ocean, given the high traffic load in the Panama Canal.

Drawing on a feasibility study by the Japan International Cooperation Agency (JICA), the project is designed as a public-private partnership. Components considered to have a public good nature (quay walls and cranes, the terminal area, maintenance of the navigation channel and basin and pilot service, and basic utilities needed to run port activities) will be provided by the public sector, while the private terminal operator must provide all other equipment. The private operator will be responsible for daily and minor maintenance of the terminal facilities, while the implementing agency (Comision Ejecutiva Portuaria Autonoma, or CEPA) will be responsible for major repairs (expect damage caused by the operator or other users).

During the project appraisal, CEPA and JBIC agreed to introduce terminal leasing (concession) contracts. It was also discovered that CEPA did not have any experience with concession contract and container terminal operation, so JBIC agreed to help select and negotiate a contract with the future port operator by building CEPA's capacity. That support will include study and advisory works to identify issues involved with port operations in

Latin America, identify issues for ports operated under concessions and for prospective operators, and provide CEPA with recommendations on the contracting process, the draft contract document and the final contract document.

Organising a co-operative network for rural electrification in Bangladesh

Bangladesh's Rural Electrification Programme supports the strategy established by the Rural Electrification Board, which is to provide electricity through a network of member-owned co-operatives known as *palli bidyut samities* (PBSs). The US Agency for International Development (USAID) provided technical assistance on organising beneficiaries in co-operatives and managing them, based on US experience with rural electrification. Other donors (15 in all) – including UK Department for International Development (DFID), the Japan Bank for International Cooperation (JBIC), Canadian International Development Agency (CIDA), International Development Association (IDA) and Asian Development Bank (ADB) – financed the investment component. The first PBS was organised north of Dhaka in 1978, and energised in June 1980.

The programme makes effective use of a participatory approach to organising and managing the electrification co-operatives, including:

i) Extensive training. The Rural Electrification Board provided extensive training for its staff and those of PBSs on managerial and technical issues, and for residents on basic electricity knowledge.

ii) Performance contests. Performance target agreements are used to assess individual PBSs. These assessments provide bonuses as well as penalties, and are designed to promote competition among the PBSs and improve their performance.

iii) Internal checks. The Rural Electrification Board and PBSs are carefully organised to avoid centralised authority and prevent unfair practices. The performance of general managers is checked by the board of directors, consisting of member representatives, and the institutional structure is designed to check and balance internal works.

iv) Extensive member support. PBS offices offer fast and free technical repair service so that members do not have to bribe anyone for such support.

v) Well-designed tariff collection procedures. To prevent dishonesty, different officers are responsible for meter reading, tariff calculation, bill delivery and book-keeping. In addition, officers check meters when delivering bills. Tariffs are collected through bank transactions. Meter readers are employed under annual contracts and rotated among service areas every four months.

vi) Village and female advisers. Each PBS appoints one village adviser and two or three female advisers to provide information on operations, PBS policies and basic education on electrification.

vii) Group responsibility. PBS members are all split into smaller units, and each group is collectively responsible for honouring the duties of its members.

Cleaning river basins, treating waste water and improving drinking water in Morocco

River pollution imposes high economic costs in Morocco, estimated at 1.2% of GDP over the long term (by 2020). Such pollution leads to abnormal rates of water-related diseases and damage to ground water, agricultural output, fisheries and irrigation – all of which are especially harmful to the poor.

In the mid-1990s Moroccan authorities committed to significant investments in urban and rural infrastructure. Reforms related to drinking water and sanitation included a water bill promoting the "polluter pays" principle and the launch of an integrated water resources management (IWRM) system, facilitating decentralisation.

In recent years the high costs of investment and maintenance for waste-water treatment have led to major increases in drinking water tariffs, rising 50% in 2001 and 40% in 2002, with continued increases needed through at least 2007. During 2004-09 a project to clean the Sebou Basin, in Fez, is designed to affect 265 000 people – aiming to improve livelihoods by rehabilitating waste-water networks and creating a waste-water treatment plant – at a cost of more than EUR 80 million. To facilitate an optimal operating system for waste water, local authorities, in line with national policy, have transferred their responsibilities to a public company, Régie Autonome de Distribution et d'Electricité de Fès (RADEEF), responsible for the project. At the same time, the central government has had to subsidise RADEEF for investment financing.

The World Bank, French Development Agency and European Investment Bank have supported the project by financing investments and backing its inclusion in a coherent institutional framework. The project is expected to contribute to MDG 7, reduce water-related diseases, increase drinking water quality, develop irrigated agricultural downstream and improve the technical processes of polluting companies in order to develop exportable products.

Principle 4: Increase infrastructure financing and use all financial resources efficiently

Providing a guarantee for increased telecommunications investments in Uganda

In the late 1990s the Swedish International Development Agency (Sida) provided MTN Uganda with a guarantee for a series of promissory notes issued on the local capital market. The funds were raised to expand the telephone network, with a focus on rural areas. The guarantee – which expires at the end of 2005 – reduced commercial risk and enabled MTN to find buyers and issue securities with longer durations than would otherwise be possible on the Ugandan capital market. The guarantee did not cover interest payments and absolved Sida of political risk (for example, through government intervention). Such risk was borne by the owners of the bonds.

MTN Uganda is a private company owned by MTN South Africa, Telia Overseas of Sweden and Tristar of Rwanda. In 1998 it began extending Uganda's telephone network and supplying large villages with pay phones. The goal was to install, within five years, nearly 90 000 telephone lines and 2 000 pay phones. (The company's licence stipulates that Uganda's 37 district capitals be served and that there be at least one pay phone in each of the country's 165 municipalities.) With the guarantee provided by Sida – which had a ceiling of USD 10.4 million – the company sought to mobilise USD 9-10.5 million.

The first securities issued by the company were private placements. Subsequent emissions were quoted on Uganda's stock exchange, enabling the notes to be traded in a secondary market. In 2000, for example, MTN Uganda listed a USD 8 million (denominated in local currency) floating rate note on the exchange. Thus Sida's guarantee also contributed to local capital market development.

The Emerging Africa Infrastructure Fund – drawing on a range of financing sources to develop private infrastructure

Although the public sector will remain the major provider of infrastructure services in most developing countries, many sub-Saharan countries are seeking to increase private investment. The Emerging Africa Infrastructure Fund is a public-private partnership – drawing on official aid, development finance and commercial debt – that provides long-term financing for private infrastructure. The fund represents a new financing approach for the region, combining public and private funding with commercial and development principles in support of sustainable development and economic growth. The fund was initiated by the Private Infrastructure Development Group (PIDG) – a consortium of Dutch, Swedish, Swiss and UK bilateral donors managed by Standard Fund Managers (Africa) Limited – and, following a competitive tender to the private sector, launched in January 2002.

All the fund's products are offered on commercial terms, based on detailed assessments of borrowers' credit and risk profiles. The fund's structure has reduced lending risks, enabling it to offer competitive long-term (15-year) loans to infrastructure companies across sub-Saharan Africa. Most loans are denominated in US dollars, though the fund may also provide local banks with guarantees to facilitate local currency lending. Through the PIDG Trust, the UK Department for International Development (DFID), Swedish International Development Agency (Sida), Directorate-General for International Cooperation, Netherlands Ministry of Foreign Affairs (DGIS) and Swiss State Secretariat for Economic Affairs (Seco) have jointly committed USD 100 million to the fund to use as equity. The balance of the fund's capital comprises USD 85 million in subordinated debt from development finance institutions (Netherlands Development Finance Company, Development Bank of Southern Africa, Deutsche Investitions und Entwicklungsgesellschaft) and USD 120 million in senior debt from commercial banks (Barclays Bank, Standard Bank Group). The fund considers loans in 44 countries in the region and is focused on commercially viable companies that have a positive development impact on their host economies.

Other PIDG activities include a project development facility (DevCo) that advises governments on increasing private investment in infrastructure, a facility that provides guarantees to encourage local currency funding of such investment (GuarantCo), a project development company (InfraCo) and a facility that provides technical assistance to build local capacity (TAF).

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- DevCo Advisory – a project development facility run by the International Finance Corporation (IFC) that advises governments on transactions involving private ownership and investment in infrastructure, *www.ifc.org/ifcext/psa.nsf/Content/DevCo*.
- Emerging Africa Infrastructure Fund (EAIF) – provides long-term lending on commercial terms to private infrastructure projects in sub-Saharan Africa, http://www.emergingafricafund.com.
- GuarantCo – provides guarantees to encourage local currency funding of infrastructure investment by municipalities and domestic financial institutions. Contact: sjansson@guarantco.com
- InfraCo – project development company that puts together infrastructure projects to the stage of being financeable, then tenders them to private investors. Contact: j-hodges@dfid.gov.uk.
- Local Capacity Building Technical Assistance Facility (TAF) – provides grants for local capacity building alongside projects funded by PIDG facilities. Contact: jflora@worldbank.org.

Other international programmes that promote private participation in infrastructure include:

- Public-Private Infrastructure Advisory Facility (PPIAF) – a multi-donor technical assistance facility designed to help developing countries improve the quality of their infrastructure through private sector involvement; it provides advice on the enabling environment (policies, laws, regulations, institutions) for private participation, *www.ppiaf.org*.
- Global Partnership for Output Based Aid (GPOBA) – supports the design and piloting of performance-based approaches for targeting public funding to the delivery of basic services to the poorest, *www.gpoba.org*.
- Community-Led Infrastructure Finance Facility (CLIFF) – being piloted in India; provides bridge finance and technical assistance to community-led urban regeneration projects, *www.theinclusivecity.org/cliff.htm*.
- Slum Upgrading Facility (SUF) – still under development, this programme will provide technical assistance, capacity building and bridge finance to municipalities and local NGOs and community-based organisations to design projects for financing by public, private or donor sources. The DFID and Sida are currently funding a detailed project design phase. Contact: hensby@dfid.gov.uk.

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More documents on aid effectiveness, harmonisation and alignment can be found at *www.aidharmonisation.org* and *www.oecd.org/department/0,2688,en_2649_3236398_1_1_1_1_1,00.html*.

Information and indicators on infrastructure, pro-poor growth and poverty reduction.

Several international initiatives promote and provide data, indicators and other information on infrastructure, pro-poor growth and poverty reduction:

- *Country Analytic Work Web site* – facilitates co-ordination and co operation between countries and donors, and provides a document library, contact points and examples of best practices for analytic work, *www.countryanalyticwork.net*.
- *InfoDev* – global grant programme, managed by the World Bank, that promotes innovative projects using ICT for pro-poor growth, *www.infodev.org*.
- *Partnership in Statistics for Development in the 21st Century* (PARIS21) – partnership of policy makers, analysts and statisticians that catalyses the production of high-quality statistics and evidence-based policy making and monitoring, *http://paris21.org*.
- *Poverty and Social Impact Analysis* – assesses the impacts of policy reforms on different stakeholders, with a focus on the poor and vulnerable, *http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPOVERTY/EXTPSIA/0,,menuPK:490139~pagePK:149018~piPK:149093~theSitePK:490130,00.html*.
- *Transport Results Initiative* – World Bank effort to assess the measures and indicators used in the transport sector, *http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTTRANSPORT/EXTTRM/0,,contentMDK:20283374~pagePK:210058~piPK:210062~theSitePK:515307,00.html*.

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Executive Summary

The Paris Declaration on Aid Effectiveness stresses the importance of results-oriented frameworks, harmonisation and alignment to improve aid effectiveness and to assure better pro-poor outcomes. *Ex ante* Poverty impact assessment (PIA) can inform donors and partner countries of the expected intended and unintended consequences of donor interventions.

Ex ante PIA in the context of national development strategies and the Millennium Development Goals (MDGs) helps donors and their partners to understand and maximise the poverty reducing impacts of their interventions responding both to the need for accountability to their constituencies and the importance of transparent evidence-based decision making. The *ex ante* PIA can guide and assist in modifying the design of interventions to improve the pro-poor impacts and help to identify key areas for monitoring and evaluation. It can identify interventions with high impact on poverty reduction and pro-poor growth as well as mitigating measures to protect the poor. A broad application of *ex ante* PIA could also provide a potential basis for a harmonised reporting system on poverty impacts. Poverty in the *ex ante* PIA is defined as a deprivation of multiple capabilities: economic, human, political, socio-cultural, and protective (OECD, 2001).

This methodology has been designed and tested by a group of DAC POVNET members with a key objective being to harmonise approaches. Consistent with the Paris Declaration, this objective seeks to avoid both incoherent assessments created by competing methods and the often conflicting demands placed on partner governments. The value added of *ex ante* PIA lies in providing a relatively simple but effective and flexible methodology, which can draw on more intensive data collection and analysis where these are available, but also provides useful guidance in their absence.

Ex ante analysis of the multi-dimensional impacts of policy and investment decisions on poverty reduction is a highly complex task, built on possibly contentious assumptions and demanding data requirements. The *ex ante* PIA outlined in this document is based on a simple framework and associated assessment procedures which build on existing methodologies and definitions, particularly the Poverty and Social Impact Analysis (PSIA) approach, the OECD/DAC capabilities framework, the Asian Development Bank's (ADB) work on poverty impact and the Sustainable Livelihoods Approach.

The relationship between PIA and poverty and social impact analysis (PSIA) can best be characterised by understanding PIA as a light version of PSIA. PIA is less demanding in terms of data, time, personnel and financial resources than PSIA, but still provides a sound basis for partner countries and donors to transparently assess interventions with respect to their poverty outcomes and impacts and to identify further data and analytic requirements. *Ex ante* PIA complements rather than replaces other assessments during the appraisal process, such as for example logframe analysis, cost-benefit/cost-effectiveness analysis or environmental assessments.

The approach sets out a structured presentation of relevant information (and identifies information gaps) by providing an overview using three matrices. These matrices help analysts and decision makers to quickly identify key aspects and risks with respect to pro-poor impacts of the proposed intervention. They comprise guidelines for types of information to be collected. For each cell of the matrices a rough quantification of its relevance needs to be assessed. More detailed information is provided in texts below the matrices and in a summary assessment. The matrices comprise:

i) Transmission channels and outcomes for target groups.

ii) Outcomes by selected stakeholder groups.

iii) Aggregate impacts in terms of the MDGs and other strategic goals considered important by partner countries and donors.

The methodology can be applied to most modalities of donor support: projects, programmes, sector-wide interventions and policy reforms. It is not meaningful to conduct the *ex ante* PIA to assess budget support. Nor is it recommended to use the approach for identifying poverty impacts of very small projects.

Analytical rigour can be balanced with resource constraints in a cost-effective way depending on the scale and significance of the proposed intervention. *Ex ante* PIA is guided by the principle that it is more important to be roughly right than precisely wrong about the potential impacts of interventions on the well-being of people. Should some agencies require more detailed analysis, the complexity of this framework can easily be scaled up to meet their needs or, for example, a full-fledged poverty and social impact analysis (PSIA) can be conducted. *Ex ante* PIA may serve as a framework for monitoring impact hypotheses during implementation and as an input for *ex post* evaluation exercises.

The broad implementation of *ex ante* PIA will be promoted in an initial phase starting in 2006 involving activities such as a series of hands-on pilot exercises conducted by the agencies involved in the design of the approach. A guidance manual/handbook will be completed and distributed *via* the Internet and on CD-ROM. Training programmes to strengthen capacities of both donors and partners are planned.

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PART V

Chapter 23

The Rationale for *ex ante* Poverty Impact Assessment

What is *ex ante* PIA

Ex ante Poverty impact assessment is a process enabling donors to inform themselves, and their partner countries, of the expected intended and unintended consequences of donor interventions. It also provides an assessment of the well-being of different social groups, focusing on poor and vulnerable people. A multi-dimensional approach to poverty is taken as defined by the OECD/DAC Guidelines on *Poverty Reduction* and engrained in the MDGs. The actual application process may vary from a quick review to a more comprehensive analysis.

The rationale for a harmonised approach to *ex ante* PIA

The Paris Declaration stresses that partner countries and donors are mutually accountable for development results. Monitoring and evaluating the progress of country-led strategic development goals (such as MDGs and pro-poor growth) is mainly the responsibility of partner government. Together with their partners, donors strive to understand and maximise the poverty reducing impacts of their interventions in order to to accelerate pro-poor growth and to assure better pro-poor outcomes.

For this reason, a methodology for *ex ante* PIA has been designed by a POVNET Task Team.[1] The primary consideration has been the need to seek harmonisation between donor approaches to avoid both the confusion created by competing methods and the often conflicting demands placed on partner governments.

The leadership taken by donors in this area should be seen as a reflection of their concern to demonstrate accountability and transparency: accountability both to their own constituencies in terms of exercising due diligence over the resources that they disburse and to partner countries, in terms of accepting joint responsibility for agreed strategic decisions. A harmonised PIA provides a basis for future joint assessments with partner governments and between donors.

The main benefits of an *ex ante* PIA

The *ex ante* PIA provides an opportunity to clearly expose the reasons for donor actions – for example, preference of one intervention over another – and allows partners and other stakeholders to examine the assumptions, logic and evidence underlying resource allocation decisions. Interventions with high impact on poverty reduction and pro-poor growth can thus be identified.

In particular, for a given intervention, *ex ante* PIA provides:

i) Estimated qualitative and/or quantitative outcomes for the target population taking into account the multi-dimensionality of poverty and an assessment of the intervention's broader implications for a range of stakeholders in terms of the OECD/DAC capabilities framework.

ii) An estimation of the potential impact on the MDGs and, if desired, other strategic goals (*e.g.* governance, security).

iii) An understanding of the importance and inter-relationship of individual transmission channels through which changes are transmitted to the stakeholders.

iv) An assessment of the relation of the intervention to national development strategy/ poverty reduction strategy.

v) An assessment of key assumptions and identification of potential risks; at the same time an assessment of the reliability of data/information used in the exercise and identification of key knowledge gaps.

vi) Recommendations for decision makers on: how the intervention might be improved to increase the pro-poor impact; on appropriate monitoring procedures and whether or not to support the intervention.

vii) A framework for monitoring impact hypotheses during implementation and as an input for *ex post* evaluation exercises.

As *ex ante* PIA documents the assumptions implicit in the intervention design and the causal pathways between intervention outputs and intended outcomes, it can provide a rational basis on how to design monitoring systems which will gather the data required to test the assumptions and to investigate the operation of the proposed causal pathways. Such an approach can address the familiar "missing middle" issue – the need for monitoring to focus not only on input and outcome indicators but to track the processes whereby activities result in the achievement of identified outcomes.

Due to its simply structured matrices, a broad application of *ex ante* PIA could also provide a potential basis for a harmonised reporting system on poverty impacts.

Ex ante PIA in relation to other assessment methods

Ex ante PIA as discussed here can be seen as an extension of the logframe/causal chain analysis that strengthens the focus on direct and indirect poverty impacts for a wide range of stakeholders.

The approach has a number of sources, in particular ADB work on poverty impact (Fujimura and Weiss, 2000), the PSIA approach (World Bank, 2003), the OECD/DAC capabilities framework (OECD, 2001) and the Sustainable Livelihoods Approach (DFID, 1999). The PIA outlined here does not replace any of these approaches and frameworks, but draws heavily from their terminology and cognition as they are already well established and each of them covers aspects important for PIA. The application of the terminology used in *ex ante* PIA is thus defined to ensure transparency and comparability between different donor agencies and their partners and to ensure a widespread recognition and acceptance of the approach.

The value added of *ex ante* PIA lies in providing a relatively simple but effective and flexible methodology, which can draw on more intensive data collection and analysis where these are available, but also provides useful guidance in their absence.

The relationship between PIA and PSIA can best be characterised by understanding PIA as a light version of PSIA. PIA is less demanding in terms of data, time, personnel and financial resources than PSIA, but still provides a sound basis for partner countries and donors to transparently assess interventions with respect to their poverty outcomes and impacts. PIA also identifies information gaps and the need to conduct further data collection and analysis, including a full PSIA.

PIA complements rather than replaces other assessments during the appraisal process such as, for example, log frame analysis, cost-benefit/cost effectiveness analysis, and environmental assessments.

The level of application

There is a broad consensus within the donor community that aid effectiveness is greatly enhanced if provided in support of country-owned strategies. Such an approach entails a focus on policy dialogue, national planning frameworks, especially poverty reduction strategies (PRS), and programme support, for example in sector-wide approaches (SWAps).

There is a move towards programmatic lending, such as SWAps, basket funding and budget support. However, there is no suggestion that the existing range of aid instruments will be radically restructured in the short term. Projects will remain an important component of the aid portfolio, even if seen as having a much greater potential impact when embedded within a programme or national development strategy (OECD, 2003). Capturing such diversity in aid delivery is difficult to reconcile with the aim of developing "a unified simple methodology", which was the primary objective of the PIA.

The *ex ante* PIA approach described here can be applied to most modalities of donor support – projects, programmes, sector-wide interventions and policy reforms – though the frequency of application, level of detail and allocated resources would vary. However, PIA does not work for budget support, since such assistance can be used to fund any part of the partner country's budget. In this case, a PIA would have to address the relevant policy reforms. Neither is it recommended to use the approach for identifying poverty impacts of very modest projects.

Resource implications

There would be little point in recommending elaborate procedures which would entail an allocation of resources far in excess of those that agencies are prepared to consider. On the other hand, partner country stakeholders should feel confident that decisions which have serious consequences for their populations are being taken on the basis of sound analysis, and that the analysis is presented in a format which they can easily understand. Therefore, it cannot be assumed that a "quick and dirty" approach will ensure cost-effectiveness.

The level of detail in the proposed approach inevitably represents a compromise between comprehensive analysis and a realistic attitude to resource implications. In general, the approach is guided by the principle that it is more important to be roughly right than precisely wrong about the potential impacts of interventions on the well-being of people.

The resources allocated to do the assessment can be largely decided by the implementing agency depending on the scale and significance of the proposed intervention.

A minimal exercise relying only on available data can be undertaken by a single knowledgeable consultant in one or two days. A number of examples developed during the preparation of the methodology confirmed this. However, such a limited exercise has a primarily descriptive role and does not reflect the intended iterative and interactive process.

Typically, an *ex ante* PIA relies on the abilities of a small team of competent analysts, working during the preparation of an intervention in collaboration with colleagues from partner countries and making the best use of existing knowledge to address a specific intervention within a given context.

For major interventions where significant effects on the poor and vulnerable are expected, it is important to have more substantial data and reliable analysis about their potential impacts and risks. The approach can then be enhanced by using a range of qualitative and quantitative methods to address crucial knowledge gaps. The resource cost can then be substantial. Alternatively and/or additionally a full PSIA could be carried out. The information gained and information gaps identified through the *ex ante* PIA provide a good starting point.

Implementation of *ex ante* PIA

Ex ante PIA is intended to become an integral part of the overall appraisal process and can be used at various points in that process, either in a descriptive manner, for example to provide a basis for discussion at the initial identification phase, or more analytically, for example, to provide quantified estimates (or at least detailed descriptions) of the primary expected outcomes and impacts. Best results can be achieved if PIA is used iteratively throughout the preparation process allowing it to influence the design of the intervention.

Implementation of the *ex ante* PIA typically involves the use of data and analyses provided by a wide range of different tools and methodologies (both qualitative and quantitative) from different disciplines depending on the specific situation, data availability, type of intervention and main transmission channels.

The methodology is intended for initial use by donor agency staff. It is important that every effort is made to draw on local sources, including key stakeholders. To render communicable and operational results and to promote the widespread use of PIA, it should be done in close co-operation with the partner countries. In the medium term it is expected that partner countries would demand the application of PIA to improve their evidence-based policy making process and to increase accountability towards their own domestic constituencies.

The analytical framework for *ex ante* PIA

Ex ante analysis of the multi-dimensional impacts of policy and investment decisions on poverty reduction is a highly complex task, built on possibly contentious assumptions and with demanding data requirements. The *ex ante* PIA that was developed by a POVNET Task Team is based on a simple framework and associated assessment procedures, building on existing methodologies and definitions.

It is based on the following key elements:

i) The main entry point is the national development strategy; in particular the poverty reduction strategy and its associated sector strategies. These strategies determine the required interventions (policies, programmes and projects).

ii) In turn, the nature of these interventions determines the main transmission channels through which they achieve their intended and unintended outcomes and impacts. The main transmission channels are assets, transfers and taxes, access to goods and services, prices, employment and authority.[2]

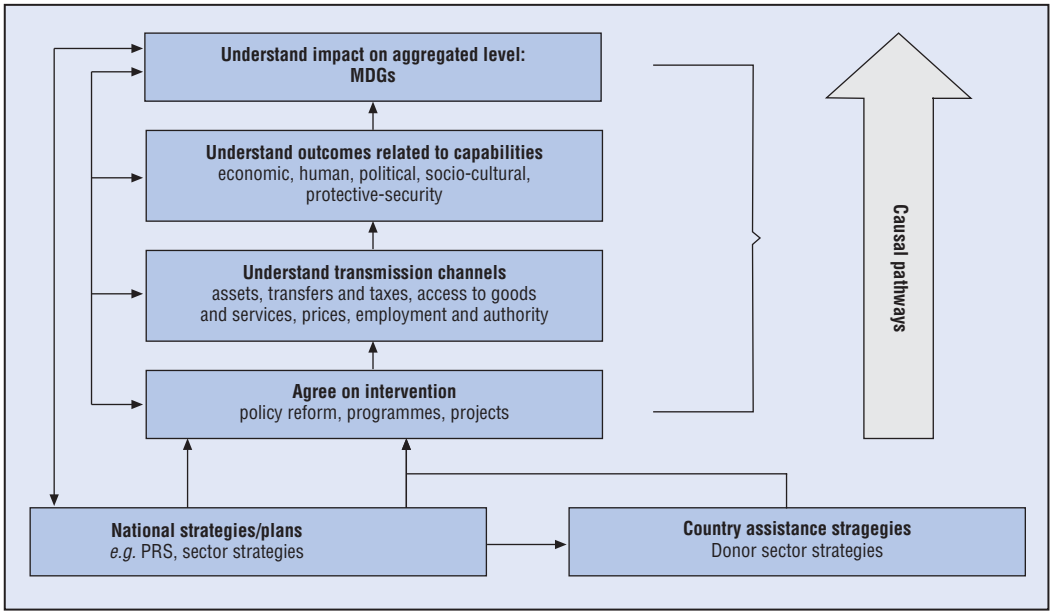
iii) Planned interventions are thus linked to expected outcomes and impacts through a better understanding of transmission channels, risks and assumptions.

iv) The changes that are transmitted through these channels affect the socio-economic, political, legal, cultural and security capabilities required for people to reduce their poverty. An assessment of outcomes on the basis of causal chain analysis with respect to the multiple dimensions of poverty is thus necessary.

v) In this context, it needs to be recognised that the circumstances and needs of poor people and the associated potential for differential outcomes, for example as between men and women will differ.

vi) With enhanced capabilities people will be able to improve their standards of living individually and collectively, short term and long term. This, in turn, will result in improvements in MDGs and accelerated pro-poor growth or other goals prioritised by partner countries and/or donors (*e.g.* governance, global environmental security).

Figure 23.1. **Analytical framework of the *ex ante* PIA**



In the following section, the steps for conducting an *ex ante* PIA are set out. Each step involves the statement of assumptions, description of causal pathways, identification of risks and an assessment of the various sources of information used in the analysis. Each builds on the findings of the previous step; and there will be a degree of iteration between the steps. Together, they can be considered as the technical background for the final stage in the assessment process: the development of a summary overall assessment of the intervention. This will include recommendations as to whether or not it should be supported; how it might be improved; and appropriate monitoring procedures.

Ex ante PIA is based on a series of simple matrices, intended to structure the analysis to the extent that a range of key issues are addressed and that comparability between interventions is possible. Further elaboration of these tables is possible where more detailed analysis is warranted and necessary resources available.

Notes

1. In addition to regular working meetings of donor representatives, one meeting was held with representatives from various partner countries (Bangladesh, Malawi, Sri Lanka, Uganda and Viet Nam).
2. These transmission channels are based on those adopted in the poverty and social impact analysis (PSIA) methodology developed by the World Bank, DFID and others.

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PART V

Chapter 24

How to Do an *ex ante* PIA

The steps in conducting an *ex ante* PIA are described in this section in very general terms. More detailed instructions on how to use the approach are made available in a manual "Guidance on Undertaking an *ex ante* Poverty Impact Assessment" (OECD, 2005), which is work in progress.

Relevance of the intervention for the national poverty reduction strategy

The initial task of the assessment is to ascertain the circumstances within which the proposed intervention is to be introduced. The level of detail required depends on the magnitude of the intervention and whether the PIA is undertaken as one component of a detailed proposal, or as a stand alone activity. The objective is to briefly describe, with supporting quantitative data where available:

i) The overall poverty situation in the country, with a particular focus on sectors, regions or population groups of particular relevance.

ii) Existing national poverty reduction strategies, or similar plans, highlighting the priority given to areas addressed by the intervention and any relevant joint programming discussions/decisions/documents involving the donor and development partner(s).

iii) The key objectives of the intervention and a brief outline of what is proposed, including the aid instrument(s) to be implemented (support for policy reform, SWAp, project, etc.) and the *main* transmission channel they are expected to use.

Identification of transmission channels and assessment of target group outcomes

Transmission channels

The assessment next considers the potential outcomes (positive or negative) of the intervention for the identified target groups. The links between intervention and outcomes are described in terms of six (interacting) transmission channels which are outlined below. They are based on the transmission channels used in PSIA.

Prices

This channel focuses on changes in consumption and production prices, as well as wages, salaries,[1] and interest rates.

Employment

All aspects of formal and "informal" employment (including self-employment and employment in household enterprises)[2] may be discussed under this heading. Changes in either employment levels or the associated wage rate (under prices) will impact on the cash or kind income flowing to households and individuals. Other aspects of employment, for example security, status and work loads, may also be considered here. Gender issues will be of considerable importance.

Taxes and transfers

This channel covers public and private transfers, and taxation. A primary concern includes an examination of the impact of targeted transfers to poor households, either by means of subsidies or direct payments in cash, vouchers or kind. This may be associated with attempts to mitigate the negative impacts of an intervention on the poor. It can also be used to consider tax payments associated, for example, with the introduction of a compulsory levy or social insurance scheme, or the degree of progressiveness of a tax. Private transfers, such as urban/rural, and from overseas workers are major sources of income transfers in many countries.

Access

In most countries, PRSs have prioritised increased expenditure on health, education, water, sanitation, micro-finance, roads and infrastructure. The associated projects and programmes can be seen in terms of providing or enhancing the access of the poor to public and private goods and services. This may involve the actual removal of barriers, for example physical or financial, or improvements to the quality of the goods and services available.

Authority

The term "authority" is used to address issues relating to formal and informal institutions, organisations, relationships and power structures (DFID and World Bank, 2005). It includes, for example, laws governing land rights, civil service codes of conduct and behavioural norms in specific population groups. This channel examines the effects on poor households of changes in political, legal, social or cultural factors. It is seen as particularly important in addressing issues of empowerment, equity and inclusion. Implications for changes in the behaviour of economic agents may also have considerable consequences for growth and distribution.

Assets

The ability either to cope with adversity or take advantage of opportunities is seen as highly correlated with the extent to which individuals or households are in possession of (or have access to) assets (Siegel, 2005). The Sustainable Livelihood Approach used here differentiates between five assets:

i) *Physical* (buildings, tools, equipment, livestock, access to infrastructure, etc.).

ii) *Natural* (land, water, forest, natural resources, etc.).

iii) *Human* (labour supply, education, skills, knowledge, health, nutritional status, etc.).

iv) *Social* (networks, groups, relationships).

v) *Financial* (savings, access to credit, pension or similar guaranteed income flow, etc.).

Interventions which tend to increase or decrease the value of, and returns to, any of these assets will change the livelihood options of poor households in ways which may impact on their welfare. Changes in asset holdings will also have consequences in terms of the vulnerability of households to external shocks. For example, increasing the area of irrigated, cultivable land or construction of weather-proof crop storage buildings will tend to improve food security. Training and education will help improve the quality of human assets and the ability of people to make use of opportunities and respond to challenges.

Transmission channels and outcomes for target groups

The matrix associated with this step (shown in simplified form below, excluding the detailed rows for text) is intended to allow a detailed examination of the intervention in terms of:

i) The primary transmission channels used for implementation.

ii) Details, assumptions and risks associated with these transmission channels.

iii) The anticipated short-run outcomes associated with all transmission channels.

iv) The probable medium-term outcomes associated with all transmission channels.

v) Assessment of critical risks and mitigation associated with each outcome.

vi) Sources of information that have been used or consulted.

Note that step one identifies the primary channels used by the intervention. However, these will typically stimulate others and it is the outcomes of all channels that are the focus of this step. To give a simple example, a new road might primarily be seen as using the "access" channel to deliver beneficial outcomes. However, it would potentially give rise to a range of outcomes *via*, for example, the "prices" channel (lower transport costs) and/or the "employment" channel (increased production resulting from improved access to markets). It may also activate the "authority" channel, by changing the balance of authority in the region, *i.e.* making it easier for police to control the area and increase security by undermining the influence of local gangsters.

The content of Matrix 24.1 would be primarily descriptive but with a ranking of outcomes and, to the extent possible, the estimation of quantitative indicators (*e.g.* number of probable beneficiaries) for those identified as of primary importance.

Matrix 24.1. **Transmission channels and outcomes for target groups**

Transmission channels	Transmission channel used	Results by transmission channel categories			Information sources
	Details and risks that may influence the effectiveness of this channel	Short term	Medium term	Details and risks that the results will not be achieved	
Prices					
Employment					
Transfers					
Access					
Authority					
Assets					

NB: Simple indicators such as ++, +, 0, - and -- are entered into these cells with reference to more detailed text below the matrix.

Analysis of specific population groups using the capabilities framework

Matrix 24.1 was concerned with detailed analysis of specific interventions related to outcomes for targeted population groups. Drawing on this analysis, the next step considers aggregate welfare outcomes, using the OECD/DAC capabilities framework (OECD, 2001), both for the target groups and a broad range of other relevant stakeholder groups. These include:

i) Sub-populations within the target groups that are likely to experience differential outcomes – for example, an assessment of the outcomes for women members of those target groups would almost always be required.

ii) Vulnerable groups who may be significantly positively or negatively affected.

iii) Other stakeholders that may influence the success of the implementation – for example, certain elites may undermine an intervention that hurts them, or may capture a substantial proportion of the benefits intended for the target groups.

The specific groups to be included are determined by those undertaking the assessment, following consultation with agency colleagues, partner country officials and other key informants. Any other stakeholder analysis undertaken during the planning phase of the intervention will have to be carefully considered.

The OECD/DAC framework identifies five capabilities required by stakeholders to help them to escape from or to avoid poverty:

i) *Economic* – covers the ability to have and use assets to pursue sustainable livelihoods, to provide income to finance consumption and savings.

ii) *Human* – covers the need for health, education, nutrition, clean water and shelter, necessary to engage effectively in society.

iii) *Political* – covers human rights, having a voice and authority to influence public policies and political priorities, and be adequately represented at the community, local and national levels.

iv) *Socio-cultural* – covers the rights and abilities to be included and participate as a valued member within social and cultural relationships and activities.

v) *Protective-security* – covers all the issues that help to lessen vulnerability, such as protection from threat to person and property (including unfair treatment by the state), the ability to withstand economic shocks; formal or informal forms of insurance.

Again, the analysis would mainly be qualitative, but where possible with a simple ranking scale for outcomes and quantitative estimates, for example numbers affected, where possible.

For negative impacts, mitigation measures should be discussed and at the same time measures that can reinforce pro-poor outcomes should be strengthened. Particular attention should be paid to a gender sensitive analysis.

Matrix 24.2. **Outcomes by selected stakeholder groups**

Stakeholder groups	Outcomes in terms of capabilities										Details and risks	Information sources	Mitigation or reinforcing measures
	Economic		Human		Political		Socio cultural		Protective security				
	Short term	Medium term	Short term	Medium term	Short term	Medium term	Short term	Medium term	Short term	Medium term			
Target													
Vulnerable													
Other													

NB: Simple indicators such as ++, +, 0, - and -- are entered into these cells with reference to more detailed text below the matrix.

Aggregate impacts in terms of the MDGs and other strategic goals

This step, again based on the findings of the previous stages of analysis, is intended to provide a higher level summary, showing the likely contributions of the intervention to strategic poverty reduction goals. Note that some interventions may be identified as potentially having significant impacts in terms of improving the welfare of specific target groups, even if their overall national impact is limited because of the limited scale of the intervention.

Matrix 24.3 presented here focuses on the MDGs 1 to 7. Additional goals might be included if they are of primary concern to the donor and partner country:

MDGs

1. Eradicate extreme poverty and hunger.
2. Achieve universal primary education.
3. Promote gender equality empower women.
4. Reduce child mortality.
5. Improve maternal health.
6. Combat HIV/AIDS, malaria, other diseases.
7. Ensure environmental sustainability.

Other strategic goals that can be included in such an assessment (derived from the Millennium Declaration or reflecting other goals of importance for partner and donor countries) are for example: *i)* pro-poor growth; *ii)* protecting the vulnerable; *iii)* peace, security and disarmament; *iv)* human rights, democracy and good governance; or *v)* protecting the common environment. Obviously, assessing the contribution of the intervention becomes increasingly difficult at these impact levels.

Matrix 24.3. **Aggregate impacts in terms of the MDGs, Millennium Declaration and/or other strategic goals**

Strategic Development Goals	Impacts	Details and risks	Information sources
MDG 1. Eradicate extreme poverty and hunger			
MDG 2. Achieve universal primary education			
MDG 3. Promote gender equality and empower women			
MDG 4. Reduce child mortality			
MDG 5. Improve maternal health			
MDG 6. Combat HIV/AIDS, malaria, other diseases			
MDG 7. Ensure environmental sustainability			
Pro-poor growth			
Protecting the vulnerable			
Peace, security and disarmament			
Human rights, democracy and good governance			
Protecting the common environment			

NB: Simple indicators such as ++, +, 0, - and -- are entered into these cells with reference to more detailed text below the matrix.

Summary assessment and recommendations

Drawing on the information gained through conducting the previous four steps, a summary assessment is prepared. This summary assessment and recommendations could best stand at the beginning of a PIA report as an executive summary of the detailed analysis that follows. It outlines:

i) The nature of the intervention and its relation to national policies on poverty reduction.

ii) Key benefits.

iii) Potential risks that should be monitored.

iv) Possible modifications to the design.

v) Overall assessment of the quality of available knowledge, and whether it is sufficient to make an informed decision (if it is not considered sufficient the recommendation may be to collect more data and undertake more analyses, or even not to undertake the intervention).

vi) Mitigating or reinforcing measures that should be included to assist stakeholders who may be adversely affected by the intervention or to strengthen the pro poor impacts of the intervention, respectively.

vii) Outline of key issues that need to be included in the monitoring of the intervention (to address risks, determine progress, clarify issues that were not clear at the start of the intervention, identify when mitigating measures may no longer be required, etc.), and whether any additional information/systems are required to those that are already in place to provide this monitoring.

viii) Recommendations to decision makers on whether or not to go ahead with this intervention, based on the assessment of the poverty consequences and the available quality of information and analysis.

Notes

1. Changes in wages are handled in the "prices" channel, while changes in the level and nature of employment is covered in the "employment" channel. This means interventions in these areas may use both channels.
2. Household enterprises include farm households and other small-scale enterprises owned by poor households.

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PART V

Chapter 25

Adjusting Donors' Reporting to Impact Orientation

The international community requires a reporting system that is no longer exclusively based upon "inputs" but takes into consideration "impacts and results". Many donors are currently experimenting with different approaches to achieving this.

Comparing reporting systems, there are a number of features which may be seen as building blocks for impact and results-based reporting of donors:

i) The reporting systems are understood by most donors as dual purpose instruments. They should satisfy fiscal control needs (accountability) as well as supporting the agency in managing portfolios.

ii) Most of the reported data originate either from self-evaluations, independent evaluations, embassy reports, PRSP reviews, and project progress reports.

iii) The data are usually stored in data banks for in-depth analysis and special studies.

iv) However, all agencies face problems in attributing highly aggregated development achievements at impact level to donor interventions. Many agencies maintain the opinion that attribution and verification is not feasible and propose to focus on contributions and plausibility.

v) The Millennium Declaration and the MDGs constitute the measuring frame for results-based management of donor agencies and more so of partner countries. This should contribute to a more effective focus on fighting extreme poverty.

vi) Though conceptually difficult to grasp, contributions of development interventions to the attainment of MDGs are increasingly becoming the basis for budgetary decisions and allocations by donors.

One of the core issues to be solved is the generation of valid and internationally comparable data for measuring the true poverty reducing qualities of development interventions. Besides national task forces who work on improving their internal reporting systems, a number of working groups have been tasked by the DAC Secretariat to develop workable approaches and methodologies. If the *ex ante* PIA approach described above is widely used it is seen as a potential basis for the development of an improved and harmonised reporting system on poverty impacts.

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PART V

Chapter 26

How to Support and Monitor Implementation of *ex ante* PIA

The integration of a new methodology into established donor procedures will clearly only take place if it is seen as providing benefits which outweigh the implied resource costs. One major advantage of this *ex ante* PIA is clearly that it integrates already established approaches, their terminology and procedures. Its novelty is that it merges them into one model and the results of the assessment are visualised in relatively simple matrices. This allows the possibility of sharing *ex ante* PIA exercises based on a common format across a number of agencies. This in turn considerably reduces the burden on partner governments having to deal with competing methods and the often conflicting demands placed on them. Harmonising *ex ante* PIA is clearly in line with the spirit of the Paris Declaration on Aid Effectiveness.

The establishment of an internet based user group, providing access to good practice guidelines, templates and a database of studies will be an excellent starting point to promote the approach. This would provide a resource base for a series of introductory workshops on the approach, which can be either stand-alone or undertaken in association with existing donor meetings. It should also provide opportunities for an open critical debate on the approach, allowing a much wider group of potential practitioners to contribute both to the refinement of the methodology and the quality of the available materials. A web based version could be maintained, with a CD version distributed at regular intervals to ensure that all potential users, including those in partner countries, had access to current "best practice".

The broad implementation of *ex ante* PIA will be promoted in an initial phase starting in 2006. It includes a series of pilot exercises conducted by the agencies involved in the design of the approach. Several POVNET members expressed interest in testing the methodology. First results are expected to be available from June 2006 onwards.

A guidance manual/handbook will be completed, published and distributed via the Internet and/or on CD-ROM. The current draft will guide the pilot exercises. Further refinements will be incorporated as the pilot results come in.

Training for donor staff, responsible for project and programme appraisals is planned. The main focus shall be the familiarisation with the approach. Local partners shall be involved in a timely manner.

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