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Pro-poor growth in the context of the global financial crisis: A selective overview

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This literature review forms part of a package of materials on economic growth and poverty reduction which includes a media brief 'Beyond the financial crisis: What next for economic growth and poverty reduction in developing countries?', a glossary and a selected annotated bibliography. All these materials are available for free download from www.panos.org.uk/financialcrisis

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Executive summary

In the wake of the global financial crisis, a number of leading scholars are questioning old assumptions, including those about how best to achieve economic growth and poverty reduction. In particular, a new impetus has been added to debates regarding the proper role for government in managing economies.

Marking a return to active government?
In many developed countries, governments have been stepping in as increasingly active participants in economic governance. Recent examples include the drive to increase the regulation of markets for derivatives and other high-risk financial instruments, massive public support to troubled financial institutions considered 'too big to fail' and large fiscal stimulus packages. Although these initiatives have been embraced by some as the return of the Keynesian economic thought that dominated much of the post-war period, they have not been universally embraced. In the US, legislation reforming financial regulation has been working its way through the House of Representatives and the Senate since late in the summer of 2009, while being subjected to intense lobbying efforts from a number of stakeholders. In the UK, Chancellor of the Exchequer Alastair Darling's 2009 pre-budget report, which proposes caps on public sector pay, adjustments to national insurance and income tax regimes and a 50 per cent super-tax on bank bonuses above £25,000, has been hotly debated.

The fact that these strategies are being debated seriously in two of the countries that have championed the adoption of 'free market' policies during much of the past three decades suggests that the crisis has legitimised a more active role for governments in managing their economies. However, an alternative interpretation of the global financial crisis takes the argument for an active state one step further, by highlighting the importance of balanced growth in reducing the likelihood of financial instability.

What then are the implications of this reading of the crisis for developing countries? The economies of many low- and middle-income countries are not closely linked to the financial markets where the crisis began. Yet these countries have not been spared the economic turmoil of 2008 and 2009 and the crisis has had strong impacts on livelihoods through changes in key areas including trade, aid, availability of financing and prices of goods and services. Although poverty reduction remains a key development goal, projected rates of both growth and poverty reduction are down across the developing world. In this context, an interpretation of the crisis that legitimises policies to support equity and balanced growth is necessarily concerned with pro-poor growth.

Revisiting the debate on 'pro-poor growth'
In Section 3 we lay out some of the pertinent debates regarding the way in which pro-poor growth is conceived and defined. While it has been suggested that economic growth in general is good for poor people, a significant body of research argues that the poverty-reducing effect of growth depends on enabling a pace and pattern of growth that allows the poor to participate in, and benefit from, economic growth. What matters is not the fact that growth is on average beneficial for poor people, but that any given level of growth can have varying poverty reduction effects. This suggests that policies designed to shape the growth process have the potential to help maximise the benefits that accrue to poor people.

Section 4 therefore aims to ensure that this review is relevant to policies at the national level and not just to academic debates. We begin by presenting a selective overview of macro-economic policy for pro-poor growth. The types of monetary, exchange rate and fiscal policies a country pursues are critical, not only to ensuring a stable environment for economic growth but also to shaping that growth. While not contradicting arguments in favour of stability in the macro-economy, a review of the literature suggests that policies for pro-poor growth may vary from orthodox economic opinion in a number of ways.

There is also a significant body of literature that suggests that unorthodox strategies may be required to ensure that trade policy supports pro-poor growth. In contrast with the 'free trade produces growth that, in turn, results in poverty reduction' mantra that has dominated in recent decades, a number of authors suggest that the relationship between these factors is likely to be more complex. This does not imply a rejection of trade or even trade liberalisation in some contexts. The argument is no longer whether or not trade is better for growth and poverty reduction than no trade, but rather how to be smart about managing integration into the world trade system. Sequencing of reforms is clearly key, but a significant amount of trade policy remains up for debate, including the extent to which protectionist policies are a viable option. This last point is particularly critical in the context of the large trade shocks associated with the global financial crisis.

Growth patterns and sectoral challenges

In addition to macro-economic and trade policies, achieving pro-poor growth is heavily dependent on growth in 'the sectors and regions where the poor are (or are moving to) and [where they] use the factors of production they possess (or are able to acquire)'.[1] Section 5 begins to address some of the sector-specific challenges facing policymakers. However, it is important to note that the relevant sectors in any given country context will vary. The few sectors included for discussion were selected as a result of their broad relevance in a number of countries (agriculture, private sector development) or the centrality of their role in certain economies (extractives).

Many of the world's poor continue to work in the agriculture sector, and those who do not can nevertheless benefit from improvements in sector productivity through, for example, reduced prices for staples. Yet, differences in opportunities and constraints among groups and areas mean that the policy response needed to support poor people currently engaged in agriculture must be adaptable. A single set of policies will not meet the needs of a diverse rural population. We highlight a framework that proposes different policy implications for three different groups: those able to intensify current activities, those who might shift to different activities and those for whom the relevant strategies will be the ones designed to maintain current levels of wellbeing and protect future potential.

While the degree of reliance of poor people on extractive industries is far lower than that on agriculture, these industries (eg mining of precious metals, oil and gas) have attracted significant attention within the development community. This is in part because the large economic rents associated with these activities have significant implications for poor people. A number of authors note that, as direct participation rates are often low, beneficial impacts often depend on the degree to which the sector is integrated with other parts of the economy. Linkages to other industries can provide important employment and investment opportunities. Pro-poor growth can be encouraged independently if systems of taxation effectively redistribute gains from the extractive sector to the wider economy.

However, in practice, these links are not automatic, and even where positive links to the rest of the economy do exist, there are a number of significant potential drawbacks. The 'resource curse' literature suggests that extractive commodity export booms can put upward pressure on the exchange rate, hurting poor people working in other sectors. When rents dry up, as in the case of the dramatic drop in oil prices during the global financial crisis, governments that rely on resource revenues can find their budgets for critical social services stretched.

Private sector activities occur in a variety of shapes and sizes so it remains difficult to generalise. However, broadly speaking, previous strategies for encouraging pro-poor growth in the private sector have often centred around ideas of segregating (even protecting) poor people from traditional markets by focusing on particular sectors or activities thought to be important to poor

1 Stephan Klasen (2003) 'In search of the holy grail: How to achieve pro-poor growth?' in *Towards pro-poor policies*: *Proceedings from the Annual Bank Conference on Development Economics – Europe,* eds Bertil Tungodden and Nicolas Stern, Washington DC: World Bank

people. Newer thinking stresses the importance of better integrating poor people into markets. In other words, participating in private sector activities is insufficient to achieve poverty reduction at scale; what matters is *how* poor people are able participate. In this interpretation, the literature highlights linkages between large firms and small and medium-sized enterprises as well as those between the formal and informal sectors.

Governance and the importance of politics

> *'Policymaking that helps to determine the pace and pattern of growth remains an inherently political process.'*

Although poverty reduction that results from growth processes (producing a larger pie) is likely to be more politically feasible than that which relies solely on static redistribution of a fixed quantity of resources, policymaking that helps to determine the pace and pattern of growth remains an inherently political process. Section 6 therefore builds on the idea that making growth more pro-poor is likely to require changes to the political settlement. Authors have identified barriers to pro-poor policy occurring during all three stages of the policy process: agenda setting, policy formulation and implementation.

Despite these barriers, successful pro-poor policies have been enacted in a wide variety of political circumstances. Given this variation, debate continues as to what institutions are either necessary or sufficient for pro-poor growth. While well-established arguments for democratic participation and developmental states occupy either end of the spectrum, a number of new papers are attempting to move past this dichotomy. One stream of work attempts to fuse these two positions. Another suggests that difficult political economy contexts may require a more incremental approach to pro-poor change. What is clear throughout the literature is that there are no easy answers; no universally effective set of institutions can be transplanted from one country to another. Achieving pro-poor growth will therefore require context-specific solutions.

The context of the global financial crisis has lent new weight to calls for a more balanced pattern of growth. It has also renewed the confidence of many in the ability of a strong state to help ensure such a distribution. This selective survey of the literature ultimately reveals that, while earlier work often assumed a trade-off between policies to support growth and those to ensure equity, there is a growing sense that these assumptions are misplaced. The established body of work on pro-poor growth provides a base for new policy solutions that address both goals and work to ensure that all citizens have the opportunity to participate in, and benefit from, economic growth.

1. Introduction

The relationship between the state and the economy has long been at the centre of debates about how best to enable sustained growth and poverty reduction. Often, this is presented as a spectrum of possible policies, with state control on one hand and 'free markets' on the other.[2] Over time the pendulum has swung between these two positions.[3] The global financial crisis has once again focused considerable attention on economic governance. This paper aims to provide an overview of the key issues involved in these debates.

Section 2 presents a brief review of the movement between more and less interventionist periods of economic governance orthodoxy since World War II. In this context, the current global financial crisis has been interpreted as a call for a return to a more active role for governments in managing the economy. However, this section suggests an added layer in this interpretation – that future economic governance should not only address the pace of growth but also facilitate a certain pattern of growth: one that is more balanced and inclusive. The remainder of this literature review therefore examines what is known about pro-poor growth, how the ongoing financial crisis might affect strategies for pro-poor growth and debates about why and how pro-poor growth issues might contribute to policy agendas.

Section 3 highlights some key issues in the conceptualisation and definition of pro-poor growth. Section 4 then outlines some of the key ongoing debates about how macro-economic and trade policy can contribute to pro-poor growth. Section 5 addresses some of the sector-specific challenges facing policymakers. Here we readily acknowledge that the relevant sectors in any given country context will vary as trends in globalisation lead to the increasing specialisation of regional and national economies. The few sectors included for discussion were selected because of their broad relevance in a number of countries (agriculture, private sector development) or because of the centrality of their role in certain economies (extractives). Section 6 details the challenging political economy of pro-poor growth, including debates on participation, democracy and the developmental state. Section 7 concludes.

To prompt further reflection by different audiences, some sections are followed by questions on the issues raised by the analysis. This literature review is also complemented by a Panos London media brief, *Beyond the financial crisis: What next for economic growth and poverty reduction in developing countries?,* which is specifically aimed at supporting accessible coverage by the media.

Given the breadth of the potential subject matter, it should be recognised that this review has inevitably involved a selective overview. The impact of climate change on future growth models, for example, has not been covered, as this merits attention in its own right. Instead the focus is on revisiting recent debates on 'pro-poor growth' in the light of the international financial crisis. The impact of, and responses to, the international

2 This dichotomy is undoubtedly an oversimplification. The recent selection of Oliver Williamson and Elinor Ostrom as winners of the 2009 Nobel Prize in Economics recognised their work on alternative governance structures that were neither exclusively market driven nor solely state driven. Williamson's work in a series of papers (1971, 1975, 1985) theorises important differences between markets and firms as organisational structures. Ostrom's work (1990) on common property 'challenged the conventional wisdom that common property is poorly managed and should be completely privatised or regulated by central authorities' (Royal Swedish Academy of Sciences, 2009, *Economic governance: Scientific background on the Sveriges Riksbank Prize in Economic Sciences in memory of Alfred Nobel 2009*, Stockholm: Royal Swedish Academy of Sciences). Together, this body of work suggests a rich institutional diversity, which very much challenges the supremacy of private market forms of economic governance

3 Karl Polanyi (1944) *The great transformation: The political and economic origins of our time*, 3rd edition, Boston: Beacon Press

economic crisis are of course still unfolding. For this reason, the review confines itself to providing an initial snapshot of how debates may evolve on the relationship between economic growth, poverty reduction and development, in particular whether the current situation marks a return to more active government in the economy. In the interests of continued debate, feedback is welcome. Please send comments to: governance@panos.org.uk

2. Back to the future? Economic governance, development and poverty reduction in historical perspective

2.1 The post-war period: State-directed development

In the two decades or so that followed World War II, development thinking tended to be fairly interventionist. It was generally 'assumed that states in the developing world could act as engines of development and therefore could be funded to enable investments and generate growth'.[4] A number of reasons explain why interventionist strategies were popular during this period, including the emergence of the Soviet Union as a major industrial power, the success of Keynesian policies in the years preceding the war and the acknowledgement of potentially severely debilitating market failures in many developing countries.[5] A number of prominent Latin American economists, including Celso Furtado and Raul Prebisch, argued strongly for development strategies such as import substitution industrialisation, which envisioned a larger role for the state.

2.2 The rise and fall of the 'Washington Consensus'

The Washington Consensus has come to be identified with the period of marketisation that spanned the 1980s and much of the 1990s. However, it is well worth noting that the content of the Washington Consensus, which originated with John Williamson in 1989 in his description of policy advice for Latin American countries under the shadow of the debt crisis (see Box 1), is in fact far from the neo-liberal, market fundamentalist ideals with which it is associated.[6]

Box 1: The original 10 reforms of the Washington Consensus[7]

1. Fiscal discipline
2. Reordering public expenditure priorities
3. Tax reform
4. Liberalisation of interest rates
5. A competitive exchange rate
6. Trade liberalisation
7. Liberalisation of inward foreign direct investment
8. Privatisation
9. Deregulation
10. Property rights

Kanbur suggests that critics of the policy package often described as the Washington Consensus would be surprised to know that Williamson highlighted the importance of spending on basic healthcare and education when reprioritising public expenditure; identified differing views on the proper speed of trade liberalisation; and did not include the comprehensive liberalisation of the capital account in his ideal policy toolbox.[8] In short, there is a significant difference between the Consensus as Williamson conceived it and the Consensus that most of us would recognise. This aside, the policies of the period

4 Verena Fritz and Alina Rocha Menocal (2007) 'Developmental states in the new millennium: Concepts and challenges for a new aid agenda', *Development Policy Review* vol 25 no 5, pp531-52

5 Ravi Kanbur (2009) 'The co-evolution of the Washington Consensus and the economic development discourse', *Macalester International* vol 24, Article 8

6 Ravi Kanbur (2009) (see footnote 5); John Williamson (2004) 'A short history of the Washington Consensus', for conference 'From the Washington Consensus towards a new global governance', Barcelona, 24-25 September

7 John Williamson (2004) (see footnote 6)

8 Ravi Kanbur (2009) (see footnote 5)

were overwhelmingly ones that reduced the role of the state in managing the economy.[9] In practice, Williamson's point regarding liberalisation of inward foreign direct investment was often applied as total capital account liberalisation. Reordering of public expenditure to protect health and education proved politically difficult and thus was ignored. Privatisation was pursued without attention to *how* it was carried out, sometimes resulting in the transfer of assets to privileged elites for only a fraction of their true value.[10] Market liberalisation under Ronald Reagan and Margaret Thatcher was given a further boost by the fall of the Berlin Wall and the collapse of state-directed models in the Soviet Union in 1989.

> *'Both the failures and the successes of the 'neo-liberal' period hold lessons.'*

In many countries, liberal market reforms and the retreat of the state failed to produce the anticipated gains in growth and poverty reduction. Dani Rodrik suggests that both the failures and the successes of the 'neo-liberal' period hold lessons.[11] The failures, which included economic collapse in transition economies,[12] poor performance in sub-Saharan Africa during the 1980s and 1990s[13] and recurrent economic crises, especially in Latin America,[14] all suggested the need for a new direction.[15] Proponents of liberal market approaches suggest that the problem was inadequate liberalisation. For example, Anne Krueger cites 'insufficiently ambitious reform' and 'lack of follow-through for those reforms that were adopted'.[16] However, the success stories of this same period, in which growth and poverty reduction were the greatest (ie Korea, China and India), often involved the application of fairly interventionist and statist policies.[17] A number of studies have delivered empirical evidence that interventionist macro-economic policy, price distortions, heterodox financial policies and trade restrictions have negative effects on national growth rates only when they are applied in an extreme way.[18]

In the face of these types of arguments, by the late 1990s the pendulum was swinging back and there was greater acceptance of a larger role for the state. Fritz and Rocha Menocal cite the emphasis given to 'rethinking the state' in the World Bank's 1997 *World development report* (*The state in a changing world*) reaffirming the position that 'the state is central to economic and social development'.[19] Since that time there has been a considerable body of work on the role of the state in development, economic management and what constitutes 'good governance'.

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9 Ravi Kanbur (2009) (see footnote 5); Verena Fritz and Alina Rocha Menocal (2007) (see footnote 4)
10 John Williamson (2004) (see footnote 6)
11 Dani Rodrik (2006) 'Goodbye Washington Consensus, hello Washington confusion? A review of the World Bank's *Economic growth in the 1990s: Learning from a decade of reform*', *Journal of Economic Literature* vol 44, no 4 pp973-87
12 Those countries making the transition from communism to market economies following privatisation and liberalisation
13 Since the turn of the century, and prior to the global financial crisis, a number of countries within sub-Saharan Africa, as well as the region as a whole, have shown impressive growth rates (see http://go.worldbank.org/J1M295NU60 for more detail)
14 Alfredo Saad-Filho (2007) 'Pro-poor monetary and anti-inflation policies: Developing alternatives to the new monetary policy consensus', Discussion Paper no 2405, London: Centre for Development Policy and Research
15 Branko Milanovic (2003) 'The two faces of globalization: Against globalization as we know it', *World Development* vol 31, pp667-83
16 Anne Krueger (2004) 'Meant well, tried little, failed much: Policy reforms in emerging market economies', Roundtable Lecture at the Economic Honors Society, New York, 23 March
17 Ha-Joon Chang (2002) *Kicking away the ladder: Development strategy in historical perspective*, London: Anthem Press; Robert Wade (1990) *Governing the market*, Princeton NJ: Princeton University Press
18 William Easterly (2005) 'National policies and economic growth: A reappraisal', in *Handbook of economic growth vol 1A*, ed Philippe Aghion and Steven Durlauf, Amsterdam: North-Holland, pp1015-59; William Easterly and Ross Levine (2003) 'Tropics, germs, and crops: How endowments influence economic development', *Journal of Monetary Economics* vol 50, no 1, pp3-39; Rodríguez (2005) in Dani Rodrik (2006) (see footnote 11)
19 Verena Fritz and Alina Rocha Menocal (2007) (see footnote 4)

2.3 Understanding the global financial crisis in historical perspective

History shows us that thinking has shifted about the relative importance of markets and the state. This helps us understand different perspectives on the relative importance of the global financial crisis for the relative importance of state intervention vs liberal market approaches to development. Some have suggested that the crisis highlights the importance of a more active role for the state in managing the economy. Government stimulus packages have been enacted in diverse contexts worldwide, including US$25 billion in additional public works in Latin America and the Caribbean in 2009 alone;[20] China's US$586 billion fiscal stimulus package;[21] and significant increases in public investments in employment, social protection and the boosting of domestic demand in Tunisia, Mauritius and South Africa.[22] Marcelo Giugale, the World Bank's Director of Poverty Reduction and Economic Management for the Latin American and Caribbean region, sums up this policy response as a worldwide change in the role of the state defined, in part, by 'a new faith in the power of public investment to affect growth in the short term'.[23]

This interpretation is certainly true to some extent, but it does not seem to be the turning point some authors suggest. Our brief summary of historical shifts in development orthodoxy identifies a preference for an active state in development as having had a long history. The 'developmental state' is discussed in greater detail in Section 6 below, when we discuss the political economy of pro-poor growth.

> *'There is a growing body of evidence that increasing inequality has contributed to financial instability and eventually to crisis.'*

An alternative interpretation of the global financial crisis takes the argument for an active state one step further, by highlighting the role of equity and balanced growth in reducing the likelihood of financial instability.[24]

There is a growing body of evidence that increasing inequality has contributed to financial instability and eventually to crisis. Vandemoortele lays out the argument in detail, but here we limit ourselves to a brief summary.[25] At the national level, rising income inequality leads to both a reduction in aggregate demand, as money is transferred from those likely to spend to those with more than they can spend,[26] and increasing social and political instability.[27] However, rather than addressing the structural issues behind rising inequality, in a highly unequal setting powerful interests are also more likely to dominate politics, thereby entrenching special interests and delaying policy reforms.[28] As a result,

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20 Marcelo Giugale (2009) 'Latin America beyond the crisis – Impacts, policies and opportunities – A synthesis', in *Latin America beyond the crisis: Impacts, policies and opportunities – Compilation*, ed World Bank, Washington DC: World Bank

21 David Barboza (2008) 'China unveils sweeping plan for economy', *The New York Times*, 9 November

22 African Development Bank (2009) 'Impact of the crisis on African economies – sustaining growth and poverty reduction: African perspectives and recommendations to the G20', Report from the Committee of African Finance Ministers and Central Bank Governors, Tunis: African Development Bank

23 Marcelo Giugale (2009) (see footnote 20); https://blogs.worldbank.org/meetings/a-renewed-faith-in-public-investment

24 Commission on Growth and Development (2008), in Ravi Kanbur (2009) (see footnote 5)

25 Milo Vandemoortele (2009) 'Within-country inequality, global imbalances and financial instability', desk study for the Netherlands Ministry of Foreign Affairs, London: Overseas Development Institute

26 Joseph Stiglitz et al (2009) 'Report of the Commission of Experts of the President of the United Nations General Assembly on reforms of the international monetary and financial system', New York: United Nations

27 Alesina and Perotti (1996) in Milo Vandemoortele (2009) (see footnote 25)

28 Nancy Birdsall et al (2008) *Fair growth: Economic policies for Latin America's poor and middle-income majority*, Baltimore: Brookings Institute Press; Behrman et al (2009) in Milo Vandemoortele (2009) (see footnote 25)

policymakers in Northern countries allowed and even encouraged policies that fuelled financial instability, including lax regulation and loose monetary policy.

Poverty reduction is a priority for development policy. As such, an increased focus on the relative merits of state intervention vs market liberalism and a reawakened interest in balanced growth (within and between countries) have given greater prominence to existing debates on the interface between poverty reduction and economic growth. How to achieve a pace and pattern of growth that enable the poor to participate in and benefit from the growth process is at the very heart of these debates.

Key questions for Section 2

- What have been the major historical turning points in economic governance in your country?
- To what extent has policy reform implemented in recent decades been in line with the Washington Consensus, as originally conceived?
- To what extent has policy reform been in line with the more neo-liberal, market fundamentalist interpretation of the Consensus?
- What have been the key internal and external drivers of major policy reforms?
- In the period leading up to the crisis, what were the trends in government involvement in economic issues, including management of the growth process?
- How has the role of the government changed since the onset of the financial crisis?

3. Growth and poverty reduction: 'Pro-poor growth' debates and the impact of a changing policy context

3.1 Isn't all growth pro-poor?

As Ravallion notes:[29]

> 'Among those who know the survey-based evidence, there is unlikely to be much disagreement with the claim that economic growth is typically (though by no means invariably) pro-poor, in the specific sense that absolute poverty (measured against a poverty line with a fixed real value), tends to fall with growth.'

This argument, that economic growth is good for the poor, is presented most famously in a widely debated paper by Dollar and Kraay.[30] The authors present a statistical framework that leads to the conclusion that, on average across countries and over time, growth is distribution-neutral, that is, poor people benefit from growth just as much as rich ones. The authors (and many observers since) have drawn the secondary conclusion that policies and programmes that increase growth are therefore also those best suited to reducing poverty. Ravallion provides one such example in Bhalla's discussion of policies intended to shape the pattern of growth for poverty reduction: ' ... such actions are not needed … Growth is sufficient. Period.'[31]

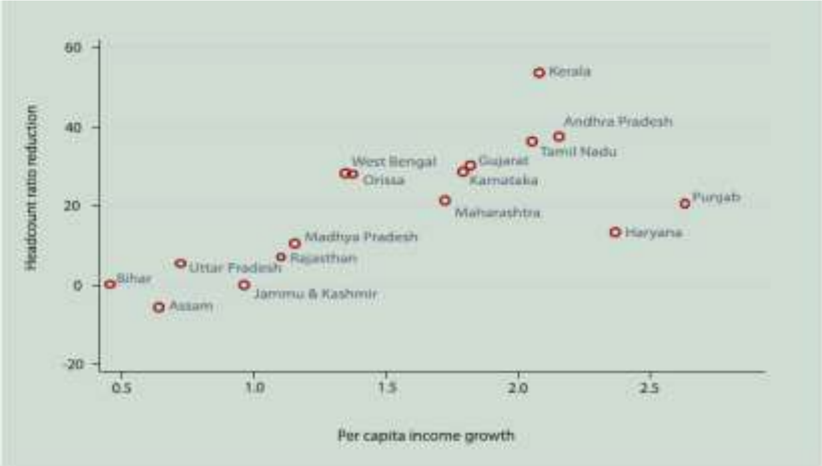
> *'If we are interested in poverty reduction, clearly the pattern of growth matters as well as the pace.'*

However, critics argue that, while the general association between growth and absolute poverty reduction is hardly controversial, the policy conclusions are far from clear. Without denying the correlation between growth and poverty reduction, Ravallion finds that a 1 per cent increase in per capita incomes may reduce income poverty by as much as 4.3 per cent, or by as little as 0.6 per cent, depending on the country as well as the time period.[32] As the distribution of growth and poverty reduction among India's states demonstrates (Box 2), if we are interested in poverty reduction, clearly the pattern of growth matters as well as the pace.[33]

29 Martin Ravallion (2003) 'The debate on globalization, poverty and inequality: Why measurement matters', *International Affairs* vol 79, no 4, pp739-53
30 David Dollar and Art Kraay (2002) 'Growth is good for the poor', *Journal of Economic Growth* vol 7, no 3, pp195-225
31 Bhalla (2002) in Martin Ravallion (2003) (footnote 29)
32 Martin Ravallion (2004) *Pro-poor growth: A primer*, Washington DC: World Bank
33 See also Louise Cord et al (2003) '"When I use a word …": Pro-poor growth and poverty reduction', paper for the World Bank, Washington DC: World Bank

Box 2: The poverty-reducing effect of growth[34]

Poverty reduction and income growth across India's states 1960–2000



This figure above, showing economic growth and poverty reduction performance in Indian states 1960–2000, shows that faster growth is generally associated with larger reductions in poverty headcounts (that is, growth is good for the poor). However, the distribution also raises an interesting question as to why there is some variation within this correlation. For example, what accounts for relatively low levels of poverty reduction in the two states with the highest growth rates, Haryana and Punjab? A related question is, what accounts for the variation in poverty-reduction performance between Kerala and Tamil Nadu, two states with nearly identical growth rates?

3.2 Defining pro-poor growth

A number of definitions of pro-poor growth have been suggested in the literature. While there is some variation, two broad types have emerged: a relative definition and an absolute definition.[35] Both are valid approaches to measuring the poverty impacts of growth, but neither provides a complete picture – especially when compared across countries.

According to the relative definition, pro-poor growth describes a situation in which incomes of the poor grow at a higher rate than those of the non-poor.[36] Over a period of sufficient length pro-poor growth of this type would reduce inequality.[37]

A number of authors have challenged this definition on the basis that it does not reflect changes in the absolute level of wellbeing of poor households. A couple of hypothetical cases demonstrate the reasons for this. First, imagine a situation in which the incomes of non-poor households increase by an average of 10 per cent whereas the incomes of the

34 Besley et al in International Poverty Centre (2007) 'Analysing and achieving pro-poor growth', *Poverty in Focus*, Brasilia: International Poverty Centre
35 Ricardo Fuentes (2005) 'Poverty, pro-poor growth and simulated inequality reduction', Background Paper for the Human Development Report 2005, New York: UN Development Program; Humberto Lopez (2004) 'Pro-poor growth: A review of what we know (and what we don't)', for the Pro-Poor Growth program sponsored by the World Bank; Martin Ravallion (2004) (see footnote 32)
36 Stephan Klasen (2003) 'In search of the holy grail: How to achieve pro-poor growth?' in *Towards pro-poor policies*: *Proceedings from the Annual Bank Conference on Development Economics – Europe,* eds Bertil Tungodden and Nicolas Stern, Washington DC: World Bank; Nanak Kakwani and Ernesto Pernia (2000) 'What is pro-poor growth?', *Asian Development Review* vol 18, no 1, pp1-16; Alfredo Saad-Filho (2007) (footnote 14); McKinley (2004); Rathin Roy and John Weeks (2004) 'Making fiscal policy work for the poor', Synthesis Paper for the UN Development Program; Howard White and Edward Anderson (2000) 'Growth vs redistribution: Does the pattern of growth matter?' DFID white paper, London: DFID
37 For further detail on the relationship between growth, poverty and inequality, see François Bourguignon (2004) 'The poverty–growth–inequality triangle', presented to the Indian Council for Research on International Economic Relations, New Delhi, February 4

poor increase by 9 per cent. Despite the massive increase in the incomes of poor households, using the relative definition this is not pro-poor growth. Similarly, imagine a situation in which a recession results in a 3 per cent decrease in the incomes of the non-poor and a 2 per cent decrease in the incomes of the poor (in the midst of the current financial crisis, this situation does not seem hypothetical). While the rich may be unable to purchase the same wines as they could prior to the 3 per cent decrease, the poor are likely to feel severely negative impacts on wellbeing, as many exist at subsistence levels already. This has led to the alternative 'absolute' definition of pro-poor growth as 'growth that reduces poverty by some agreed measure'.[38]

3.3 Direct vs indirect patterns of pro-poor growth

The second critical distinction to be made when defining pro-poor growth is between a pattern of growth that directly raises the incomes of the poor and one that operates indirectly through public redistributive policies. The former must be 'growth that favors the sectors and regions where the poor are (or are moving to) and [where they] use the factors of production they possess (or are able to acquire)', while by the latter definition:

> 'High growth of any sort could, in principle, be made pro-poor if it involved progressive taxation and targeted government spending on the poor. The government spending on the poor could either try to promote their inclusion in economic growth and thus improve the direct linkage between growth and poverty reduction ... or it could simply provide transfer payments to the poor through a safety net that could become ever more generous with the increase in economic growth.'[39]

Key questions for Section 3

- What have been the aggregate growth and poverty reduction trends in your country?
- Aggregates tell us something about a country's performance, but how effectively do they reflect whether different economic sectors and social groups are being affected positively or negatively by the growth process?
- How has performance varied over time? Specifically, what have been the effects of your country's performance on different social groups?
- Does breaking these figures down by specific regions, income levels[40] or portions of the population reveal any interesting patterns (rural bias, gender disparities, etc)?
- Is there data on levels of both poverty and inequality?
- What are current trends in inequality, both on a national level and between particular relevant groups? What are public and policy-maker attitudes towards these trends?
- To what degree has growth (on average or in relevant breakdowns) been pro-poor using an absolute definition of the term? Using a relative definition?
- What reasons would various parties have for preferring to use one definition rather than the other?
- Is growth benefiting poor communities and groups directly (eg through creation of jobs and income) or indirectly (eg by increasing the opportunities for higher social spending)?

38 Martin Ravallion (2003) (see footnote 29); Humberto Lopez (2004) (see footnote 35)
39 Stephan Klasen (2003) (see footnote 36)
40 A useful tool for measuring the distribution of growth at different income levels is the growth incidence curve (see McKay in International Poverty Centre (2007), see footnote 34)

4. Policies for pro-poor growth: A selective overview

4.1 Macro-economic policy

Ideas about what constitutes good macro-economic management changed during the 20th century. Many of the key debates can be traced to the work of John Maynard Keynes. *The general theory of employment, interest and money* was published in 1936 in the wake of the Great Depression and its appalling impacts on the working class. Keynes explored how market economies work, why they might fail and whether it might be possible to improve their functioning.[41] He suggested that economic stability should be a central concern and called for active government intervention to fight unemployment during economic downturns using a range of measures, including the printing of money and spending on public works. His ideas, that markets needed supervision, ran counter to the then accepted orthodoxy of market fundamentalism, yet it soon became widely (although not universally) accepted, and Keynesian ideas dominated much of macro-economic policymaking through to the late 1970s, when they began to be replaced by neo-liberal market fundamentalism (as described in Section 2 above).

Here we examine how specific types of macro-economic policy might go beyond the stabilisation and the management of economic cycles proposed by Keynes to contribute to a more balanced, pro-poor pattern of economic growth.

4.1.1 Monetary policy

> *‘Inflation tends to hurt poor people more than rich people... However, there remains significant debate over the extent and level at which policymakers should become concerned with inflation.’*

Monetary policies are critical to pro-poor growth as they affect the price of money and credit within an economy, and thus have major implications for enterprises in the productive sector generating employment, income and wealth. A wide range of policies, including the setting of interest rates, the printing of money and open market operations (the buying and selling of government securities), are used to help achieve growth and stability in the economy. How these policies are implemented has important consequences for the distribution of growth.

Policies to protect against excessively high rates of inflation have long been a fundamental element of pro-growth monetary policy.[42] At first glance, this seems to work well in a pro-poor growth framework, as there is a significant consensus that inflation tends to hurt poor people more than rich people because the poor tend to hold more of their financial assets in the form of cash, are less able to protect the value of their assets and income from inflation[43] and have a lower discretionary element to their household budget, meaning that any price increases are likely to result in reduced consumption and wellbeing. However, there remains significant debate over the extent and level at which policymakers should become concerned with inflation. Ames et al suggest 'setting a target in the single-digit-a-year range, the precise target depending on the country’s history of

41 John Hicks (1937) 'Mr Keynes and the "Classics": A suggested interpretation', *Econometrica* vol 5, no 2, pp147-59

42 Stephan Klasen (2003) (see footnote 36)

43 William Easterly and Stanley Fischer (2000) ‘Inflation and the Poor’ World Bank Policy Research Working Paper 2335. Washington DC: World Bank; Brian Ames et al (2002) ‘Macroeconomic Issues’ In World Bank PRSP Sourcebook, Washington DC: The World Bank

inflation and stage of development'.[44] Khan and Senhadji find a significant and robust negative relationship between inflation and growth where inflation exceeds 11-12 per cent for developing countries, and suggest targeting below that level.[45]

In contrast, several authors writing on pro-poor monetary policy question the increasing obsession with targeting very low rates of inflation.[46] McKinley argues as follows:[47]

> 'There is no evidence that very low inflation is good for growth. Many studies confirm that moderate inflation—certainly above 5 per cent and at least up to 20 per cent—can have a positive effect on growth. The standard justification for minimizing inflation is that it hurts the poor. But this misreads the facts: very high, destabilizing inflation (such as above 40 per cent) definitely hurts the poor. And very low inflation (below 5 per cent) can also harm their interests by impeding growth and employment.'

Restrictive monetary policy designed to achieve low inflation targets risks ending up in a 'stabilisation trap', defined as a 'self-reinforcing downward spiral of prices, profits, output and employment'.[48] This suggests that it might be worth tolerating slightly higher inflation in order to achieve income stability, price stability or employment, as a more pro-poor form of monetary policy.

Capital controls are more controversial (see Box 3). This is where cross-border movements of capital are managed.[49] Such an approach is controversial, as current orthodoxy prefers the free movement of capital, which allows it to flow efficiently to wherever returns will be greatest, regardless of international boundaries. However, capital controls can reduce volatility and vulnerability by helping to prevent the speculative inflows and pressures on domestic currencies that can contribute to financial and economic crises, such as those in Thailand that precipitated the Asian financial crisis of the late 1990s and those in a number of Latin American countries during the debt crisis years. Such policies can also support the development of autonomous monetary policy, enabling developmental states to (in theory) allocate public expenditure to the funding of pro-poor policies. In such situations, capital controls can be used in place of managing interest rates to protect the balance of payments.[50]

At the very least, this debate highlights an important sequencing issue. It seems clear that policymakers should at least delay capital account liberalisation in the face of large budget deficits and weak regulatory capacity.[51] Where capital flows are liberalised, controls on capital flight can be imposed during crises, as happened in Malaysia during the Asian financial crisis of the late 1990s.

44 Brian Ames et al. (2002) (see footnote 43)

45 Mohsin S Khan and Abdelhaks S Senhadji (2001) 'Threshold effects in the relationship between inflation and growth', IMF Staff Papers Vol. 48, No. 1

46 Giovanni Cornia (2006) 'Potential and limitations of pro-poor macroeconomics: An overview', for conference on 'Post-liberalization constraints on macroeconomic policies', Chennai, 27-9 January; Alfredo Saad-Filho (2007) (see footnote 14)

47 Terry McKinley (2004) 'Economic policies for growth and poverty reduction: PRSPs, neoliberal conditionalities and 'post-Consensus' alternatives', for Conference on 'The economics of the new imperialism', New Delhi, 22-4 January.

48 Chowdhury (2003) in Terry McKinley (2004) (see footnote 47)

49 Giovanni Cornia (2006) (see footnote 46)

50 Alfredo Saad-Filho (2007) 'Life beyond the Washington Consensus: An introduction to pro-poor macroeconomic policies', *Review of Political Economy* vol 19, no 4, pp513-37

51 Giovanni Cornia (2006) (see footnote 46); Stephan Klasen (2003) (see footnote 36)

Box 3: Brazil and the International Monetary Fund: Battling over capital controls[52]

Brazil's move in the autumn of 2009 to impose a 2 per cent tax on short-term capital inflows has attracted significant attention as a test of current attitudes towards capital controls. The tax, intended to prevent a speculative bubble and further appreciation of its currency in the wake of the financial crisis, has been criticised by the International Monetary Fund as costly, difficult to implement and likely to be ineffective. This position has been challenged by a number of authors, who suggest that a less doctrinaire approach by international financial institutions would yield better designed policies.

4.1.2 Exchange rate policy

Exchange rate policies determine the way in which countries manage their currency with respect to foreign currencies and the foreign exchange market. In the context of a globalised economy, exchange rate policies are critical in determining the real cost of imports and the competitiveness of exports, and shaping the way in which individuals and businesses interact with the world economy. A weaker local currency makes exports cheaper for foreign buyers, while a stronger local currency favours imports.

Broadly speaking there are three types of exchange rate regime: the two 'corner solutions' of fully fixed, or 'pegged', and free-floating exchange rates, and the intermediate regimes that lie between them. The trend from the 1970s to the present, with the exception of the European movement towards a single currency (which can be thought of as the ultimate 'pegged' exchange rate) has been away from fully fixed exchange rates and towards intermediate regimes and floats,[53] which are thought to be better at preventing speculative attacks and currency crises.

However, stable and competitive exchange rates can do more than prevent crises. Strategic exchange rate policy can be used to kick-start growth, help poor people to participate in that growth and help maintain such growth in the long run.[54] In order to accomplish these goals, policymakers must select an exchange rate regime that combines the crisis-prevention characteristics mentioned above with the ability to pursue pro-poor monetary policy and encourages investment in the sectors in which the poor possess the factors of production.[55] In East Asia, undervalued exchange rates, maintained through either fixed or intermediate exchange rate regimes, have helped increase exports and drive growth and poverty reduction (Box 4).

Box 4: The contentious value of the Chinese renminbi[56]

The consistently strong performance of Chinese exports, particularly in US markets, has been enabled in part by a stable but undervalued exchange rate. This has been achieved through the use of a fixed exchange rate in the decade up to 2005, and a carefully managed float since then.

Growth in China has been labour intensive, with the creation of millions of low-skilled and semi-skilled jobs in manufacturing centres along the east coast of the country, and remittances from as many as 120–200 million internal migrants have supported investment and growth more widely. There has been speculation that the Chinese government will have to adapt its strategy to respond to the new trading environment emerging following the global financial crisis. Nevertheless, such reforms remain politically complex.

52 Dani Rodrik (2009) 'The IMF needs fresh thinking on capital controls', *Business Standard*, 17 November; Arvind Subramanian and John Williamson (2009) 'The Fund should help Brazil to tackle capital inflows', *The Financial Times*, 25 October

53 Giovanni Cornia (2006) (see footnote 46)

54 Giovanni Cornia (2006) (see footnote 46)

55 Stephan Klasen (2003) (see footnote 36); Alfredo Saad-Filho (2007) (see footnote 50)

56 Sri Kumar (2009) 'Chinese yuan–USD peg – the operational issues revisited', 17 November, www.voxeu.org/index.php?q=node/4222. For more on this debate, see Morris Goldstein (2007) 'A (lack of) progress report on China's exchange rate policies', Working Paper no 07-5, Washington DC: Peterson Institute for International Economics; Jeffery Frankel (2006) 'On the yuan: The choice between adjustment under a fixed exchange rate and adjustment under a flexible rate', *Economic Studies* vol 52, no 2, pp246-75; Yin-Wong Cheung et al (2007) 'The overvaluation of renminbi undervaluation', *Journal of International Money and Finance* vol 26, no 5, pp 762-85

4.1.3 Fiscal policy

'It is not clear which type of tax regime most benefits poor people.'

Fiscal policy, referring to government decisions on taxation, spending and borrowing, has the potential to significantly support development and pro-poor growth. It shapes the business environment,[57] determines the extent of fiscal redistribution and supports the provision of public goods like healthcare, infrastructure and education. In practice, the degree to which taxation benefits poor people depends on the total revenue collected, the structure of the tax regime and subsequent patterns (and impact) of public expenditure. A significant body of research has demonstrated the benefits to the state of increasing reliance on tax vs non-tax sources of government revenue (that is, international development assistance or non-tax natural resource rents).[58] Perhaps contrary to expectations, many developing countries have scope for increasing tax revenues above current rates.[59] More specifically, as Cornia suggests:[60]

> 'Public savings can be raised to finance infrastructural development and safety nets by increasing tax pressure as done in China in 2000–2004, where revenue rose from 15 per cent to 20 per cent of GDP. This approach is recommended in particular in the 60 or so developing countries with tax/GDP ratios below 10–12 per cent.'

It is not clear which type of tax regime most benefits poor people. In the stabilisation or structural adjustment era, the need to reduce the distorting effects of the tax regime was strongly emphasised in many countries. One example of how this played out in reality is through the shift away from import and export taxes (as a part of larger liberalisation of trade regimes) and towards domestic taxes, such as value-added tax (VAT). Yet there is good evidence to question whether such initiatives are pro-poor. It may be difficult to maintain government revenues during such a switch.[61] This suggests that, especially where tax administration capacity is lacking, retaining taxes on imports may be a pragmatic 'second best' because of ease of collection and the reliability of revenues. A bigger challenge than possible revenue shortfalls is that uniform VAT, which is administratively straightforward to implement, is not pro-poor. Pro-poor VAT requires complex mechanisms such as a tiered VAT or exemptions for the goods consumed more heavily by the poor, or for the poor themselves on all goods.[62] Alternatively, basic pro-poor reforms might include enlarging the income tax base (as income taxes are nearly always progressive)[63] and simplifying tax administration, such as reducing the number of tax rates to increase the ease of tax administration while helping to avoid evasion.

Key thinkers on pro-poor growth all stress the importance of public sector investment in an active programme of fiscal policy designed to enable pro-poor growth.[64] Public investment can be used for demand management and to encourage capacity creation. The critical point here is the tendency in developing countries for public investment to

57 There continues to be significant debate on what country characteristics are conducive to a strong business environment. For one example, see the evaluation of the World Bank's Doing Business Indicators by the Bank's own Independent Evaluation Group at: http://go.worldbank.org/CYH45V15G0. With respect to fiscal policy, controversial tax policies (ie tax holidays) designed to attract investment have been criticised in a number of countries and sectors
58 Mick Moore (2007) 'How does taxation affect the quality of governance?' IDS Working Paper 280, Brighton: IDS
59 Alfredo Saad-Filho (2007) (see footnote 50)
60 Giovanni Cornia (2006) (see footnote 46)
61 Rathin Roy and John Weeks (2004) (see footnote 36)
62 Raghbendra Jha (2006) 'Pro-poor fiscal policy in the globalized economy' in *Pro-poor macroeconomics: Potential and limitations*, ed Giovanni Cornia, Basingstoke: Palgrave MacMillan
63 Chu et al (2004) in Raghbendra Jha (2006) (see footnote 62)
64 For example Raghbendra Jha (2006) (see footnote 62); Terry McKinley (2001) 'Introduction', in *Macroeconomic policy, growth and poverty reduction*, London: Palgrave; Rathin Roy and John Weeks (2004) (see footnote 36)

crowd in, rather than crowd out, private investments, stimulating growth through the multiplier effect.[65] By removing physical bottlenecks, government investment can raise factor productivity, providing incentives for greater private investment. Public and private resource mobilisation can therefore be viewed as complementary strategies rather than as being in competition with each other. Pasha and Palanivel and Roy and Weeks both point out the success of China and India in capitalising on this complementary effect.[66]

The composition of public spending is also critical to pro-poor growth. The government needs to provide an effective enabling environment through the sequenced introduction of effective policies and complementary measures. Specifically, investments in health, education and infrastructure are critical in giving poor people the skills, physical wellbeing and access to opportunities they need to participate in the growth process.[67] However, budget constraints mean that such investments are often in conflict with other spending priorities in a country. Powerful interest groups may divert funds towards their own interests and away from those of the poor (see Section 5). In other cases changes in country context may provide opportunities to increase pro-poor expenditure (Box 5).

Box 5: Public spending following the 1992 peace agreement in El Salvador[68]

The 1992 Peace Agreement in El Salvador opened the door for a reassessment of public spending following extended conflict. Military spending decreased from nearly 25 per cent of total government spending in 1991 to under 10 per cent by 1994. The peace dividend produced by this reduction enabled the expansion of social spending, including an expansion in the relative shares of budgets allocated to both health and education. This dramatic shift in the composition of public spending, in conjunction with high levels of efficiency and well targeted expenditure, strongly favoured poor people, with average number of years of schooling increasing faster in the poorest quintiles and significant improvements in both primary and secondary enrolments during the 1990s.

Crisis impacts

Fiscal policies which disrupt the boom–bust cycle can also support a pro-poor pace and pattern of growth. These countercyclical policies achieve this by helping to smooth public expenditure and by increasing the reliability of programmes that protect poor people.[69] Most experts prefer the domestic funding of public expenditure, where this is possible (that is, in middle-income countries).[70] This is because 'foreign savings and investment tend to be volatile, difficult to target, and they are often inimical to pro-poor objectives'.[71] Thus the bedrock of conducting a countercyclical fiscal policy in lean years involves the strengthening of tax/gross domestic product (GDP) ratios and retrenchment of non-productive expenditures during normal times.[72] The current crisis has supported such conclusions. Giugale suggests that room for countercyclical policies in Latin America is small in all but a few countries.[73] This is because of a combination of factors: a tradition of low tax collection; insufficient institutional capacity; and a shortage of lenders willing to finance large fiscal deficits. Similar challenges have been encountered in a number of African countries, particularly those resource-rich countries where budgetary decisions

65 Rathin Roy and John Weeks (2004) (see footnote 36)
66 Hafiz Pasha and Thangavel Palanivel (2003) 'Pro-poor growth and policies: The Asian experience', *The Pakistan Development Review* vol 42, no 4, pp313-48; Rathin Roy and John Weeks (2004) (see footnote 36)
67 World Bank (2007) *Agriculture for development: World development report 2008*. Washington DC: World Bank
68 José Silvério Marques (2004) 'Operationalizing Pro-Poor Growth: The case of El Salvador', country case study prepared for the World Bank Operationalizing Pro-Poor Growth (OPPG) Work Program, Washington DC: World Bank
69 Hafiz Pasha and Thangavel Palanivel (2003) (see footnote 66)
70 Giovanni Cornia (2006) (see footnote 46); Alfredo Saad-Filho (2007) (see footnote 50); Rathin Roy and John Weeks (2004) (see footnote 36)
71 Alfredo Saad-Filho (2007) (see footnote 50). Explaining the last of these objections, Saad-Filho suggests that foreign investment often supports luxury goods and services rather than basic consumer goods and manufactures.
72 Giovanni Cornia (2006) (see footnote 46); Raghbendra Jha (2006) (see footnote 62)
73 Marcelo Giugale (2009) (see footnote 20)

have been based on an assumption of continued high commodity prices.[74] Trade tax revenue losses are expected to be as much as US$4.6 billion in the major oil-exporting countries of Algeria and Nigeria.[75]

In contrast, countries like Chile, Brazil and Colombia have been able to save during expansionary periods, and this has created a buffer enabling them to fund fiscal stimulus during the crisis. One particular strategy available to policymakers is the creation of stabilisation funds. Such funds are particularly useful in the case of resource-dependent economies or other situations in which sudden changes in terms of trade can lead to a period of boom and bust for fiscal revenue collection. Jha highlights the Copper Stabilization Fund of Chile and the Macroeconomic Stabilization Fund of Venezuela as good examples of mechanisms by means of which public expenditure can be protected against price fluctuations often driven by exogenous change (in other words, changes in markets external to the producing country).[76]

Key questions for Section 4.1

- What is the policy for setting interest rates in your country? Is it targeted at achieving particular levels of inflation or employment?
- What is the exchange rate policy? Does it favour importers or exporters and in what ways might this decision affect the prospects for growth and poor people?
- What is the structure of the current tax regime in your country? How progressive is it? Has the balance of different taxes (eg indirect taxes such as VAT, direct taxes on personal income and wealth, corporate taxes) changed?
- What share of tax do different economic actors (eg large firms, multinational companies, micro- and small and medium sized enterprises) pay or avoid paying?
- Are tax exemptions provided to favour poorer groups (eg on VAT) or to provide incentives for actors in the economy? How effective are they?
- To what extent is the composition of public spending pro-poor?
- What constraints or flexibilities do national policymakers have in their macroeconomic policy (eg, in the form of policy conditions attached to loans provided by international financial institutions)?
-

4.2 Trade

There is a significant body of work establishing the links between trade, growth and poverty reduction. However, there remains considerable debate across disciplines and ideologies on the causal linkages between trade, growth and poverty.[77] In their analysis of the existing literature on trade-poverty linkages, Bird and Vandemoortele identify two perspectives.[78] The first suggests a one-way causal chain in which trade triggers growth processes that result in poverty reduction.[79] The second school of thought on trade, growth and poverty recognises that there are dynamic two-way links between trade, growth and poverty. Some suggest that economic integration into the world economy is a *result* of successful and inclusive growth and development, rather than a *prerequisite* for it.[80]

74 African Development Bank (2009) (see footnote 22); International Monetary Fund (2009) 'Regional Economic Outlook Sub-Saharan Africa Oct 2009: Weathering the Storm', Washington DC: IMF
75 African Development Bank (2009) (see footnote 22)
76 Raghbendra Jha (2006) (see footnote 62)
77 Martin Ravallion (2005) 'Looking beyond averages in the trade and poverty debate', Policy Research Working Paper no 3461, Washington DC: World Bank. See also Panos London (2006) 'Making or missing the links? The politics of trade reform and poverty reduction', Panos: London
78 Kate Bird and Milo Vandemoortele (2009 forthcoming) 'Trade, growth and poverty: Making Aid for Trade work for poor people', London: ODI.
79 Edwards (1998); Sachs and Warner (1995) in Kate Bird and Milo Vandemoortele (2009) (see footnote 78)
80 Chang (2007); Malhotra (2004); Rodriquez and Rodrik (1999); Rodrik (2007); Seguino (2006); UN Development Program (2003) in Kate Bird and Milo Vandemoortele (2009) (see footnote 78)

It is accepted that trade liberalisation and wider 'globalisation' have generated mixed results for poor people and for developing countries.[81] This means we need to take a closer look at trade-related policies for pro-poor growth. The argument is no longer whether or not trade is better for growth and poverty reduction than no trade – the small number of countries that have attempted to withdraw from the world trade system entirely (North Korea) illustrate the negative impact that this has on both wealth and wellbeing – but how to be smart about managing integration into the world trade system.

> *'The argument is no longer whether or not trade is better for growth and poverty reduction than no trade... but how to be smart about managing integration into the world trade system.'*

Several accompanying factors increase the likelihood that trade will deliver poverty reduction, including gender equality, education and literacy, sound institutions, industrialisation policies and more. Prioritised and sequenced investments in these complementary factors need to be aligned with any potential liberalisation of trade policy.[82] While the neo-liberal trade policy prescription that dominated much of the policy advice given to (and occasionally forced on) developing countries since the 1980s has stressed opening up markets and removing trade distortions in order to maximise comparative advantages, the idea of sequencing suggests that, although liberalisation *can* be beneficial, it needs to occur within the proper institutional context and must therefore be properly sequenced. Indeed, liberalising trade reforms in China and India, two countries thought to exemplify the potential pro-poor gains from free trade, were not implemented until roughly a decade after significant increases in growth rates began (Box 6).[83]

Box 6: Setting foundations first – sequenced reforms in Mauritius[84]

In the 1970s, using revenues created in the sugar sector (where prices were high because of European Union protection of sugar), Mauritius invested in clothing factories that were to operate in a new export- processing zone. This export processing zone, underpinned by free trade principles, saw a boom of clothing exports (helped by preferential access into the European Union) and investment at home. However, these free trade policies were combined with a domestic sector that was highly protected until the mid-1980s. In addition to these protectionist policies, the Mauritian government maintained quite significant budget allocations for health, education, water, sanitation and housing assistance, drawing on taxes levied on sugar exporters. The result of this sequenced strategy of reform and liberalisation was a reduction in poverty and improvements in social indicators over the medium term, the latter of which are now above average in Africa and for some middle-income countries.

Crisis impacts

The effects of the global financial crisis have highlighted some of the risks associated with trade liberalisation and export-oriented growth strategies. Most clearly, the crisis appears to have confirmed arguments that integration into global markets increases exposure to trade shocks, which could undermine both growth and poverty reduction, and the current crisis has made this link explicit. The African Development Bank (March 2009) suggests that the crisis-induced decline in trade flows is the primary reason behind the current

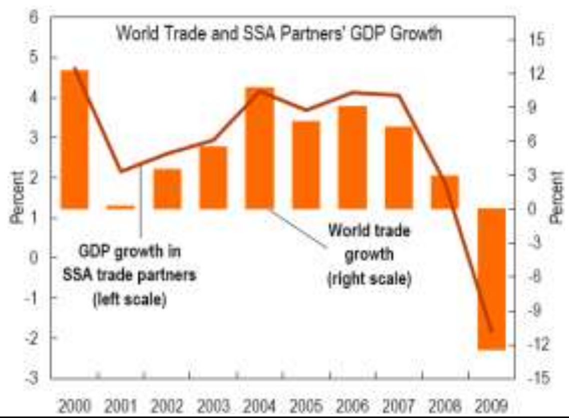
81 Martin Ravallion (2005) *Inequality is bad for the poor*, Washington. DC: World Bank; Robert Wade and Martin Wolf (2002) 'Prospect debate: Are global poverty and inequality getting worse? Yes: Robert Wade, No: Martin Wolf', *Prospect*, March, pp16-21
82 Kate Bird and Milo Vandemoortele (2009) (see footnote 78)
83 Dani Rodrik (2000); Robert Wade and Martin Wolf (2002) (see footnote 81)
84 United Nations Development Program (2003) *Making global trade work for people*. London: Earthscan; Ernest Harsch (2006) 'Combating inequality in Africa: Lessen inequities to reduce poverty and reach MDGs, says UN'. *Africa Renewal* vol 20, no 2 pp16

slowdown in African growth rates, with the shortfall in export revenues expected to exceed US$250 billion (see Box 7).

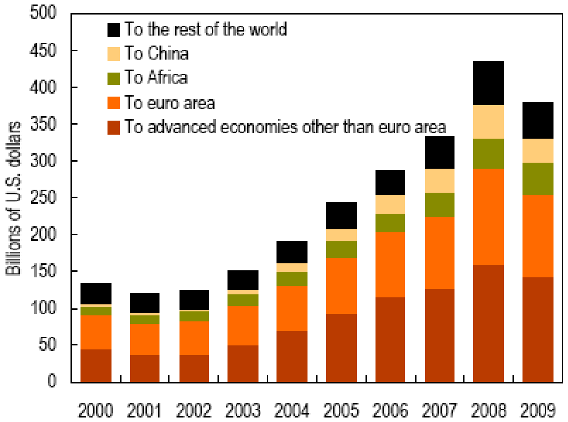
Box 7: Global financial crisis impacts on trade in sub-Saharan Africa[85]

The current global financial crisis has had strong impacts in both the high-consuming countries of the North and a number of large and rapidly growing developing countries (eg China), whose rapid growth had helped to drive the demand for sub-Saharan exports. The decrease in exports to key markets has had significant negative impacts on growth and poverty reduction rates in a number of sub-Saharan African countries. The effect has been particularly strong among commodity exporters like Nigeria and Angola, who could experience a combined shortfall of US$76.8 billion in export revenues, and middle-income economies with high degrees of integration into the world economy like Botswana and South Africa. Government budgets are likely to shrink in strongly trading nations, as the impact of reduced export revenues is compounded by falls in trade tax revenues of perhaps 4–5 per cent (of total government revenues).

Declining demand for SSA exports 2000–2009



Sub-Saharan African exports by destination 2000–2009



In response to these negative impacts, there is some debate regarding the potential costs and benefits of growing protectionism.[86] This debate reflects the need to move beyond a crisis response that focuses purely on the national level. While a move to greater protectionism is clearly worrying, Duncan Green suggests that even in times of crisis it is critical to make a distinction between protectionism in developing countries and that in developed countries.[87] Building on a considerable body of earlier work,[88] Green returns to one of the major ongoing debates regarding trade and the development process, the extent to which developing countries should use protectionist trade strategies as a form of industrial policy, allowing them to defy existing levels of comparative advantage.[89]

85 African Development Bank (2009) 'Africa and the global financial crisis: Strategies for preserving the long-term foundations of growth', Working Paper no 98, Tunis: AfDB; International Monetary Fund (2009) (see footnote 74)
86 Simon Evenett (ed) (2009) 'Broken promises: A G20 summit report by Global Trade Alert', London: Centre for Economic Policy Research
87 Duncan Green (2009) 'Protectionism – good or bad? It depends ... ', www.voxeu.org/index.php?q=node/2970
88 Chang (2002); List (1885); Wade (1990) in Duncan Green (2009) (see footnote 87)
89 For a summary of the current state of this debate, see Ha-Joon Chang and Justin Lin (2009) 'Should industrial policy in developing countries conform to comparative advantage or defy it? A debate between Justin Lin and Ha-Joon Chang', Development Policy Review vol 27, no 5, pp483-502

Key questions for Section 4.2

- What have been the effects of liberalisation on growth and the distribution of benefits from trade in key sectors?
- What have been the effects in those sectors most important to poor people?
- How has protection or opening of the national market affected production and employment levels in the country overall and in different economic sectors and regions? Have the policies made things better or worse for poorer groups?
- What do different groups of producers, consumers and business people say?
- How has trade liberalisation changed the level and composition of your country's exports and imports?
- Has tariff reduction affected government revenue and have tax reforms succeeded or failed to compensate for this loss?
- Is your government opening the national market unilaterally or as part of international negotiations? To what extent is trade policy determined by global (World Trade Organization), regional and bilateral trade agreements?
- What would be the implications of the completion of the Doha Round of World Trade Organization negotiations for your country?
- What, if any, is the current role of international Aid for Trade initiatives in your country, given the constraints affecting successful access to external markets (eg quality of goods, infrastructure)?
- How has the crisis impacted the terms of trade faced by your country?

5. Sector-specific challenges

Key sectors for pro-poor growth clearly vary according to the type of policies pursued (direct vs indirect) and other elements of the country context. However, a number of sectors remain critical to making growth more pro-poor across a large number of countries.

5.1 Agriculture

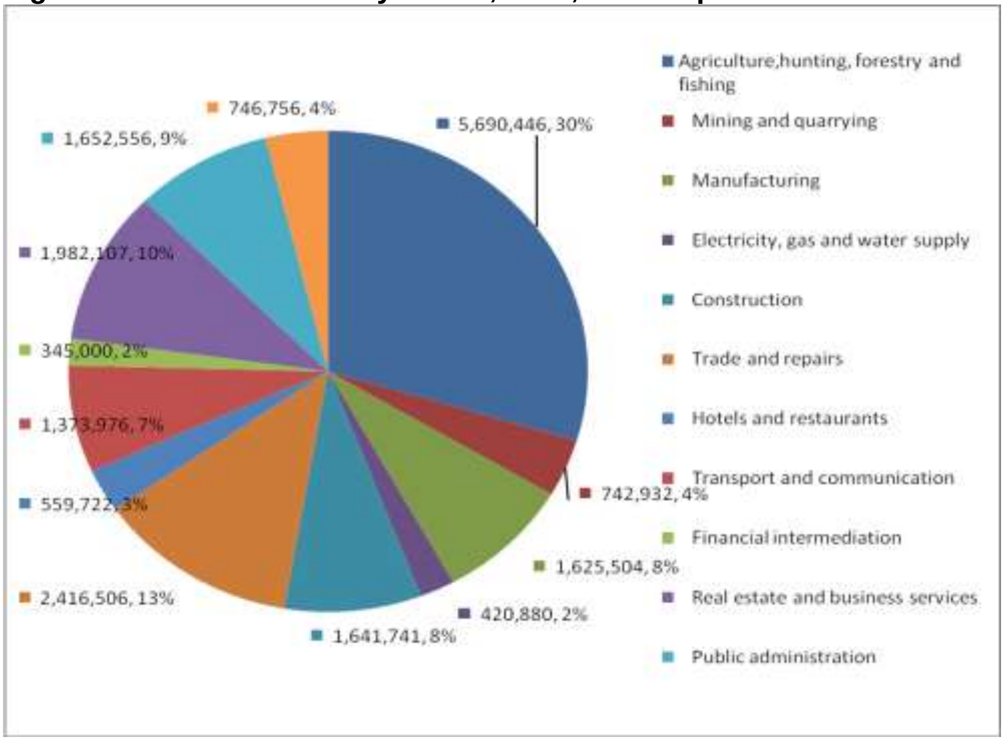
> *'As well as making future growth in other sectors possible, agriculture plays an important role in making growth more pro-poor now.'*

Historically, growth in agriculture has laid the foundations for growth in industry and services by providing the raw materials needed for industry, earning foreign exchange, creating a domestic market for manufactures and services, transferring capital, labour and land to other sectors and supplying food to the expanding urban economy.[90] As well as making future growth in other sectors possible, agriculture plays an important role in making growth more pro-poor now. Irz et al find that a 10 per cent increase in farm yields has reduced poverty by 7 per cent in Africa.[91] This is slightly more than the 5 per cent reduction estimated for Asia. This ability to reduce poverty is greater than that derived from growth in manufacturing and services.

This is partly because many poor people work in agriculture.[92] For example, whereas 30 per cent of Tanzanian GDP was derived from agriculture (including related activities in hunting, forestry and fishing) in 2007 (see Figure 1), the sector accounted for 76.5 per cent of total employment.[93] These numbers illustrate that to enable growth for poverty reduction, policies need to address the sectors in which poor people work.

90 Johnston and Mellor (1961) in Steve Wiggins (2009 forthcoming) 'Agriculture and pro-poor growth', paper commissioned by the Executive Committee of the Joint Steering Committee on Pro-Poor Growth (Train4Dev and OECD DAC POVNET), London: ODI
91 Xavier Irz et al (2001) 'Agricultural productivity growth and poverty alleviation', *Development Policy Review* vol 19, no 4, pp449-66
92 World Bank (2007) (see footnote 68)
93 United Republic of Tanzania (2007) *Poverty and human development report*, Dar es Salaam: Research and Analysis Working Group, United Republic of Tanzania

Figure 1: Tanzanian GDP by sector, 2007, current prices[94]



The pro-poor benefits of strong growth in the agriculture sector extend well beyond the portion of the population employed in agriculture itself. Poor people are consumers as well as producers and increased productivity, resulting in lower prices, potentially benefits all food consumers including poor urban and rural households that have to buy most of their food.

An adaptable policy response is needed to support groups and areas facing differing opportunities and constraints in order to enable pro-poor agricultural growth successfully. Dorward proposes linking such differences to policy implications through three paths out of poverty:[95] 'stepping up', 'stepping out' and 'hanging in'. The first of these strategies suggests that the best option for certain parts of the population working in agriculture will be to invest in 'assets to expand the scale or productivity of existing assets and activities'. For others, the best option will be 'stepping out' into the rural non-farm economy or migration to urban areas. For a third group, potential stresses and shocks mean the most immediately relevant strategies will be those designed to maintain current levels of wellbeing and to build assets to enable positive change in the future. The precise mix of these three strategies to encourage pro-poor growth in agriculture will depend on the local context.

Crisis impacts

Increased productivity and other advances in agricultural development can benefit poor producers and consumers. However, the recent food and financial crises have highlighted how the poor can also be faced with a paradoxical double burden of continued high domestic food costs and falling prices for their commodities on international markets.

Problems generated by the increase in food prices during the food crisis of 2007–2008 have been compounded by the current financial crisis, producing substantial volatility in most commodity prices, including those for food. Most recently, prices for many key

94 National Bureau of Statistics, www.nbs.go.tz/METADATA/NSDF.htm

95 Andrew Dorward (2009) 'Integrating contested aspirations, processes and policy: Development as hanging in, stepping up and stepping out', *Development Policy Review* vol 27, no 2, pp131-46

commodities have fallen significantly.[96] Although this has hurt net exporters of food, one would expect that consumers would benefit from lower prices. However, in many cases, food prices have proven to be 'sticky', failing to fall following reductions in the price of oil and other key inputs associated with reduced consumption owing to the financial crisis.[97]

5.2 Extractives

> *'Extractive industries tend to have low labour intensity, limiting pro-poor transmissions through wages, and high import intensity of intermediate and capital inputs.'*

Debate rages about whether growth in extractive sectors can be made pro-poor. Drawing on the distinction between direct and indirect pro-poor growth outlined above, a number of key issues arise. The first concern is the degree of integration with the non-extractive economy. Many extractive industries, for example oil industries in Equatorial Guinea, Gabon and Nigeria,[98] are highly enclaved, meaning that benefits from resource extraction often fail to benefit the rest of the economy. Also, modern extractive industries tend to have low labour intensity, limiting pro-poor transmissions through wages, and high import intensity of intermediate and capital inputs (Zambian copper industries). Where there is a significant labour component to operations, a second issue is the evolution of relationships between the government, large companies, employees and small-scale miners. A number of media reports have highlighted issues of objectionable working conditions, including child labour.[99]

Natural resource revenues can be large, with significant consequences for the other parts of an economy. The literature on the 'resource curse' suggests that increases in extractive commodity exports can result in large inflows of foreign currency that drive appreciation of the real exchange rate. In one example, a boom in copper revenues in Zambia resulted in an appreciation of the kwacha in November 2005, and again from mid-2007 to mid-2008. According to Bova, as a result of this appreciation 'Zambia's non-traditional exporters of tobacco, cotton, coffee and horticulture experienced a 30 per cent decrease in their earnings in domestic currency terms, and thus contracted their production in 2006–2007.'[100]

The size of resource revenues also suggests that, with a carefully designed tax regime, scope remains for mining to contribute indirectly to pro-poor growth. However, in practice, a number of challenges arise here as well. Otto et al highlight the lack of success among many developing countries in establishing regimes of taxation on natural resource rents (Box 8).[101] This is particularly difficult in the competitive context in which countries seek to provide incentives for foreign investment.

96 UN Conference on Trade and Development (2009) *Trade and development report, 2009: Responding to the global crisis, climate change mitigation and development*, New York and Geneva: UNCTAD
97 Naomi Hossain et al (2009) 'Accounts of crisis: Poor people's experiences of the food, fuel and financial crises in five countries', Brighton: IDS; FAO (2009) *The state of food insecurity in the world 2009: Economic crises – impacts and lessons learned*, Rome: Food and Agriculture Organization
98 Brendan McSherry (2006) 'The political economy of oil in Equatorial Guinea', *Africa Studies Quarterly* vol 8, no 3
99 S Sanga (2008) 'The role of poor governance in the Tanzanite–al-Qaeda link controversy, and policy options for Tanzania enabling it to escape from "curses" in the mining industry', Budapest: Open Society Institute
100 Elva Bova (2008) 'Exchange rate management for commodity booms: Examining Zambia's copper exports', *Development Viewpoint* 19, London: Centre for Development Policy and Research, SOAS
101 James Otto et al (2006) *Mining royalties: A global study of their impact on investors, government, and civil society*, Washington DC: World Bank

Box 8: Extractives in Tanzania[102]

Since 2000, mining has been the most dynamic sector in Tanzania, averaging growth of 15 per cent over the period 2000–2006. However, the sector's contribution to total GDP is small, at roughly 3.7 per cent (see Figure 1 above). The degree of pro-poor contribution of the sector has also been limited by a number of factors. Sanga finds limited linkages between mining and the rest of the economy. With royalty rates in Tanzania (ranging from 0 to 5 per cent) that are among the lowest of any mineral-rich African country and low levels of direct taxation (ie corporate taxes), even indirect links via government budgets have been limited.

Crisis impacts

The dramatic way in which the crisis has impacted countries that are heavily dependent on revenues from natural resources has demonstrated the risks of economic dependence on commodity production. For example, Botswana has experienced a sharp decline in industrial production, export and government revenues, owing to its high dependence on diamond exports (35 to 50 per cent of government revenues).[103] Where excessive specialisation is combined with poor governance and weak state institutions outcomes have been even worse, as risk-averse investors have relocated to lower-risk countries. In the Democratic Republic of Congo, more than 100,000 jobs have been lost as a result of smelter closures.[104] The oil economies have been hit similarly hard as demand and prices have fallen, putting pressure on terms of trade and creating large fiscal deficits.[105]

5.3 Private sector development

> *'Newer thinking on pro-poor growth stresses the importance of better integrating poor people into markets.'*

Given the diversity of both developing country contexts and private sector activities, it is difficult to generalise as to which policies will enhance the pro-poor impact of private sector development. Here we will limit the discussion to the key debate that applies to a number of specific industries: the degree to which the poor can, and should, be integrated into traditional markets.

Previous strategies for encouraging pro-poor growth in the private sector have often centred around ideas of segregating (even protecting) poor people from traditional markets by focusing on particular sectors or activities that were thought to be important to poor people. In many cases this was supported by certification initiatives designed to ensure certain standards and create a niche market aimed at consumers concerned about socially or environmentally responsible production. However, a number of studies have recently brought into question the extent to which the implementation of standards and certification regimes have benefited poor people in areas including fisheries,[106] forestry[107] and ethical trade,[108] despite some of the recognised achievements of such programmes.

102 Clemens Breisinger and James Thurlow (2008) 'Asian-driven resource booms in Africa: Rethinking the impacts on development', Discussion Paper 00747, Washington DC: International Food Policy Research Institute
James Otto et al (2006) (see footnote 101); S Sanga (2008) (see footnote 101); United Republic of Tanzania (2007) (see footnote 95)
103 African Development Bank (2009) (see footnote 22)
104 African Development Bank (2009) (see footnote 22)
105 UN Conference on Trade and Development (2009) *Trade and development report, 2009: Responding to the global crisis, climate change mitigation and development*, New York and Geneva: UNCTAD; International Monetary Fund (2009) (see footnote 74)
106 Stefano Ponte (2006) 'Ecolabels and fish trade: Marine Stewardship Council certification and the South African hake industry', Working Paper no 9/2006, Stellenbosch: tralac
107 Benjamin Cashore et al (2006) *Confronting sustainability: Forest certification in developing and transitioning countries*, Report no 8, New Haven CT: Yale School of Forestry and Environmental Studies;

Newer thinking on pro-poor growth stresses the importance of better integrating poor people into markets. In other words, participating in private sector activities is insufficient to achieve poverty reduction at scale; what matters is *how* poor people are able participate. This perspective is best captured in the value chain literature, which focuses on the activities required to take a product or service from conception to the supply of raw materials, through the manufacturing process, branding and distribution and finally to consumption and disposal.

Two issues are key here. First, linking small and medium-sized enterprises to larger firms helps link them to larger international markets. In many cases, this also includes linking formal enterprises to the informal sector, where many poor people are employed through value chains (Box 9). Second, through value chain analysis, pro-poor growth advocates are now attempting to identify context-specific opportunities to upgrade the position of poor people within these larger value chains by changing the distribution of value among various parts of the chain or changing the activities in which the poor participate.

Early upgrading success stories at the national level include the shift in the newly industrialising economies during the 1970s and 1980s, and China in the 1990s, from the mere assembly of imported inputs to 'a more domestically integrated and higher value-added form of exporting known alternatively as full-package supply or OEM (original equipment manufacturing) production'[109] and eventually to original brand name manufacturing. This process enabled firms in these countries to capture additional value during production. On a smaller scale, examples include the new entrepreneurial activities generated through the advent of Coca-Cola's manual distribution centres in Ethiopia and Tanzania.[110]

Box 9: Unilever Indonesia – pro-poor growth via big business[111]

One of the clearest studies demonstrating the potential in linking poor people working in small and medium-sized enterprises through larger value chains is the study of Unilever Indonesia carried out by Oxfam GB and Novib in 2005. The analysis revealed that, taking into account the activities along the entire length of the Unilever Indonesia value chain, more than 97 per cent of employment generated by its business activities took place outside its core operations. Additionally, 40 per cent of the total value generated is located in supply and distribution chains, with an additional 26 per cent going to the Indonesian government in the form of tax revenues. This study, and others like it, has highlighted the potential for pro-poor growth initiatives to focus on mainstream business activities (including those of large multinational firms) rather than peripheral corporate social responsibility initiatives or niche activities.

There are, of course, a number of debates within the value chain perspective, including the degree to which there is scope for poor people and firms in poor countries to upgrade their position,[112] how best to manage value chains that spread across international

Kirsti Thornber et al (1999) 'Certification: Barriers to benefits – a discussion of equity implications', Briefing Paper and Discussion Paper no 8, Joensuu: European Forest Institute

108 Karen Ellis and Jodie Keane (2008) 'A review of ethical standards and labels: Is there a gap in the market for a new "Good for Development" label?' Working Paper 297, London: Overseas Development Institute; Peter Taylor (2004) 'In the market but not of it: Fair Trade coffee and Forest Stewardship Council certification as market-based social change', *World Development* vol 33, no 1: 129-47

109 Gary Gereffi (2002) 'Outsourcing and changing patterns of international competition in the apparel commodity chain', for conference on 'Responding to globalization: Societies, groups and individuals', Boulder, CO, 4-7 April

110 Jane Nelson et al (2009) 'Developing inclusive business models: A review of Coca-Cola's manual distribution centers in Ethiopia and Tanzania', research study, Cambridge MA and Washington DC: Harvard Kennedy School and International Finance Corporation

111 Jason Clay (2005) 'Exploring the links between international business and poverty reduction: A case study of Unilever Indonesia', Oxfam GB, Novib and Unilever Indonesia joint research project, Oxford: Oxfam GB

112 Kaname Akamatsu (1962) 'A historical pattern of economic growth in developing countries', *Journal of Developing Economies* vol 1, no 1, pp3-25; Mitchell Bernard and John Ravenhill (1995) 'Beyond product cycles and flying geese: Regionalization, hierarchy, and the industrialization of East Asia', *World Politics* vol

borders,[113] the question of employment standards and compensation differences between formal and informal parts of the value chain[114] and the challenges of competing with established clusters of economic activity in China, Vietnam and other existing economic agglomerations.

Key questions for Section 5

- Which economic sectors (eg agriculture, manufacturing, services such as tourism) are likely to be important contributors to pro-poor growth in your country?
- Are they sectors in which the poor own the factors of production (that is, their own labour) and work?
- What are the potential benefits and shortcomings of extractives for growth and poverty reduction in your country?
- How can policies best combine the promotion of food security and rural livelihoods with the growth-enhancing potential of commercial agriculture, including exports?
- To what extent are the economic activities in growth sectors linked with others in the local economy? Do they generate jobs, income and demand for local goods and services?
- If they are weakly linked, what could be done to secure stronger benefits, for example through the effective generation and spending of tax revenues?
- How can the government best promote the vital contribution of the private sector to economic development and poverty reduction?
- Does this mean government providing an enabling environment for businesses to operate freely or is stronger intervention required to create the conditions in which a vibrant private sector can emerge?
- How diverse is the private sector in your country and which groups comprise it? How responsive is the government to the views and interests of different parts of the private sector?
- Does the government have policies to promote beneficial linkages between micro-enterprises and small- and medium-sized businesses with larger national and foreign firms that could promote both economic growth and development and poverty reduction?
- Are there unnecessary regulatory obstacles? Are markets competitive? How appropriate and effective is regulation in promoting more transparent and equitable markets so that poorer producers and consumers can be better involved and served?
- To what extent do present government policies or proposed reforms address constraints on achieving pro-poor gains in different economic sectors?

47, no 2, pp171-209. See also debates on industrial policy: Ha-Joon Chang and Justin Lin (2009) (see footnote 89)

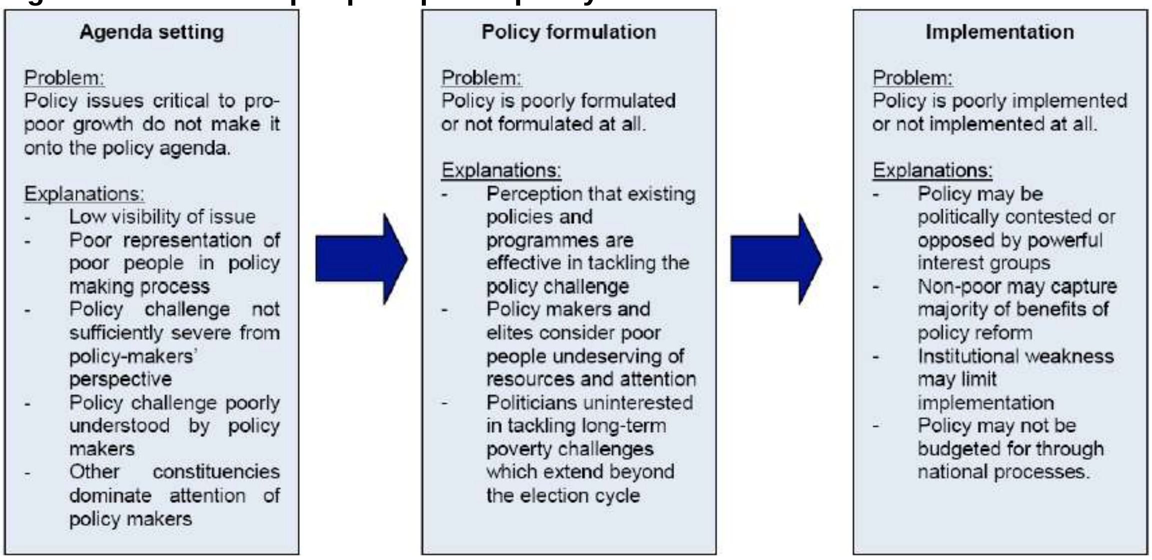
113 Raphael Kaplinsky (2000) 'Globalisation and unequalisation: What can be learned from value chain analysis?' *Journal of Development Studies* vol 37, no 2, pp117-46; (2004) 'Spreading the gains from globalization: What can be learned from value chain analysis?' *Problems of Economic Transition* vol 47, no 2, pp74-115

114 Jason Clay (2005) (see footnote 111)

6. The political economy of pro-poor growth

Despite the fact that poverty reduction achieved through pro-poor growth based on production of a larger economic pie is likely to be more politically feasible than that which relies solely on static redistribution of a fixed quantity of resources, policymaking that helps to determine the pace and pattern of growth remains an inherently political process. Pro-poor growth is likely to require changes to the political settlement. The common interpretation of this is an inevitable contestation between the forces of the rich and those of the poor, in which the rich benefit from asymmetries in wealth, power and knowledge. Thus, in many cases the policy decisions that help to determine the pace and pattern of economic growth are taken in ways that exclude or under-represent certain interest groups, often including the poor themselves. Bird outlines barriers to creation of pro-poor public policy (Figure 2).[115]

Figure 2: Barriers to pro-poor public policy[116]



How can advocates of pro-poor growth hope to respond if this interpretation is correct? One answer comes from the Organisation for Economic Co-operation and Development (OECD), which argues in its guidelines for pro-poor growth that '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.'[117] This theme of informed participation has a strong following in the development community[118] and can be often be found in debates on economic governance structures. Studies such as Bwalya et al's recent work in Zambia[119] have demonstrated the potential for non-state actors to significantly influence government budgets if they have the capacity and skills to articulate and justify their proposal. Participation as a mechanism for increasing the voice of marginalised groups, including the poor, therefore remains at the heart of a number of key development tools, including participatory rural appraisals (PRAs), participatory poverty assessment (PPAs) and poverty reduction strategy papers (PRSPs). The PRSP process in particular has attracted a significant amount of attention in the literature.

115 Kate Bird (2008) 'The political economy of pro-poor growth', Briefing Paper no 35, London: ODI
116 Kate Bird (2008) (see footnote 115)
117 Organisation for Economic Co-operation and Development (2006) *Promoting pro-poor growth: Key policy messages*, Paris: OECD
118 For an early and influential example, see Robert Chambers (1994) 'The origins and practice of participatory rural appraisal', *World Development* vol 22, no 7, pp953-69
119 Samuel Bwalya et al (2009) 'How non-state actors lobby to influence budget outcomes in Zambia', Discussion Paper no 27, Manchester: Improving Institutions for Pro-Poor Growth

In short, results of participatory initiatives have been mixed. Ali notes that strong participatory elements in the Ugandan, Rwandan and Vietnamese PRSP processes were built on clearly planned and communicated strategies for local-level influence, pre-existing participatory traditions and the influence of local non-governmental organisations (NGOs).[120] Yet in a number of other contexts, participatory elements failed significantly to influence PRSPs.[121] In many countries, especially in the early phases, PRSPs were often viewed as a necessary step towards receiving debt relief under the Heavily Indebted Poor Country (HIPC) Initiative, limiting the possible extent of national ownership.[122] Similarly, Braunschweig and Stockli find that this perception of PRSPs as externally imposed undermines the credibility of the participatory process.[123]

It has also been suggested that, as well as policy frameworks specifically dealing with poverty reduction, public policy has an important role to play in helping poorer groups organise and have a greater say in how markets operate and are governed in practice. The UN Conference on Trade and Development (UNCTAD), for example, in stressing the importance of boosting investment in agriculture in its 2009 World Investment Report, suggests that small producers can be better organised to negotiate with transnational corporations in supply chains, and that appropriate regulation, such as effective competition laws, can help prevent abuse of market power.[124]

Some research suggests that a wide range of public policy interventions is needed to foster more inclusive economic growth, including the promotion of social, political and legal empowerment as well as measures specifically on the economy, whilst recognising that the scope for such action can be impaired by personalised rule and a state–citizen relationship based on clientelism (involving the exchange of favours, gifts and transfers).[125] Some researchers stress the need to empower people themselves to take greater control of their lives, for example increased self-confidence and the capacity for individual and collective action, so as to tackle the allegedly deep-seated inequalities of markets and the ready access of powerful interest groups to policy-makers.[126]

> *'Where rent-seeking, patronage politics and elite capture are the norm in determining policy outcomes, achieving pro-poor outcomes is likely to be difficult.'*

Notions of interest-group representation and the challenge of strengthening the inclusion of poor and marginalised people in decision making are often based, either explicitly or

120 Syed Mohammed Ali (2006) 'Participation as the means to assess effectiveness of the poverty reduction strategy paper for Pakistan'. Budapest: Open Society Institute. For additional detail on the role of NGOs and civil society in the PRSP process, see Thomas Braunschweig and Bruno Stockli (2006) 'Civil society's perspective on their involvement in
PRSP monitoring: Assessing constraints and potentials in Nicaragua' Berne: AllianceSud; David Brown (2004) 'Participation in poverty reduction strategies: Democracy strengthened or democracy undermined?' in *From tyranny to transformation? New approaches to participation*, eds Samuel Hickey and Giles Mohan, London: Zed Books, pp. 237–251; Marta Foresti et al (2002) 'What role for civil society in monitoring poverty reduction policies?' Roundtable on 'Role of civil society in monitoring poverty reduction policies', Seville, 9-11 October

121 Syed Mohammed Ali (2006) (see footnote 120); Laure-Hélène Piron and Allison Evans (2004) 'Politics and the PRSP approach: Synthesis paper' ODI Working Paper 237, London: ODI

122 IMF et al (2005) in OECD (2006) (see footnote 117); Frances Stewart and Michael Wang (2003) 'Do PRSPs empower poor countries and disempower the World Bank, or is it the other way round?' Working Paper no 108, Oxford: Queen Elizabeth House

123 Braunschweig and Stockli (2006) (see footnote 120)

124 UNCTAD (2009) *World investment report, 2009: Transnational corporations, agricultural production and development*. New York and Geneva: UNCTAD, p176

125 Kate Bird and Stefanie Busse (2006), *Pro-poor policy: An overview*, Poverty-wellbeing platform, Swiss Development Cooperation and ODI

126 Rosalind Eyben, Naila Kabeer and Andrea Cornwall (2008), *Conceptualising empowerment and the implications for pro-poor growth:A paper for the DAC Poverty Network,* Brighton: IDS

implicitly, in theories of democratic political equality.[127] However, whether or not democratic institutions contribute to pro-poor growth remains a complex and unresolved issue. Outcomes in Brazil, India and South Africa, as well as Mauritius and Botswana, seem to substantiate claims that democratisation can lead to pro-poor results .[128]

Yet, as Williams et al note,[129] no difference between growth rates in democracies and non-democracies has been observed. Democratic systems are certainly not always pro-poor.[130] While there are clearly examples of non-developmental autocratic regimes, the effectiveness of South Korea and Taiwan and more recently China and Vietnam in achieving broad-based growth and poverty reduction has led a number of authors to suggest that, although giving voice to the poor in decision-making processes may be desirable, it is not necessary for pro-poor growth, instead crediting the initiatives of enlightened elites.[131] Such an interpretation suggests that the democratic institutions that are often thought to provide the equitable political voice that enables effective participation matter less than achieving the final policy agenda that participation is meant to produce. Essentially, this is an argument for a renewed focus on the developmental state (Box 10).

Box 10: Characteristics of the developmental state[132]

- **State control and legitimacy.** State authority and systems are strong, consolidated and viewed as legitimate, such that political stability is maintained, both upper and lower classes are taxable, labour is regulated and disciplined and the permanently poor are protected. A strong and realistic sense of nation and nationalism exists. Domestic and foreign capital is attracted and tamed to promote national development goals.
- **Public service.** A powerful, competent and insulated economic bureaucracy exists that is stable and has the authority to create, direct and manage the broad shape of economic and social development. Other effective institutions, formal and informal, exist to promote and implement economic policy.
- **Government legitimacy.** Government has legitimacy and support and is not required to redistribute public goods or to change or block development policies or processes in order to retain support and power.
- **State and non-state actors.** The state is relatively independent of special interests, although it remains closely linked to non-state and other state actors who help to define, redefine and implement developmental objectives.
- **Policy priority.** Economic development is the consistent and top priority of government policy, and policy is transformed into 'rules of the game' that promote productive entrepreneurship.
- **National behaviour and attitudes.** Social and technical innovations are generated domestically, or adopted from abroad, then adapted and used to solve problems.
- **Elite.** There exists a determined developmental leadership that either is relatively uncorrupt or performs corrupt acts that are not predatory but promote national productivity.

A recent report by the UN Conference on Trade and Development[133] tries to bridge the debate between older 'good governance' agendas and the emulation of 20th century developmental states in East Asia by suggesting that the ideal developmental state would pay attention to both processes and outcomes. How specific processes take shape would vary from country to country. However, in such an interpretation, the 'LDCs [least-

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127 Dahl (1953) in Peter John (2009) ‘Can citizen governance redress the representative bias of political participation?’ *Public Administration Review*, Vol 69, No 3, pp494-503
128 Verena Fritz and Alina Rocha Menocal (2007) (see footnote 4)
129 Gareth Williams et al (2009) 'Politics and growth', *Development Policy Review* vol 27, no 1, pp5-31
130 Kate Bird (2008) (see footnote 115); Diana Cammack (2007) 'The logic of African neopatrimonialism: What role for donors?' *Development Policy Review* vol 25, no 5, pp599-614; Mick Moore and James Putzel (1999) 'Thinking strategically about politics and poverty', Working Paper no 101, Brighton: IDS
131 Steve Wiggins et al (2009 forthcoming) ‘Introducing Pro-Poor Growth’, paper commissioned by the Executive Committee of the Joint Steering Committee on Pro-Poor Growth (Train4Dev and OECD DAC POVNET), London: ODI
132 Adapted from Diana Cammack (2007) (see footnote 130)
133 UN Conference on Trade and Development (2009b) *The least developed countries Report, 2009: The state and development governance – overview*, New York and Geneva: UNCTAD

developed countries] should aspire to a kind of good governance in which the practices of governing are imbued with the principles of participation, fairness, decency, accountability, transparency and efficiency in a non-culturally-specific way'. The report argues that these principles have a value independent of the achievement of developmental outcomes, but are insufficient without such outcomes.

In the absence of a developmental state, for example, where rent-seeking, patronage politics and elite capture are the norm in determining policy outcomes, achieving pro-poor outcomes is likely to be difficult. While there remains significant potential for the creation of pro-poor political alliances,[134] finding points of leverage depends on acknowledging the political nature of opposition to reform. Recent debates on the politics of pro-poor reform have therefore centred on the potential contributions of political economy analysis.

In the context of the crisis, a shift towards political economy analysis would represent a significant departure from the good governance agenda often associated with the post-Washington Consensus era. As Williams et al argue,[135] under the good governance agenda, 'development agencies have taken an increasingly normative view of the importance of good governance as a precondition for economic development' that has 'often been based on an unspoken assumption that it is possible and desirable to transplant institutional models from OECD countries to the developing world' and has 'expanded to cover multiple objectives, such as human rights, democratisation, voice and accountability'.

In contrast, authors writing on political economy analysis[136] emphasise the need to develop an awareness of local institutional contexts and the distributions of power and incentives among relevant actors in order to identify points of leverage for pro-poor change that work with the grain of local politics.[137] In some states, this may require development practitioners to set their sights lower, or at least accept more incremental changes. However, for many experts, a shift away from a tutelary conception of development and strict normative conditionality towards one that works within institutionally diverse contexts is an important step towards more effective development policy.[138]

Key questions for Section 6

- How do different economic actors and social groups influence the various stages of policy processes relevant to growth and poverty reduction (ie, agenda setting, policy formulation, policy implementation and policy review)?
- Which institutions are involved and what informal channels do the various actors and groups use?
- Which are the most powerful lobbies and interest groups? Which groups have little say?
- To what extent are the poor consulted in decisions of economic governance?
- Which of the key barriers to pro-poor public policy outlined in Figure 2 are most relevant in your country?
- Do government, parliamentary or civil society mechanisms exist for poorer social groups to represent their views? What barriers (social, political, institutional) hinder their representation in this way?
- What technical and political challenges stand in the way of a diverse range of views being taken into account in the complex and potentially sensitive area of economic policy-making?

134 Mick Moore and James Putzel (1999) (see footnote 130)
135 Gareth Williams et al (2009) (see footnote 129)
136 David Booth and Dirk Willem te Velde (2008) 'Integrating political analysis into growth policy thinking: A general approach for DFID country offices', London: ODI; Department for International Development (2009) 'How to note on political economy analysis', Practice paper, London: DFID; World Bank (2008) 'The political economy of policy reform: Issues and implications for policy dialogue and development operations', Washington DC: World Bank
137 David Booth (2009) 'Elites, governance and the public interest in Africa: Working with the grain?' APPP Discussion Paper no 6, London: ODI
138 Dani Rodrik (2006) (see footnote 11); Organisation for Economic Co-operation and Development (2009) *Policy ownership and aid conditionality in light of the financial crisis: A critical review*, Paris: OECD

- Does the government promote stakeholder involvement in economic policy? How does it coordinate the input of different ministries and institutions and that of various constituencies outside the state?
- How strong are the links between policy-making regarding specific sectors driving economic growth and those addressing poverty reduction (such as PRSPs) and national development?
- How well is the allocation of resources from the national budget aligned with objectives for economic growth and poverty reduction, and what input do citizens have in budget decisions?
- What social, economic and political pressures and incentives shape decision making on the economy? How do they affect its public openness, transparency and accountability?
- What are the potential opportunities for pro-poor political alliances, including those involving the elite?
- Which stakeholders are likely to gain from proposed reforms? Which are likely to lose? Are there potential mechanisms for gaining the support of the 'losers'?
- What can different state and non-state actors do to strengthen the inclusiveness and effectiveness of policies affecting economic growth and poverty reduction?

7. Conclusion

Even as the effects of the financial crisis are still taking shape, the new literature starting to emerge suggests that the crisis is changing the way many people think about growth processes, and will do so for some time to come. In many cases, the themes of equity, balanced growth and the role of the state in shaping economic processes that are now being talked about (grudgingly, perhaps) in mainstream economic development circles were, as recently as the immediate pre-crisis period, dismissed as economic heresy by an orthodoxy governed by market principles and normative conceptions of best practice. However, these types of arguments, which support policies aimed at producing a balanced growth process in which all segments of the population can participate, do have a strong theoretical history and empirical foundation in the existing and expanding literature on pro-poor growth. The selected review of this literature in the previous sections demonstrates that, although debate continues on the appropriate form of policies in any given context (particularly those in which the state is not driven primarily by developmental goals), earlier debates that assumed a trade-off between growth and equity are misplaced. Although the crisis has raised a number of key questions, policies for pro-poor growth do have the potential to contribute to growth, poverty reduction and a more stable economic system.

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