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Promoting Pro-poor Growth
Policy Guidance for Donors

PART III

Chapter 14

Promoting Diversified Livelihoods

While enhanced productivity is essential to achieve pro-poor growth through agriculture, poor rural households also depend on a range of non-farm economic activities as part of their livelihood strategies. This diversification of livelihoods by members of agricultural households augments and provides alternatives to earnings from agricultural production – alternatives that are critical pathways to poverty reduction.

Agricultural households benefit from mobility and growth in both the agricultural and non-agricultural sectors. They benefit from rising demands for diversified and higher value foods, from income and employment opportunities in an expanding rural-based agribusiness sector, from remittance income that can be invested in better practices, from the increased skills and market awareness of returnees and from the potential for reversing farm fragmentation by renting or buying land.

Diversifying livelihoods is partly predicated on, and itself increases, human capital in the skills, experience and willingness to innovate. It generates earnings and remittances that alter the options open to the household by providing cash resources that can be flexibly deployed. It ameliorates risk and reduces the adverse consumption effects of seasonality. Diversification thus generally improves livelihoods.

While rural or urban-based "off-farm" economic diversification is relevant to Rural Worlds 1-4, the main attention of this chapter is on Rural Worlds 3 and 4. Surplus labour and low stocks of assets both push and pull them towards non-farm livelihood opportunities.

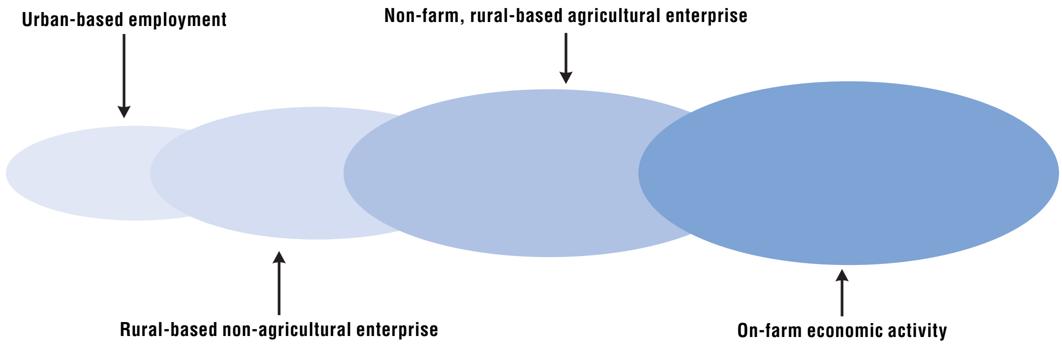
Sources of livelihood diversification

The core economic activity for agricultural households in developing countries takes place at the site of their agricultural production (on the farm) and can be enhanced by increasing productivity and access to markets (Chapter 2). Outside their own agricultural production activities (off the farm) three broad spheres of economic activity provide livelihood diversification opportunities for agricultural households (Figure 14.1):

- Non-farm, rural-based agricultural enterprise.
- Rural-based, non-agricultural enterprise.
- Urban-based employment.

Non-farm, rural-based agricultural enterprise, generally located in rural towns, includes agricultural processing and marketing, input supply and services and related industries. It represents the backward and forward linkages with agro-industry, the services and trade sectors and the rest of the economy. And it has traditionally been undervalued when assessing agriculture's contribution to economic development, since agriculture is measured using information about harvests and the sale of raw materials. Research in eight Latin American countries showed that official statistics, based on traditional measurements, indicated that agriculture contributed just 7% to GDP in 1997 while "extended" agriculture (which incorporates farm and non-farm agricultural enterprises) contributed about 30% of GDP (IICA, 2004). Most of these enterprises in

Figure 14.1. **Spheres of diversified livelihood opportunities for agricultural households**



developing countries are small and intensive in labour, providing important income and employment opportunities for rural people. In India, for instance, agro-based enterprises accounted for 22 million of the 33 million workers in the manufacturing sector in the early 1990s (Chadha and Gulati, 2002).

Rural-based, non-agricultural enterprise is found mainly in the informal economy. It provides a degree of income through a vast number of enterprises that are adaptable and easy to enter and exit and that have low transaction costs. It is an important source of livelihoods, particularly for women (Sida, 2003). Many of the activities require limited capital and skills, operate in highly localised markets and are based on self-employment. Rural-based, non-agricultural enterprise is usually the bridge between commodity-based agricultural production and livelihoods earned in the modern industrial and service sectors in urban centres (Timmer, 2005). Sida (2004) estimates that the rural poor in sub-Saharan Africa and Asia acquire 30%-50% of household income from non-agricultural activities (which may be rural or urban based).

Urban-based employment from temporary migration and commuting has become a routine part of the livelihood strategies of the rural poor. The mobility of labour between rural and urban areas has increased with better roads and communication networks. While the majority are employed in the informal and unorganised urban sector, they can earn more than they would be able to in traditional agricultural labouring or marginal agricultural production (Deshingkar, 2004). The contribution of remittances from this form of employment varies depending on proximity to urban centres. A review of 25 cases in Africa indicated migration earnings (both within rural areas and to urban centres) were as low as 20% of the total non-farming income in villages far from major cities – while this rose to 75% in villages near major cities (Reardon, 1997). Evidence from India suggests that, in unirrigated and forested villages of Madhya Pradesh, migration earnings accounted for half the annual household earnings (Deshingkar and Start, 2003).

The connections between the agricultural and non-agricultural rural economies in rural areas should not be underestimated. A thriving agriculture underpinned by improved sector productivity and markets will drive and expand the non-farm rural economy and influence real wages and food security (Dorward *et al*., 2004). This underscores an important relationship between Rural Worlds 1 and 2 with Rural Worlds 3 and 4, whereby commercial producers create demands and opportunities for labour. Small traders do much to connect the farm and non-farm rural economies.

Combining rural and urban livelihoods provides a dual advantage to the poor; agricultural labouring and marginal agricultural production are important safety nets when urban employment is mainly in the informal sector (Deshingkar, 2004).

Empirical studies across Asia, Africa and Latin America have established that occupational diversification levels are higher and more complex than official statistics indicate. According to Ellis (2004), the contribution of non-farm income sources was, on average, roughly 60% of rural household income in South Asia, 50% in sub-Saharan Africa and 40% in Latin America.

The nature of diversification in rural areas

Diversifying livelihoods is a continual adaptive process for households to add new activities and to continue existing ones or drop others, thus maintaining diverse and changing livelihood portfolios. This diversity of income sources prevails across different income classes, but the nature differs between better-off and poorer households. The better off tend to diversify in non-farm business activities (trade, transport, shop keeping, brick making) or salaried employment. The poor tend to diversify in casual wage work, especially on other agricultural production units, while remaining heavily reliant on subsistence crop production. Diversification by the poor thus tends to leave them highly reliant on agriculture; that by the better off reduces this reliance.

The way diversification patterns change across the income ranges is illustrated for a case-study of agricultural households in Tanzania (Figure 14.2). The relative dependence on agriculture declines across the income ranges from 68% for the poorest quartile to 43% for the richest. Analysis within agricultural income showed that the share of livestock in the income portfolio of the top quartile is more than twice that of the bottom quartile. The share of non-farm business income quadruples from 11% to 44% of the income portfolio. This provides strong evidence that diversification in and outside agricultural production reduces poverty for agricultural households.

Figure 14.2. **Total income portfolio by income profile: Tanzania**

Source: Ellis and Mdoe (2003).

It might be thought that the attention that better-off households pay to non-farm activities would result in the neglect and poor performance of their agricultural production activities. Not so. Evidence from four sub-Saharan African countries indicates that agricultural productivity per hectare rises steeply across the income ranges. Compared with the lowest income quartile, net farm output per hectare for the top income quartile of households was between three and six times higher (Ellis and Freeman, 2004).

The opportunities for poor men and women to diversify their livelihoods vary considerably across locations, religions and ethnic groups. But cultural barriers to women's participation in labour markets should not be seen as fixed and immutable – they evolve and sometimes collapse rather suddenly. In sub-Saharan Africa, women, the elderly and children tend to stay at the agricultural residence while men circulate for varying periods. Elsewhere, the rising demand for domestic labour long dominated migration in Latin America, as it does today in migration from Bangladesh, the Philippines and Sri Lanka to the Persian Gulf.

Women dominate many of the off-farm economic activities that grow most rapidly during structural transformation – activities such as food processing and preparation, trading and many other services. So women are key actors in the economic transition of the broader rural economy (Sida, 2004).

Why people diversify

Diversification helps to reduce risks, especially those related to seasonality in rain-fed agriculture. It can also be part of a strategy of combining (sequentially or in parallel) activities that contribute to the accumulation of wealth at different points in the household life cycle.

Becoming less dependent on agricultural production is part of becoming better off. The poor and the better off may diversify to the same degree, but the absolute non-farm income of the better off is several times that of the poor. Perceptions in South Asia have been rather more mixed. Some studies note that non-farm incomes are lower and less reliable than farm incomes, particularly in marginal areas – and that agricultural development is an important prerequisite for more remunerative kinds of rural non-farm sector employment (Deshingkar, 2004).

Diversification overcomes risk and seasonality in natural resource – based livelihoods, but it also reflects the failure of agricultural production to deliver better livelihoods in the post-liberalisation era. Poverty and vulnerability are often associated with undue reliance on agricultural production rather than the converse. Farms achieving yield growth often do so thanks to cash resources generated from non-farm activities, rather than being the origin of growth in such activities, as is the conventional wisdom. Migration, mobility, flexibility and adaptability are downplayed, ignored and sometimes blocked by policy and institutions. But these are the very attributes of occupational diversification that can strengthen livelihoods – and improve rather than degrade natural resources.

Diversification has always played a role in overcoming the "consumption-smoothing" problem created by the seasonality of agricultural output patterns (Morduch, 1995). The degree to which it is necessary to diversify for this reason varies according to the robustness of the underlying agricultural basis of people's livelihoods, the degree to which they can realise cash income from market sales and their confidence in the ability of markets to provide food supplies at reasonable prices in the agricultural production lean season.

For food-insecure households, out-migration of household members in the peak food deficit season may be essential for the survival of the resident group that stays behind, by reducing the number of people to feed (Toulmin, 1992; Devereux, 1993).

Similar considerations apply to the risk reasons for diversifying. For rural households, risks are particularly related to natural shocks (floods, droughts). For urban households, risks tend to be related to job insecurity. All households, whether rural or urban, are prone to the personal shocks of chronic illness, accidents and death. Risks are reduced by diversifying livelihoods, and mobility is the main but not the only means for doing this.

Urbanisation is an important driving force in migration and commuting because urban areas can offer economic opportunities to rural people through better paid jobs, new skills and cultural changes. These may be particularly beneficial to the historically disadvantaged, such as tribal groups, lower castes (in South Asia) and women. Contrary to conventional wisdom on urbanisation and migration, high rates of migration into urbanised areas (permanent and temporary) have continued despite the fact that many migrants live in appalling conditions and work in the informal sector, which offers uncertain and underpaid work. Why? Because urban labour markets offer unmatched opportunities to switch jobs rapidly, diversify incomes and become upwardly mobile with a very low asset base and skills.

According to the "de-agrarianisation" argument, agriculture cannot provide a sufficient livelihood for a substantial and growing proportion of rural dwellers, so agricultural production becomes a part-time, residual or fall-back activity (Bryceson and Bank, 2001; Bryceson, 2002). Some of the factors implicated here are long-term demographic and economic trends while others are associated with economic policies:

- Decreasing farm size caused by subdivision at inheritance.
- Increasing inability of young people to access enough land to take up farming full time.
- Poor farm performance and declining yields due to declining soil fertility and degrading natural environments.
- Increased climatic variation, causing greater extremes across seasons and years.
- Declining returns to farming.
- The impact of HIV/AIDS, superimposed on the other disadvantages.

These widely observed rural livelihood patterns shed light on the dynamics of rural vulnerability (Chapter 4). In sub-Saharan Africa the poorest and most vulnerable are those most heavily reliant on agricultural production and most strongly locked into subsistence within agriculture. The same category of the rural poor also tend to depend on work on other agricultural production units to cover the deficit in their household food balance. This heightens rather than diminishes their vulnerability for two reasons. First, labour on other agricultural production units can mean neglect of good cultivation practices on own units (Alwang and Siegel, 1999). Second, work on other agricultural production units proves an unreliable buffer when adverse natural events affect all agricultural production in a geographical zone.

Mobility of labour

The flow of money, goods and services between rural and urban areas can create a virtuous circle of local economic development by increasing demand for local agricultural produce, stimulating the broader rural economy and absorbing surplus labour

(Tacoli, 2004). But this depends on access to infrastructure, on trading relations and markets and on market information.

The returns to infrastructure investment in poverty reduction are undisputed (Fan, 2004). But for the other prerequisites it is more challenging to offer easy policy solutions because of widespread market imperfections, such as interlocked markets for credit, agricultural produce and inputs. These imperfections tend to work against the rural poor, especially in marginal areas, so that they buy expensively and sell cheaply. Access to market information is equally problematic, suffering from elite capture in the same way as other assets and resources essential for diversification. The poor are thus adversely incorporated in the market – not the free, rational players that neoclassical theories would assume. The challenge for donors and governments is to ensure that markets work for the rural poor (Chapter 2).

Patterns of mobility reveal much about the labour markets that stimulate them. In agrarian settings, a considerable proportion of economic activity is seasonal, having to do with the cultivation and harvesting peaks of different crops in different locations. This can create truly massive seasonal movements of labour, as exemplified by the travel of harvesting labour from poorer Indian states to West Bengal for the rice harvest (Rogaly and Rafique, 2003).

But just as peak labour demand in agriculture stimulates both rural and urban workers to move to the locations of these peaks, so the agricultural slack season creates conditions for rural workers to seek temporary jobs in the urban, industrial or service economies. Circular migration of this type is well documented for many parts of the world. Examples are movements in West Africa from the interior to the coastal zones in the agricultural off-season (David, 1995) and migration of poor workers with their families to Delhi's brick kilns (Gupta, 2003).

Mobility reflects the spatial and temporal mismatch between the residential location of individuals and households and the location and dynamics of labour markets. In predominantly agrarian societies, seasonality on its own helps explain a considerable proportion of such mobility, as does risk mitigation (Chapter 4). An emerging view marshals an overwhelming array of arguments in favour of mobility – and emphasises facilitating migration and improving the social conditions under which it occurs, rather than placing barriers in its way. This view runs counter to earlier orthodoxies in development policy that were opposed to migration, and that tend to resurface in strategic documents like poverty reduction strategies (PRSs), revealing unhelpful stances for poverty reduction.

Secure land tenure facilitates engagement by members of agricultural households in the non-agricultural production rural and urban economies. Without secure rights, landowners are less willing to rent out their land, something that impedes their ability and willingness to engage in non-agricultural production employment or rural-urban migration (Deininger, 2004).

Migration and commuting to urban areas

Temporary migration and commuting are now a routine part of the livelihood strategies of the rural poor across a wide range of developing country contexts. While past determinants of migration (such as drought) are still valid and important, there are new driving forces underlying the increase in population mobility. These forces are specific to location and include improved communications and roads, new economic opportunities arising from urbanisation as well as changing market contexts as economies become more globalised and liberalised (Deshingkar, 2004).

The Global Donor Platform for Rural Development (2005) highlights the "mixed results" from migration. In general the rural poor are driven by a stagnant agricultural and rural environment, while the productivity of the urban sector can often be characterised as low as well. This "migration of despair" seldom reduces chronic poverty and may contribute to the rising social costs of urban poverty. If, however, migration follows industrialisation, it can be seen as an indicator of economic growth and structural transformation. Encouraging rural-urban migration may be helpful when there are meaningful urban jobs (Box 14.1), but the costs of human misery on the periphery of major cities must be weighed against the costs of investing in better living conditions in rural areas.

In theory it might be useful to separate circular and temporary movements of people from those occurring permanently due to structural economic change. But neither the data nor the realities of migration correspond to such a neat dichotomy. For one thing, at the individual or household level, successive temporary movements may lead to eventual more permanent relocation. For another, at the sector level, the establishment of rapidly growing manufacturing sub-sectors can also be dependent on circular migrant labour – for example, the textile mills of Mumbai and Shanghai (Davin, 1999) or Mexico's export-processing zones.

Box 14.1. **Chinese men choose the cities, women are still on the farms**

With China's rapidly growing economy, the demand for workers has sky-rocketed. And many male agriculture producers are migrating to the urban industrial areas.

The current status of rural households makes it difficult for all household members to migrate because of the near impossibility of getting a permanent residence permit in the cities. So most male migrants become temporary labourers in cities, with agriculture a kind of insurance and retreat.

The gender division of labour in the households has shifted, from "the men till and the women weave" to "the women till and the men work in industry". This new model can be described as "men control the outside world, women the inner". What's also new is that women's "inner world" is extending to agriculture.

The new gender division of labour has led to a feminisation of agriculture: about 80% of the rural labour force is female. In the poorer and more marginal south-western provinces of Guangxi, Yunnan and Guizhou, women make up more than 85% of the agricultural labour force – and in some remote mountainous areas, about 90%.

Source: Song (1999).

There is growing evidence of the importance of remittances in supporting the livelihoods of those who stay behind when some households' members migrate. In sub-Saharan Africa remittances account on average for 15% of rural incomes. The circular migration to the Persian Gulf from rural Sri Lanka has accounted for 25% of rural incomes (von Braun and Pandya-Lorch, 1991).

Long-distance commuting has become characteristic of Asia's largest cities, especially by buses and trains. For many, commuting and seasonal migration offer the chance to combine the best of a rural village – based existence with urban opportunities (Box 14.2). In these cases, better communication for migrants back to their families can sustain social capital and make temporary migration more manageable for households.

Box 14.2. **Why people may prefer temporary mobility**

Seasonal migration and commuting provide a route to diversification into work outside agricultural production rarely available in smaller, more remote villages. And this helps to spread risks. But employment in the urban unorganised sector is insecure, and many prefer to keep rural options open. So agricultural labour and marginal agricultural production remain important safety nets for the poor and vulnerable.

Supporting a household in the village is cheaper, especially if the bread-winner is earning in a town or city. In areas with good roads and transport services people can travel back home easily for peak agricultural seasons, festivals and ceremonies.

Impediments to diversification

Widespread failures of services and institutions – combined with low levels of human, physical, natural and social capital – create mutually reinforcing disadvantages, described as "interlocking logjams of disadvantage" (de Haan and Lipton, 1998). This seriously constrains efforts to improve agricultural incomes and promote diversification into occupations outside agricultural production. This may also explain why the poor living in marginal areas pursue occupations in urban areas.

Many barriers, characterised as thresholds associated with "poverty traps" (Barrett and Swallow, 2005), prevent the poor from engaging in more remunerative labour markets. At the lowest income levels, immense efforts are required to sieze the opportunities and return to labour that enable a household to climb out of poverty. But at somewhat higher incomes just above the poverty line, it becomes much less difficult to achieve a virtuous spiral that can lead to higher income levels and a more secure livelihood. The key to these traps and thresholds lies in the asset status of households, and especially in human capital (education and skills) and flexible assets that can be quite quickly converted into cash or other assets (money, credit, livestock).

The poorer a person is, the more difficult it is to navigate the barriers that the public sector places in the path emerging from poverty (Wood, 2003). Local institutional environments can be disabling in low-income countries, and it is not clear that local government decentralisation, promoted with enthusiasm by donors over the past decade, has improved matters in this regard. The reverse may be so. Some commonly observed practices:

- *Dense thickets of local taxes*. Almost all engagement in markets results in taxation of one kind or another (transit dues, market fees, commodity taxes, movement permits, bicycle taxes), discouraging engagement in the monetary economy and reducing overall trade and exchange (Fjeldstad, 2001; 2002).
- *Business licenses*. Typically all businesses, even the smallest one-person bicycle repair workshops, are subject to licenses, form filling, turn-over taxes and so on. Business registration is seen almost everywhere as a revenue-raising opportunity, not as a way of creating environments for enterprises to flourish.

- *Multiple shake-downs*. The "informal" predatory relationship between public official and subject can involve numerous fees, fines and prohibitions (Freeman *et al*., 2004).
- *Migration barriers*. Migration may be inhibited by residence permits, harassment in transit, loss of rights to services at destination locations, loss of recourse to law in the event of injustice, active discouragement by city authorities, enforced returns by slum clearances and so on.

Policy issues

In general, decisions about what and where to produce are best left to private actors. What governments, donors and NGOs can do is to contribute to the overall climate of facilitation that surrounds individual decisions. This means supporting and encouraging domestic policies that improve exchange, mobility, communication, information and infrastructure – and discouraging domestic policies that have the reverse effects. Policies that create a more enabling environment for private sector development for rural households include:

- Neutral or progressive local taxation designed to exclude those living at or below the poverty line from the tax net.
- Business registration designed to provide support services to enterprise startups rather than penalise them with taxes and other costs.
- Encouragement of mobility to broaden spatial options and encourage growth processes.
- The general removal of spurious obstacles put in the way of people going about the business of making a living by those who derive their power from public office.

A major barrier to beneficial economic change in agriculture is often the historical and prevailing land tenure system. Tenure systems that fail to allow for a purchase or rental market in land reduce mobility, slow rural-urban transitions and rigidify uneconomic agricultural production unit sizes. Equity considerations often underpin traditional and state-owned tenure systems, but in densely settled zones exhibiting extremes of land subdivision, it is doubtful that anyone gains much from the absence of a land market – or from the lack of security of ownership or tenure. And many existing tenure systems are deeply gender biased against women in custom and in law, causing serious dysfunctions between the control, decision-making and use of land as a resource.

The prevailing land rights of women provide an additional reason for promoting active government interventions. Even though women play a substantial role in agriculture in most countries around the world, they are often discriminated against by the prevailing land tenure system. In many societies women are excluded from owning property (including land), or they do not enjoy the same rights as men. In marriage and in the family, women's right to property is often subject to the authority of the husband or father. Land titling, registration and the privatisation of land under colonialism and after independence have often set women back, leaving them in a state of even greater insecurity, with poorer prospects for accessing land. The demise of the local elders and clans has made women's land tenure even less certain, leaving women with fewer possibilities of obtaining a livelihood for them and their children (Tripp, 2004).

Agro-industrial development, which generates employment for rural households and adds value to agricultural production, also has the potential to damage the natural environment through pollution. Policies and legislation to protect the natural environment are necessary in order to enable sustainable industrial development.

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At the macro policy level, second generation PRSs should contain wide-ranging recognition of the importance of occupational diversification, mobility and cross-sectoral interdependencies:

- The current social sector emphasis of PRSs requires better balance in its support to the rural economy.
- Artificial and unnecessary blockages to people's making a living should be removed wherever they occur, either in central or local government, or in private organisations.
- The antagonistic view of migration expressed in many PRSs clearly needs to be replaced by an approach that supports personal economic mobility and choice. PRSs need to recognise that rapid urbanisation can create dynamic growth processes that benefit both urban and rural economies.

A key policy issue here is to provoke a change in thinking about mobility in order to improve the political and social environment of those on the move. At the moment, migrants, in passing between jurisdictions, are generally unable to call on support from public authorities. Local governments in source areas have no interest in – and little capacity for – tracking the outward movement of their citizens. And those in receiving areas too often regard in-migrants as a blight, to be resisted or expelled.

Accepting the complexity of diversifying rural livelihoods, agricultural and rural economic development programmes within PRSs need to be based on a comprehensive understanding of diversification's extent and nature, nationally and sub-nationally. This will require strengthening the data gathering and analytical capacities of the public institutions delivering on agricultural and rural development policies. Only with such an understanding can support be targeted to assist processes that sustain poverty reduction in rural areas.

Spotlight on Global Value Chains – Does it Mean Shutting out Small Producers?

Small-scale agriculture, presented as a growth-equity "win-win", has encouraged a resurgence of interest in agriculture in the poverty reduction debate. But the case for the efficiency of small-scale agricultural production may be breaking down as the superior labour and land productivity of the small production unit is trumped by the higher costs of dealing with global food chains with new forms of private sector governance. The associated risks are the polarisation between agribusiness and small-scale agricultural systems – and the reduction in benefits of liberalisation due to problems of market structure.

A close look at global food chains is an important part of any new agenda for agriculture for a number of reasons. Private sector strategies in the agrifood sector – especially in global retailing – are moving fast, under the radar of public policy. If policy is to anticipate the changes, then those changes – and their implications for rural producers – must be better understood. And although developing countries have so far failed to significantly penetrate agricultural markets of rich countries, big hopes are invested in the idea of small producers "upgrading" into global buyer-driven food chains to escape from the cost-price squeeze of commodity production.

Meanwhile, concern is growing that markets are distorted by excessive corporate concentration in trading, processing, manufacturing and retailing. Trade liberalisation will not bring the expected benefits when agricultural markets do not function competitively. And because corporate growth and consolidation is premised on expectations that larger buyers can extract more favourable terms from suppliers, there is a risk of declining shares of value for rural actors in the food chain – the workers in agriculture and processing and primary producers. This can compromise agriculture's potential to act as an effective route for small producers to exit poverty and benefit from broader economic growth, especially when food markets are already stagnant. And the ability of buyers to set product and process standards and their demands for traceability can exclude certain classes of producers from supply chains and thus worsen inequality (Vorley and Fox, 2004).

Value chains and the rural worlds

Global food chains reach into developing country markets, as well as stretch outwards. National and regional markets may be restructured to the extent that they are no longer a refuge for smaller producers and processors, as markets are flooded with cheap export-grade produce from more competitive economies.

Rural World 1 is changing in response to the liberalisation and deregulation of agriculture. For a group that has supported and benefited from state protection and subsidies, it now comprises more free market – oriented agribusinesses with high levels of collaboration and associative relationships with downstream processors and retailers. This

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new minority of commercial producers and entrepreneurs is connected to the global food economy through contracts with a rapidly consolidating agricultural handling and processing industry, and even directly with food retailers. These producers have become a vital part of agribusiness, and the lines between Rural World 1 and agribusiness are becoming increasingly blurred.

Rural World 2 finds itself in the position of residual suppliers to retail, wholesale or least cost suppliers to bulk commodity markets, and often is increasingly reliant on off-farm income. It must compete with the lowest cost commodity producers, upgrade to higher value chains, experience decreasing returns and a move towards subsistence-level production – or get out of agricultural production.

Because only the most capitalised and tightly managed enterprises have been meeting the strict specifications of importing nations or processing and retail sectors, there is much attention on the organisation, technical and institutional arrangements for small producers in Rural World 3 to build economies of scale to deal with the requirements of "buyer-driven" chains and thereby create relationships with their downstream customers and add value with differentiated (de-commodified) products. Shifting Rural World 3 out of small-scale agriculture into the role of labour for Rural World 1 has also renewed popularity, for instance in Sahelian countries, in the debate about the "modernisation" and "competitiveness" of agriculture in an era of globalisation of agrifood chains.

Outsourcing primary production rather than owning production makes economic sense for agribusiness. In fact, major processors have been engaged in vertical disintegration, outsourcing primary production and its associated costs and risks. The exception is industrial livestock production where vertical integration and ownership of agrifood chains from "farm to fork" is quite common.

The reversal of the marketing chain can also benefit consumers; it is no coincidence that in the United Kingdom, where supermarket power is most ascendant, consumers' aversion to genetic modification technology was translated into retailer-driven programmes to purge own-brand supply chains of genetically modified ingredients.

Contract farming can also bring significant benefits to producers. A producer is assured of a buyer, price risk is reduced. Favourable credit terms may be available. And marketing costs are lower. Producers with these agreements often get more favourable terms than neighbouring producers growing a product of the same quality but without a contract. But in their worst form such as some poultry production contracts, contract farming deserves its reputation of turning producers into wage labourers on their own land.

Agricultural producers working outside these closed chains, such as those who do not have sufficient scale of production to be able to sell directly (the classic position of Rural World 2), can become relegated to the position of residual or top-up suppliers or suppliers to the shrinking wholesale market.

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Foreword

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

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

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

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

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

Richard Manning
DAC Chair

James T. Smith
POVNET Chair

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

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

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Acronyms

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

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

* Denotes acronym in original language.

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Pro-poor Growth: Policy Statement

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

Three key messages from this work are that:

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

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

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

i) **Both the pace and the pattern of growth are critical for long-term and sustainable poverty reduction.** Economic growth is an essential requirement and, frequently, the major contributing factor in reducing economic poverty. For growth to be rapid and sustained, it should be broad-based across sectors and regions and inclusive of the large part of the workforce that poor women and men make up. Pattern and pace are thus interlinked and need to be addressed together. Policies for sustaining growth such as those aiming at macroeconomic stability, institutional quality, democratic and effective governance and a favourable investment climate should promote the engagement of the poor in economic growth by increasing their incentives, opportunities and capabilities for employment and entrepreneurship.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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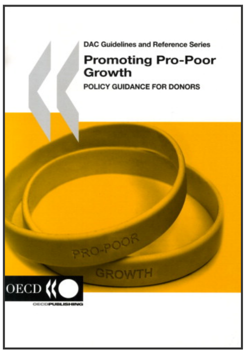

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