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Promoting Pro-poor Growth
Policy Guidance for Donors

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]

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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

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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.

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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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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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Promoting Pro-poor Growth
Policy Guidance for Donors

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.

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