

# Pro-Poor Growth & Private Sector Development



18 May 2004



## The Need

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### ***Guidance for governments & donors on conditions for achieving the MDG of halving the proportion of poor earning less than \$1/day***

1. DAC Guidelines Poverty Reduction set a robust framework for poverty reduction. Recognise importance of pace and quality of growth in private sector for jobs, incomes
2. DAC Orientations for Development Co-operation in Support of PSD focus on policies and programmes for private sector to promote growth, sustainable development
3. These guidance notes build on the two. Elaborate how the private sector can deliver rapid, pro-poor growth
4. This Conceptual Framework: Conditions that matter for rapid, pro-poor growth - **the What**
5. Phase II: Policies, programmes for delivering conditions - **the how**

## Poverty Reduction & PPG

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**The private sector is the engine of growth. Growth impacts all aspects of poverty. The poor contribute to and benefit from growth**

- 1. Growth impacts incomes & jobs, tax funded basic social services, human security, gender equity, sustainable resource use & empowerment**
- 2. Over long term, growth of average incomes is responsible for 66%-90% of poverty reduction across countries.** But, short term, variations across countries.
- 3. Absolute/Relative definition of pro-poor growth.** For MDG, absolute counts. Rate of growth, on average, of incomes of the poor.
- 4. Markets are the organising principle of economic activity.** Private sector the principle that motivates actors. Engine of growth.
- 5. Poor participate in markets along side businesses.** Contribute to and benefit from growth as farmers/entrepreneurs, workers, consumers, recipients of basic social services.
- 6. Marginalisation of poor**, through inequality or inappropriate market institutions, leads to slower, less sustained growth with lower poverty reduction.

# Conditions for PPG

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## Five conditions provide a framework for PPG

1. **Entrepreneurship & Investment:** Entrepreneurship is basis of economic activity. Higher entrepreneurship = higher, sustained growth. Investment adds to productive capacity, higher productivity and creates jobs. Differences in rates of investment explain differences in rates of growth.

2. **Productivity: Competition, Innovation.** Can have high investment but low growth (C&E Europe) & vice versa (USA). For rapid, sustained growth, need productivity gains to increase return on investment, providing more to invest in future.

3. **International Economic linkages:** openness associated with higher growth. Enables focus on competitive advantage, access to large, growing markets, innovation and access to international capital.

4. **Market Access & Functioning:** growth made pro-poor if the poor have access to & better returns from markets that matter for their livelihoods and to meet consumption needs. Increases contribution to growth & benefits

5. **Risk & Vulnerability:** Poor vulnerable to shocks that undermine ability to earn livelihoods. Risk aversion may lead to lower incomes. The elderly, the sick, the handicapped may not earn sufficient income. Economic case for reducing exclusion, inequality.

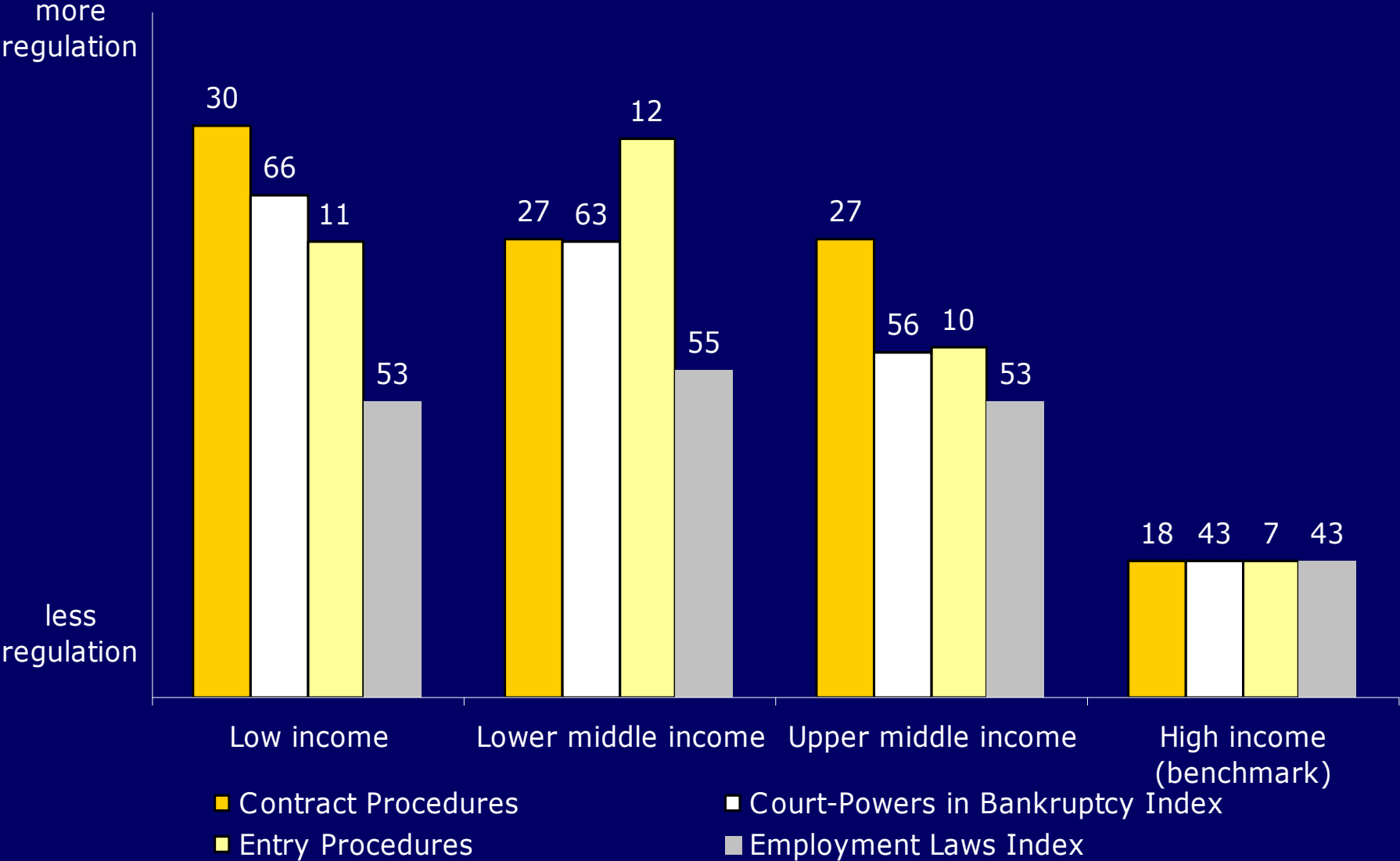
## Entrepreneurship & Investment

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**Incentive, the anticipated balance between risk and reward, drives entrepreneurship and investment. The higher the risk and costs of transactions the lower their rate**

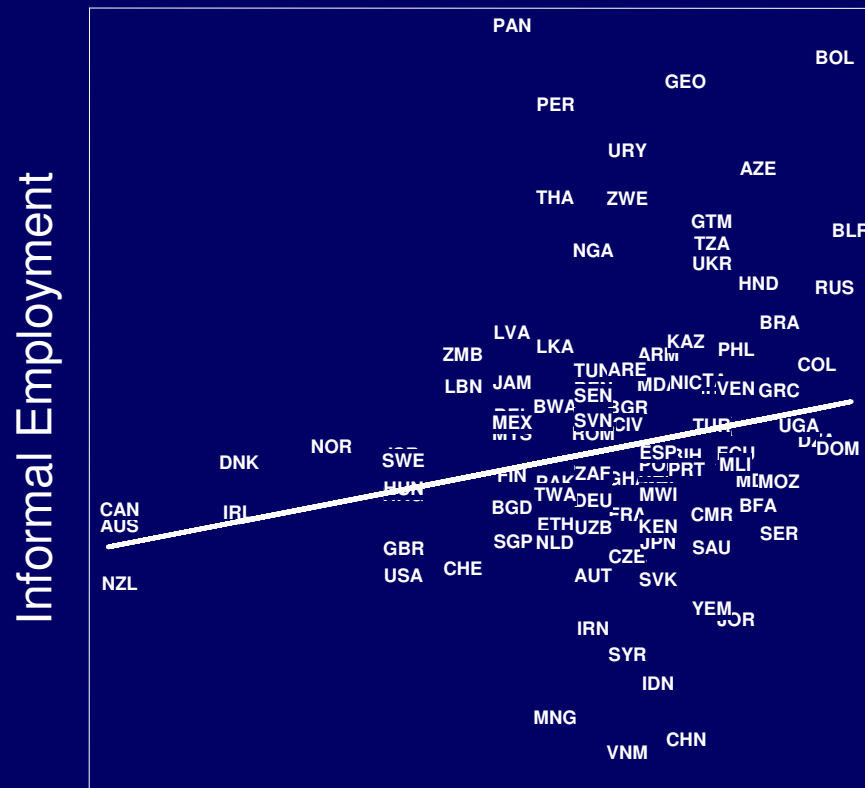
- *Incentive.* Implicitly or explicitly, entrepreneurs and intrapreneurs maximise the risk adjusted rate of return after tax. Risk and transaction costs (cost of doing business) reduce both.
- *Entrepreneurship:* history and culture do not explain fully differences in rates of entrepreneurship. Entry and exit barriers, transparency and predictability of business regulations, bureaucracy (red tape), property rights, level playing fields influence the rate. Informality is sign of inappropriate institutions. It is associated with low growth and corruption.
- *Investment:* Minimising risk. Political, social, economic stability, good governance, low regulatory barriers and access to factor markets are key. Fixed capital formation key to productivity growth and job creation. Long term nature requires stability.

# Who regulates more?



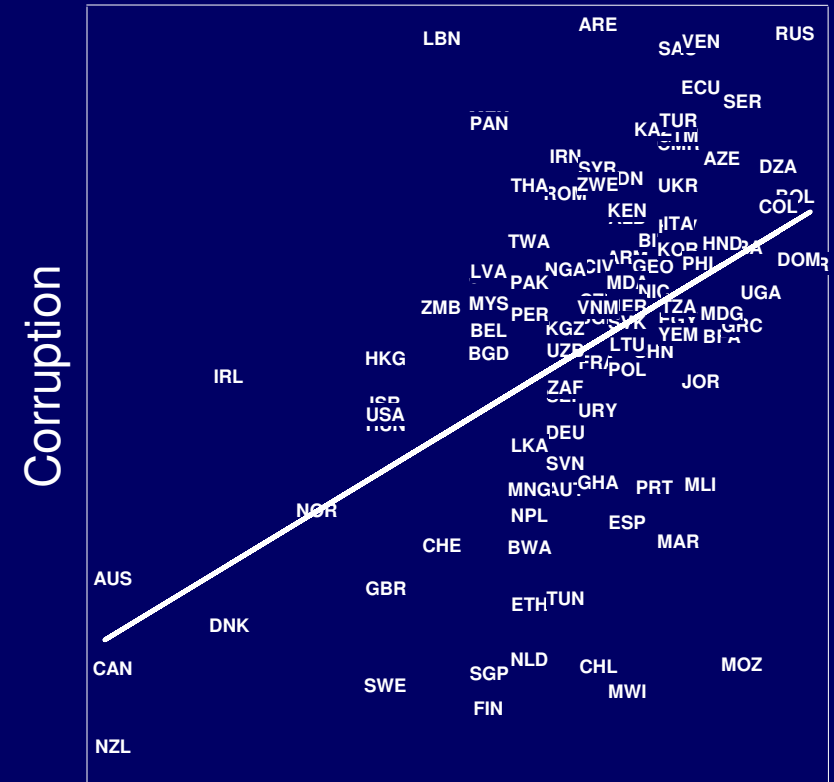
# Who loses? The poor and the disadvantaged

## A Larger Informal Sector



Procedures to Start a Business

## More Corruption



Procedures to Start a Business

Partial scatterplots controlling for income per capita. Relationships statistically significant at 5% level.

## Productivity

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### **Combination of efficiency in allocating resources and firm level efficiency brought about by creative destruction.**

- *Efficiency in resource allocation*: Allocative efficiency. Depends on markets for capital, labour and land working flexibly, without distortions caused by government or market failures. Market regulating institutions are key. Allocative efficiency contributed 1%-2% p.a to China's growth
- *Firm level efficiency*: Innovation is driven by the process of creative destruction. Competition drives innovation, with the less efficient driven out. Low entry and exit barriers are important. Market promoting institutions can help by improving access to knowledge, business support services, strengthening the structure of the private sector by addressing SMEs through business organisations and clusters.

## International Economic Linkages

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**For trade liberalisation to result in PPG, a number of conditions must be in place.**

- Not just tariffs but also NTBs.
- Trade facilitation to reduce bottlenecks – infrastructure, procedures, information
- Flexible factor markets: otherwise cannot focus on competitive advantage
- Competitive exchange rate
- Investment facilitation
- Prudent borrowing from abroad

## Market Access & Functioning

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### Level Playing field for the poor in livelihood and consumption markets

#### Basic social services

- *Key to ensuring access. Female literacy amongst the highest impacts in making growth pro-poor*

#### Institutions

- *Can exclude or provide access. Add or subtract from incentive for pro-poor outcomes*

#### Addressing market failures

- *Can cause exclusion and reduce returns to the poor.*

#### Lowering Transaction Costs

- *Provides higher returns to the poor. Developing linked markets.*

#### Reducing social exclusion

- *Public goods not club goods*

## Reducing Risk and Vulnerability

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### **Growth with equity, social protection. Dynamic redistribution preferable to static**

#### **Affordable insurance schemes**

- *Medical, crop, livestock*

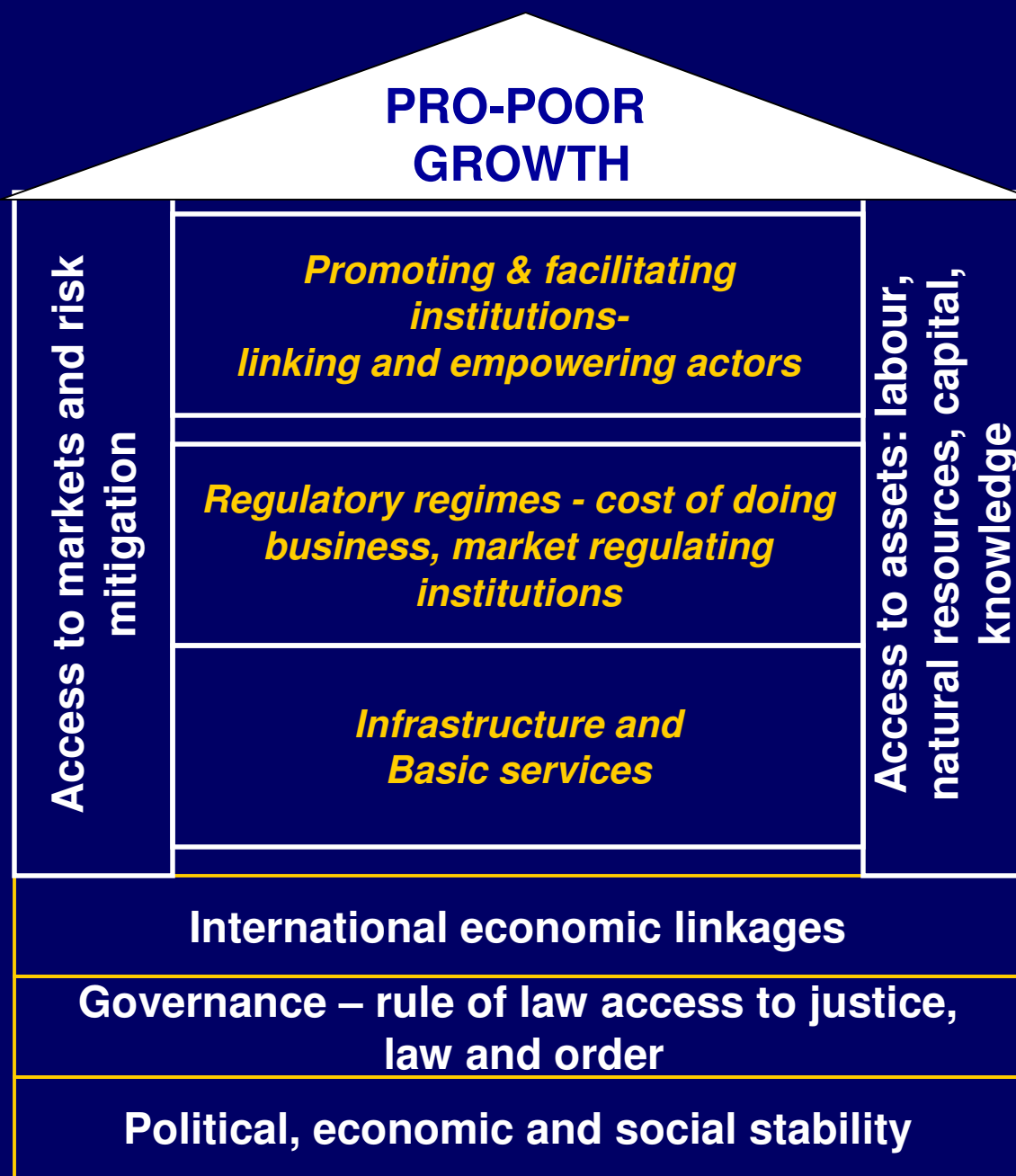
#### **Return to work after shocks**

- *Contingent transfers, food for work on infrastructure.*
- *Means to earn a livelihood*

#### **Social Protection for the Disadvantaged**

- *Pensions schemes, unemployment benefits, etc*

# A Framework for Pro-Poor Growth



## Internal dynamism of the private sector

Pillars and traverses of the **enabling environment** being a **shared responsibility** of:

- Civil Society
- Government
- Private sector

**Preconditions set by government** (in harmony with global conditions)

Source: Adapted from UNDP 2004 "Unleashing Entrepreneurship"

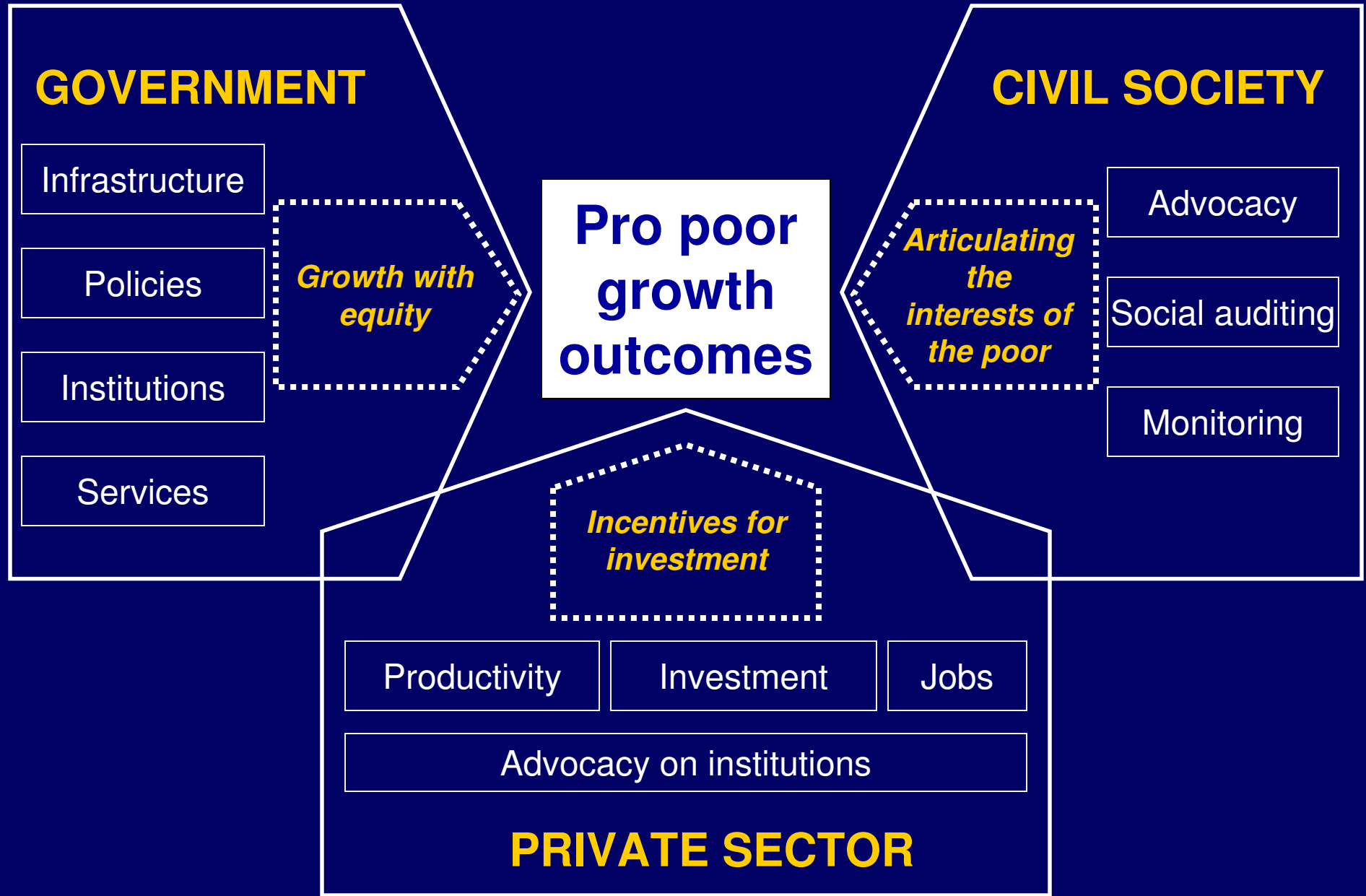
## Delivering Pro-Poor Change

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**PSD is the interplay between the state as formulator of the rules of the game, players in the private sector and civil society - SIDA**

- **Process of engagement – to identify priorities, monitor outcomes and continually improve conditions – they are relative, not absolute**
- **PRSP's currently consult the private sector, but do not involve it in monitoring and evaluation and processes of institutional change**

# Stakeholder Engagement for Pro-Poor Growth



## Patterns of Growth

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### Patterns of growth can help identify priorities

#### **Agriculture led growth**

- *Needs other sectors to develop to improve efficiency of resource allocation, and demand for agricultural products*
- *In Asia agricultural led growth followed by rapid industrialisation. In Africa today, agriculture led growth accompanied by informality is unsustainable*

#### **Manufacturing led growth**

- *Needs increases in agricultural productivity to be pro-poor.*
- *Bids up wages in both agriculture and manufacturing. Key transmission mechanism is labour markets*

#### **Extractive industry based growth**

- *Focuses attention on public expenditure management, governance, sustainable development of local communities*
- *Key transmission mechanism is taxation and how it is spent is crucial*

## Systemic Change

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### **Systemic change means changing the incentive in the system for pro-poor outcomes**

#### **Institutional Change**

- *Brought about by building issue based constituencies for change within public, private sectors and civil society*

#### **Addressing Constraints to Pro-Poor Market Outcomes**

- *In value chains, providing better access to linked goods and services to reduce value captured by non-poor participants*

#### **EXAMPLE**

*To make finance available to the poor, what is required is the flow of funds from the commercial banks to the MFI's through a wholesale market. Accrediting MFI's and developing markets for wholesale finance is a systemic change*

## Delivering change through change agents and facilitators is the key to sustainability

### **Change Agents**

- *To build issue based constituencies, facilitate evidence based dialogue, institutionalise stakeholder engagement*

### **Facilitators**

- *To design institutional change and catalyse development of linked markets to address incentive for pro-poor outcomes. Start with the top of a hierarchy of markets so that each market has a commercial logic to develop others*

### **EXAMPLE**

*To increase BDS provision, start with agreeing system of training and accreditation. Train trainers, who will then have incentive to sell services to BDS providers who will have incentive to service businesses*