ISBN 978-92-64-02477-9
Promoting Pro-poor Growth
Policy Guidance for Donors

PART III

Chapter 15

Reducing Risk and Vulnerability

Managing risks and reducing vulnerabilities are essential elements in sustainable pro-poor growth through agriculture, perhaps the riskiest sector in the economy, not only subject to the price risks facing many sectors but also highly dependent on nature, leaving it vulnerable to droughts, floods and pests. The risks vary in their nature and impact across the different rural worlds. Volatile international markets directly affect Rural World 1 producers and ultimately their need to employ workers from Rural Worlds 3 and 4. Generic risks such as weather conditions can position agricultural households in Rural Worlds 2 and 3 either above or below the thresholds of profit and food security.

For agricultural households to have more secure and prosperous livelihoods, they need more ability to cope with risk and address the attendant vulnerability. Poor rural households, particularly those relying on agricultural production as a primary source of well-being, face the inherent risks of agriculture together with such domestic risks as sickness, death and loss of property. Exposure to these risks can be heightened by inadequate or non-existent infrastructure, poorly performing markets and weak institutions.

Without strengthening the capability of poor rural households to cope with the many risks they are exposed to, they will be reluctant to take on new risks and innovate, and they will remain trapped in low-risk and low-yielding livelihood strategies. Strengthening risk-reduction methods will enable poor rural households to maintain a certain level of assets despite experiencing shocks of different kinds and magnitudes. It will also promote greater acceptance of innovation and greater willingness to assume prudent risks. Strategies include reducing actual risk or exposure to risk, together with mechanisms to mitigate or cope with shocks once they occur.

The discussion here focuses on agricultural producers in Rural Worlds 2 and 3 and the landless of Rural World 4 because they are affected through the labour markets influenced by Rural World 1 producers. The majority of people in Rural World 5 will be reached through social assistance programmes and therefore are largely outside the immediate reach and attention of agriculture-enabled economic growth policy.

In the 1970s and 1980s the risk exposure of many rural households was very different from that today. Risks were reduced by the government through marketing boards and similar institutions, which assured a price structure, input and output markets and access to improved technologies and training. Public investments in research and development resulted in higher yielding agricultural systems. And innovations were encouraged through public subsidies of one kind or another. In much of Asia and Latin America these innovations led many agricultural households to shift to more productive and higher return farming systems.

The changing pattern of risk and vulnerability

Today the dynamics of the world economy, including globalisation, mean that the nature and pattern of risk and vulnerability are also changing. Many national governments have withdrawn costly and often inefficient support for their domestic agriculture on the premise that the private sector would step in. But the failure of government to invest in the infrastructure and institutions that support the private sector's engagement in agriculture has left many poor and small producers either with no market access for inputs – such as improved seeds, pesticides and fertilisers – or with limited markets, resulting in prices vastly in excess of world market prices. Where markets are more developed, prices for the products of agriculture and the necessary inputs are more volatile, with markets more linked in a global trading environment. The withdrawal of government means that this volatility is not absorbed through floor prices and input subsidies, leaving farmers exposed. The solution is not to revert to the general agricultural support systems of the past, which often produced few benefits for the poor. It is to ensure that the public investments support market development of appropriate risk management instruments – together with broad-based safety nets for risks that cannot be handled by poor people or the market.

For agricultural households to achieve more secure and prosperous livelihoods, they need greater ability to cope with risk and the associated vulnerability. Policies, institutions and investments that reduce actual risk, strengthen risk management options and increase the availability of safety nets will enable poor households to maintain a certain level of assets despite shocks of different kinds and magnitudes. They will also promote greater acceptance of innovation and greater willingness to assume prudent risks.

Who faces what risks in the five rural worlds

High levels of risk, whether in the productive or domestic spheres, and the resulting shocks and stresses compromise both economic growth and poverty reduction. Some risks are common to all rural worlds – such health risks as HIV/AIDS, malaria and tuberculosis, and such natural disasters as earthquakes, hurricanes, floods and droughts. Though the risks may be common, the impacts differ in each rural world, as does the vulnerability of households and people.

Rural Worlds 1, 2 and 3 all engage directly in agriculture as business entrepreneurs and producers face the same natural risks, such as pests, droughts and floods, and to some extent the same commercial risks depending on the level of market engagement and type of farming system. But the vulnerability to shocks differ. A drought may affect producers in Rural World 3 most profoundly, with some impact in Rural World 2 and possibly less in Rural World 1. Subsistence producers in Rural World 3 are least likely to have irrigation systems, and producers in Rural World 1 most likely to have advanced systems. So in a drought, Rural World 1 may benefit if some producers in Rural Worlds 2 and 3 join the agricultural labour force, driving down wages. A shock with the deepest impact in Rural World 1, such as commodity price declines, may reverberate through the other rural worlds, potentially reducing agriculture labour demand and hurting the landless in Rural World 4, who rely on supplying agricultural labour.

Agriculture can fail over a large area, affecting all rural worlds. Producers in Rural Worlds 1, 2 and 3 may have to sell productive assets and increase their indebtedness, reducing their ability to bounce back quickly when the shock has dissipated. This has impacts on Rural World 4, which relies on selling labour, in large part to larger agricultural production units, and on Rural World 5, which may depend on people in Rural Worlds 1-4 for informal transfers to help them survive in the absence of formal safety nets.

Households in all five rural worlds face risks. For those in Rural Worlds 3 and 4, the inability to cope even with small shocks, due to low asset holdings and lack of risk management instruments, may lead them to adopt livelihood choices with the lowest risk but also the lowest return. These livelihood choices might include informal arrangements, such as seeking the protection of a "patron" who will provide credit in times of need (and thereby provide a degree of social protection). But in return the patron may demand priority access to the household's labour, the sole right to market its output and the sole right to provide seasonal credit. This interlocking of labour, product, input and credit markets makes it extremely difficult for poor rural households to take up new economic opportunities of the kinds that market signals might indicate (Farrington, 2004).

The spotlight at the end of the chapter shows the problems facing households in their livelihood strategy. The lowest income profile varies least. Potential troughs in income are more muted than those for the upper profile. But these lower potential troughs in income come at the cost of a lower expected average income. The higher income profile yields a higher expected average income but the possible troughs are unacceptably deep for poor households that have no ability to insure against these risks either through public or privately available instruments or through their own savings. This inability to offset risks is perhaps most acute for agricultural households given the vagaries of climate and commodity prices and the lack of instruments to handle this type of risk in underdeveloped financial markets.

If poor agricultural households are to capitalise on their production potential and escape poverty, risk management instruments are essential. But the inter-linkage between productive and domestic risks means that strategies to address risk and associated vulnerability for rural households must incorporate a portfolio of risk management instruments, addressing risk in both productive and domestic arenas.

Social risk management

Taking a strategic approach to risk management, both productive and domestic, requires a comprehensive assessment of the nature of risks that populations are exposed to. The World Bank has developed a social risk management framework that encompasses both livelihood protection and livelihood promotion to assess the degree of vulnerability faced by people and different sectors of the economy to different risks (Box 15.1).

A comprehensive social risk assessment enables a policymaker to make informed choices on reducing or eliminating risk and fostering mechanisms that allow people to deal with the troughs in their livelihood profiles. The elimination of all risks in agriculture is impossible, so the coping mechanisms are particularly important for poor people to be able to participate in and drive economic growth through agriculture.

Operationalising the social risk management framework requires careful consideration of four dimensions (Farrington, 2004):

- Different categories of poor people.
- Interactions between productive agriculture sub-sectors and non-agricultural sectors (where entrepreneurial activity is focused) and between the productive and domestic spheres (since funds are fungible between the two).
- The interface between protection and promotion options within agriculture and the promotion options outside of agriculture.
- Location-specific socio-cultural and economic conditions.

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Box 15.1. **The World Bank's social risk management framework**

The social risk management framework can be used to analyse the sources of vulnerability. It addresses how society manages risks and the relative costs and benefits of various public interventions on household welfare. It also addresses how vulnerable individuals and households can be helped to better manage risks and become less susceptible to damaging welfare losses.

Social risk management repositions the traditional areas of social protection (labour market intervention, social insurance and social safety nets) in a framework that includes:

- Three strategies to deal with risk (prevention, mitigation, coping).
- Three levels of formality of risk management (informal, market-based, publicly mandated).
- Many actors (individuals, households, communities, NGOs, governments at various levels and international organisations) against the background of asymmetric information and different types of risk.

This expanded view of social protection emphasises the double role of risk management instruments in protecting basic livelihoods and promoting risk taking. It focuses on the poor since they are the most vulnerable to risk and typically lack appropriate risk management instruments, constraining them from riskier but also higher return activities and thus from gradually moving out of chronic poverty.

Source: Adapted from Holzmann and Jørgensen (2000).

Segmenting the poor is important in identifying the types of risk they face and how they might be vulnerable to them. The policy interventions to address the risk and vulnerability profiles of people in the different rural worlds may extend far beyond agriculture. The result should be a set of investments in infrastructure and institutions to reduce actual risk where that is optimal, combined with the development of a comprehensive social protection strategy that provides the rural poor with the security they need to adopt prudent risks for agriculture to be their route out of poverty.

Protecting and promoting livelihoods

Risk management instruments that enable producers to address the risk in agricultural production protect basic livelihoods and promote improved livelihoods. This has often been overlooked. Public provision of safety nets has traditionally been viewed as a drain on investment resources that could be used to foster economic growth. But good risk management instruments – together with safety nets for those who cannot or have no access to these instruments – ensure that agricultural households do not face exposure to deep troughs in income. This enables the poor to take on prudent risk, supporting both growth and poverty reduction. Livelihood protection and promotion cover a potentially wide range of arrangements, where prevention and mitigation are strategies and coping is the response.

- *Prevention strategies* reduce the probability of an adverse shock occurring. In agriculture, these can be found in both infrastructure and technology solutions. Irrigation reduces the risk from droughts, as do soil and water conservation investments. Developments in agricultural science, such as breeding livestock resistant to disease and crops resistant to pests, diseases and drought can eliminate the impact of some pests and diseases.

Improving health service delivery, including public health measures, can reduce morbidity rates and reduce the spread of HIV/AIDS. Risk-reduction strategies minimise the downside variance in income profiles and increase the overall expected average income. Policies which increase land tenure security also reduce risk of loss of land.

- *Mitigation strategies* are implemented before a shock and reduce the impact once it occurs. Households diversify their livelihood strategies combining elements which are not all subject to the same type or degree of risk. Insurance instruments, such as health, commodity price, or weather insurance provide a payout for a household when the trigger point is reached. These strategies do not remove the troughs in the higher expected household income profile, but they reduce the impact on the household by providing a level of replacement income thus effectively minimising the depth of the worst shocks. Policies that increase the ability of household members to migrate are important to risk mitigation.
- *Coping strategies* relieve the impact on households of shocks that they are unable to protect themselves against, through mitigation or prevention, due to lack of assets, access to instruments or the magnitude of the shock. They include social assistance or welfare programmes as well as relief operations in response to natural disasters or civil disturbances. These measures prevent the troughs in income profiles that would reduce levels of well-being below accepted thresholds.

Reducing risk

Public infrastructure investments can do much to reduce the risk exposure of rural households. Rural feeder roads can do much to integrate market economies, reducing some market price volatility as well as diversifying market opportunities for the rural poor. Shorter transportation times can reduce the risk of deterioration in perishable crops. Improved flows of goods and services can enhance the information base of local people, along with investments in communications infrastructure. This enables households in Rural Worlds 1 and 2 to make more informed decisions on the sale of their crops and livestock. Similarly, investments in electrification also reduce the risk associated with the production of perishable crops, which are also often higher value crops. Public investment in local level grain storage banks are more effective for small-scale producers, such as those in Rural Worlds 2 and 3, who lack the economies of scale to make it worthwhile to invest at the individual level. They can be particularly important for women who often grow crops for their household food security and lack effective means to store their production without losses.

Private investment is also necessary to reduce risk, through such infrastructure as irrigation. But many investments in risk reduction for natural disasters need public institutional support. For example, water needs to be managed at the watershed level, which requires the co-operation of many water users, both for domestic and productive purposes. Tree planting to prevent soil erosion and landslides in the event of floods benefits the community as well as the individual producer. But agricultural producers will not invest in their land if they lack secure property rights. So institutional development in appropriate land tenure arrangements, and land registries is critical for investments in land – to reduce the exposure to such risks as droughts and floods. Intensified efforts are required in many countries to formalise women's access to and control over land and other natural resources.

Similarly, investments in agricultural research and development are critical to maintaining yield growth, increasing agricultural productivity and maintaining performance in the face of drought, soil nutrient deficiencies and pest outbreaks. New models are needed today to foster such research. It should be producer-driven, recognising both male and female producers and their different needs. Many newer technologies incur considerable expense in research and development, and the investment by the public sector pales in insignificance with investments by the private sector. Effective public-private partnerships can release some new technological developments in the private sector for use by public sector research institutions for crops, livestock, forestry and fisheries that would be regarded as non-viable from a commercial perspective.

Mitigating the effects of shocks and stresses

Public investment in early warning systems, made more efficient by advances in data collection, management and forecasting infrastructure, can mitigate risk by enabling faster response times. For example, disease outbreaks such as measles can be arrested through intense immunisation programmes.

Institutional development is also critical to the mitigation of risk. Most of the rural poor in developing countries lack the sophisticated instruments available to producers in the developed world geared to the management of price and weather risk (Box 15.2). They even lack the basic means to self-insure through financial savings. There is considerable need to invest in financial deepening in rural areas to enable individuals to save “for a rainy day” and enable them to generate working capital to engage in entrepreneurial activities.

In India just 13% of marginal producers, those typical of Rural Worlds 2 and 3, had access to formal finance mechanisms – whereas 50% of larger scale producers had access to credit and 87% had access to a savings account. Of marginal producers 44% borrow from moneylenders, often at interest rates of 50% a year. Evidence suggests that for marginal producers to access formal finance often requires payment of bribes, up to 20% of the loan amount, and the process can take up to 33 weeks. Institutional development, together with appropriate regulation, is one key to unlocking the development of financial services and the economic potential of many marginal producers.

New and innovative health care insurance systems and pension schemes to help mitigate risk in the domestic sphere have been piloted in some areas to provide coverage to the rural poor.

Box 15.2. **Weather-based insurance in Ethiopia**

The United Nations is seeking support for a novel financial-markets approach to alleviating famines: drought derivatives. According to the World Food Programme (WFP), such instruments – by serving as a sort of insurance policy based on rainfall measurements – would allow aid workers to speed the delivery of cash and food before widespread starvation sets in among the rural poor.

Currently, when rains fail in a developing nation, it typically can take as long as nine months for aid agencies to assess the damage, put out an appeal to donors, collect contributions and deliver them to the needy. By then, many poor producers are beyond help or are surviving by eating their seed grain and selling their livestock.

The hope is to test-run the concept in Ethiopia, perhaps as soon as the end of this year. In the Ethiopian pilot project, the idea would be for the WFP to buy a derivative from a reinsurance or other financial-services company that would pay out perhaps USD 100 million if the country's rainfall slip below a threshold – a level historically associated with a drought of once-a-decade severity. In the past 30 years, Ethiopia has experienced such droughts in 1984, 1987 and 2002. The 1984 drought was the worst, with the cost of food aid for the 23.4 million affected people reaching USD 1.65 billion in today's prices.

The derivative differs from a normal insurance policy in that there would be no need for an adjuster to calculate the damage done by the drought. The payout would be based on rainfall, not damage. Rainfall measures are taken almost uniformly throughout the world, and Ethiopia has reasonably reliable data that would allow financial markets to assess the likelihood of another dry spell.

If a drought occurred, the WFP would not have to round up donors during the crisis, just collect from the holder of the derivative. Famines still could arise from other causes, such as war or plagues, requiring a more traditional fund-raising appeal and response.

Similar financial products already are traded on the Chicago Mercantile Exchange. Energy companies, for instance, buy weather-based derivatives to protect themselves against unseasonable weather. Most of the derivatives are sold by reinsurers, investment banks and hedge funds.

Source: Wall Street Journal (13 May 2005).

Helping poor rural households cope

When all else fails, poor rural households need safety nets to help them cope with sudden shocks. These take the form of social transfers and emergency assistance, in cash or in kind. The programmes should be specific to the particular risks and attendant vulnerabilities that rural households face. While these programmes should in most cases have permanence in the social protection portfolio, their use will generally be temporary, with households accessing them as and when they are needed in line with the qualifying criteria. This fosters the programmes' livelihood promotion function, underpinning prudent risk taking and entrepreneurial activities by the rural poor. Guarantee schemes, such as public works programmes, can scale up and down based on need, and a pipeline of planned activities can be ready for implementation. Appropriate programmes should be designed for those in Rural World 5 to enable them to "graduate" to their place in other rural or urban worlds.

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Table 15.1. **Risks in the five rural worlds**

Categories of rural households	Types of risk typically faced	Typical measures to prevent, mitigate or cope with risk
Rural World 1 Commercial producers, globally competitive with large-scale agriculture operations.	Generic risks (pests, diseases, weather); and new risks: input/output price fluctuations, possibly associated with international market changes; stricter quality controls on products; saturation of national markets; transport and storage failures for perishables.	Improved technology (irrigation, agrochemicals, new varieties) to reduce generic risks (pests, diseases, weather). Improved infrastructure services, including feeder roads and electricity. New financial instruments such as weather and commodity price insurance. Standardisation of grades and standards.
Rural World 2 Agricultural households that produce for the market but also to meet subsistence needs.	Generic risks (pests, diseases, weather); possibly problems of new market links, but most likely to be problems of local or seasonal market saturation, and imbalances of market power.	Improved technology (irrigation, agrochemicals, new varieties) to reduce generic risks (pests, diseases, weather). Information, institutional and infrastructure development needed to improve market functioning and accessibility. Investment in local crop storage and processing facilities can help to fulfil subsistence needs more effectively. Support for livelihood strategies that include diversification within and out of agricultural production.
Rural World 3 Subsistence producers with small landholdings.	Same as for Rural World 2, but also risk of landlords withdrawing land, dearth of off-farm jobs, vulnerability of agricultural jobs in Rural Worlds 1 and 2, tenure insecurity, non-enforceable contracts, dangerous working conditions on construction sites and so on.	Same as for Rural World 2, also support for diversified livelihoods, including strengthened institutions for tenure security, contract enforcement, health and safety. Social sector investments that strengthen human capital and enable households to cope with a wide range of shocks.
Rural World 4 Agricultural labourers, mainly dependent on casual, unskilled labour.	Vulnerability of agricultural jobs to shocks affecting Rural Worlds 1, 2 and 3, which affect demand for labour, lack of off-farm jobs, non-enforceable contracts, dangerous working conditions on construction sites, communicable diseases and so on.	Economic policies that encourage investment leading to job growth. Policies that support seasonal migration, commuting and personal insurance. Investment in health care infrastructure and institutions (including public health), which reduce morbidity and inability to supply labour. Adult training programmes that support creation of alternative livelihoods including self-employment and enterprise development.
Rural World 5 Those unable to engage in regular productive activity (very elderly, sick, disabled, very young), all of whom rely on informal transfers of food, shelter, clothing.	Any risks adversely affecting the agricultural and related rural economies are likely to have secondary effects on this group through reduced informal transfers to them.	Measures as above to strengthen and stabilise the household economy as well as measures to provide social protection (health, social pensions, child and widows' allowances) including the care of orphans and people living with HIV/AIDS.

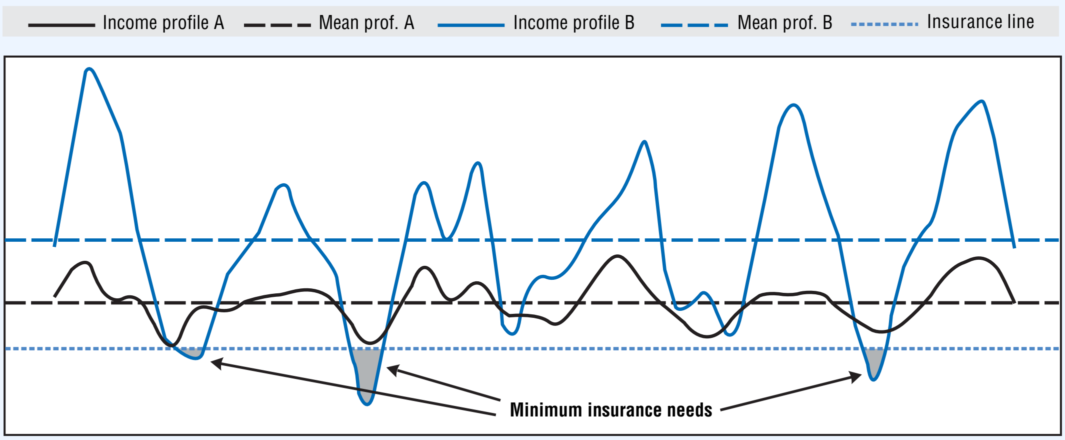
Source: Farrington (2005).

Spotlight on Higher-risk, Higher-return Strategies

Social protection, an integral part of economic policy, should consist of a wide array of programmes accessible to all. While some economists have argued that "welfare" payments to the poor are a drag on economic growth, a well designed social protection programme can be a springboard for economic growth. Many poor people's thoughts are dominated by where their next meal will come from. As a result they often adopt low-risk, low-return strategies as opposed to higher-risk, higher-return strategies.

Enabling poor rural households to adopt the higher-risk, higher-return strategies is an important dimension of increasing their opportunities for better livelihood strategies that lead to an escape from poverty. Good social protection programmes with clearly articulated, transparent, non-discriminatory eligibility and accessibility mechanisms are important in enabling the poor to adopt higher income livelihood strategies that may incur more risk.

Figure 15.1. **Two income profiles – one low, one higher**



Source: Brown and Gentilini (2005).

The figure shows two expected income profiles, A with a low mean but also a low variance, and B with a higher expected mean but a higher variance. A poor household will not adopt a livelihood strategy commensurate with profile B if it is unable to withstand the very low troughs in income that are possible.

A simple example may be a household with insecure land tenure living in an area prone to drought. Profile A may be represented by growing cassava, a food crop that is drought tolerant, with a fairly short maturation period and locally marketed or profile B by growing coffee, a long-gestation cash crop. The income from coffee is far higher but carries the risk of not being drought tolerant, or potentially losing the land before the coffee plants

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reach maturity, or the harvest occurring at a trough in the international coffee price. Any one of these events or some combination could result in the very low troughs apparent in income profile B.

A variety of strategies and instruments, both public and private, could address these problems and enable a household to adopt profile B.

- Weather-based or commodity risk management instruments would provide protection against drought or the coffee being sold at a time of lows in the global price thus reducing the size of the troughs in income profile B, and increasing the average expected income.
- A land registration programme that was sensitive to traditional tenure patterns, also promoting access by women, as opposed to single right privatisation would reduce the downside variance of both income profiles increasing the average expected income.
- Investments in appropriate irrigation infrastructure would reduce the downside variance in the income profiles, particularly of B, due to drought.

The figure is, in essence, made up of a map of higher and higher income profiles where the goal is to enable households to steadily move to a higher profile – for example, from A to B and on to C, D, E – each having a mean income higher than the last. At some point the mean of the profile will be at the poverty line. In each part of the spectrum of income profiles some will have more inherent risk than others.

At the lowest income profiles, the instruments that reduce the likelihood of the risk materialising – or remove the troughs from the income profile either *ex ante* or *ex post* – are much more likely to be publicly provided. They may include public health programmes, investment in roads and institutions, as well as safety net, social assistance and welfare programmes. At the very lowest levels of expected income, and in location-specific circumstances, assistance may be provided in kind, such as direct food or housing assistance. At higher levels of income the protection measure may be privately provided such as commodity price or weather insurance or a mix of public and private provision, including contributory schemes, such as unemployment insurance, health insurance and old-age pension provision.

ISBN 978-92-64-02477-9
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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.

PROMOTING PRO-POOR GROWTH: POLICY GUIDANCE FOR DONORS – ISBN 978-92-64-02477-9 – © OECD 2007

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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.

PROMOTING PRO-POOR GROWTH: POLICY GUIDANCE FOR DONORS – ISBN 978-92-64-02477-9 – © OECD 2007

ISBN 978-92-64-02477-9
Promoting Pro-poor Growth
Policy Guidance for Donors

Pro-poor Growth: Policy Statement

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

Three key messages from this work are that:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

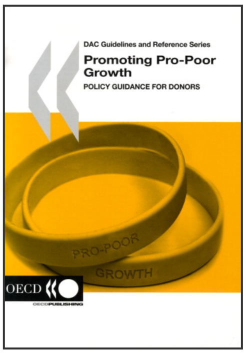
For donors, the pro-poor growth agenda is not business as usual and more of the same will not be sufficient.

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

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

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

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



From:
Promoting Pro-Poor Growth
Policy Guidance for Donors

Access the complete publication at:
https://doi.org/10.1787/9789264024786-en

Please cite this chapter as:

OECD (2007), "Reducing Risk and Vulnerability", in *Promoting Pro-Poor Growth: Policy Guidance for Donors*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264024786-18-en