Making Markets Work Better for the Poor - Contributing to Growth and Poverty Reduction

How does MMW4P contribute to poverty reduction?

DFID has been undertaking a review of the MMW4P pilot programmes[1]. The key messages from this work with respect to growth and poverty reduction are:

Context

1) **Economic growth is the most powerful way of pulling people out of income poverty on a sustainable basis.** Cross country evidence and in-country analysis shows that poverty falls only when there is growth and, frequently, growth is the major contributor to a rise in the incomes of the poor. Across countries, between two-thirds and 90% of the reduction in poverty has resulted from growth. A study of 14 developing countries found that poverty only fell when there was growth and the faster the growth the greater the fall in poverty. In these countries, growth, rather than distributional changes, played the major role in increasing the incomes of the poor.

2) **Growth is the exit strategy for aid. Scaling up of aid should not come at the expense of neglecting growth.** Growth is not only the most powerful way of pulling people out of poverty, it is the best way of ensuring that countries develop the means (government revenues) to chart their own destinies without the support of donors, as the experiences of China and India has highlighted. The current scaling up agenda has prioritised general and sector budget support, focusing on social services and frequently neglecting growth. Without faster growth, the outcome of such assistance may be continued donor dependence. The lower transaction costs associated with aid for health and education, may cause greater priority to be given to human over economic development. This may lead to unbalanced development that may hinder sustained poverty reduction, as proved by the experience of the Soviet Union and China (pre-1980) in the past and many Latin American countries at present. In most developing countries, a high rate of unemployment or employment in unproductive informal occupations has resulted in the returns to additional investment in education and health becoming low.

3) **Though challenging, it is possible to scale up aid in support of growth.** Expenditure on institutions responsible for investment climate reforms and greater investment in public goods such as infrastructure and agricultural research that have proven to have strong impacts on growth and the incomes of the poor, may be increased through budget support and SWAps. Basket funding arrangements should enable a scaling up of aid to enable the private sector, especially those representing the interests of the poor, to participate in policy making processes, shape investment climate reforms, contribute to infrastructure and the supply of other public goods and bring about broad based growth. This will help to produce a more balanced approach to human and economic development establishing a virtuous circle whereby faster growth results in greater demand for productive labour, increasing the returns to education and health.

Key Messages

4) **Growth is likely to be faster and more effective in reducing poverty if the pace and pattern of growth are pro-poor.** Whilst growth is essential for pulling people out of poverty, the effect growth has on reducing poverty varies appreciably, depending on levels of inequality and the extent to which the poor are able to participate in and benefit from the growth process. Greater participation of the poor in the growth process helps to sustain faster growth and increases the rate at which their incomes rise. Both the pace and pattern of growth matter for reducing poverty and the two are interlinked. Broad based growth that encompasses the regions in which the poor live, sectors from which they currently earn their livelihoods (stepping up) and to which they can move to earn higher incomes (stepping out) is likely to be faster and longer sustained and more effective in reducing poverty. The old policies of

[1] This is note 1 in a series of 4 notes on that set out the findings of the review: note 2 addresses MMW4P's Role in Growth Strategies; note 3 describes the MMW4P Framework; note 4 documents the Lessons Learnt.

grow now and redistribute later were ineffective because they failed to address the beneficial participation of the poor in the growth process. The pattern of growth that is emerging in Africa today is a cause of concern as growth is not resulting in the creation of jobs in the formal sector and rural incomes are rising slowly.

5) **Macro Economic stability and Investment climate reforms are necessary but not sufficient.** Macro-economic stability and investment climate reforms are pre-conditions for bringing about a pace and pattern of growth that will help to reduce poverty rapidly. They help to reduce the risk and cost of entrepreneurship and investment, thereby broadening growth. Such reforms, however, take time as opposition from vested interests will need to be overcome and capacity built within the state to implement reforms effectively. Moreover, progress on these fronts may not be sufficient to bring about a pace and pattern of growth that reduces poverty rapidly. The poor may lack access to productive assets and to markets to sell the goods and services they produce. Their vulnerability to risk may prevent them from taking advantage of the opportunities growth provides to improve their incomes.

6) **Markets play an important role to play in bringing about a pace and pattern of growth that will reduce income poverty rapidly.** Markets are the central organizing principle of economic activity and determine what gets produced where and who gets what out of economic activities. They play a crucial role in determining the pace and pattern of growth. The poor participate in the growth process through markets whether as farmers, workers, entrepreneurs or as consumers of goods and services. Market outcomes determine their opportunities to improve their incomes and meet their consumption needs. It in only through understanding markets, how they function and grow and the way that the poor participate in them that economic growth can be strengthened and interventions to stimulate shared growth undertaken.

7) **However, markets often do not function effectively on their own and the poor are often disadvantaged in participating in markets**. Though market forces are the most efficient way of allocating resources to enable growth and wealth creation, they often require public functions such as appropriate policies and institutions and the supply of public goods such as infrastructure to enable them to work effectively. Markets also do not consider broader benefits or costs to society, so governments need to be able to measure these externalities and then implement policies that enable a more optimal allocation of resources (i.e. through taxes, subsidies or other mechanisms). In order to function efficiently, markets require healthy competition incentivizing firms to find cheaper and innovative ways to produce goods and services profitably. They also require the flow of information so that producers and consumers can make informed decisions. However, in developing countries markets are often weak, information is poor and Governments are often unable to fulfil the required public functions. Instead market and government failures are pervasive and market outcomes frequently determined by wealth and power. On occasions, markets may be captured by vested interests. When markets fail or disadvantage poor men or women, they undermine the growth process and the benefits that the poor obtain from it.

8) **Additionally, some groups in society may not be able to participate in markets as doing business with them is not attractive.** Those who have few assets or skills to sell and/or who live in remote and difficult to reach locations, sometimes find it difficult to participate and benefit from markets. The cost to serve them with goods and services may be higher than they can afford. In developing countries, infrastructure may be poorly developed, information on the poor is frequently unavailable and the forces of competition weak resulting in slower innovation to find new ways to bring the poor into markets. Analysing how the different types of the poor are disadvantaged in markets and identifying the causes sets up an agenda for action to improve access and find new and cheaper ways to serve the needs of the poor. Along with actions to improve market access and functioning, marginalised groups may require social transfer and safety net programmes to find new ways to become more productive, move to areas where there are greater opportunities for improving livelihoods or escape poverty traps into which they have fallen.

9) **However, markets can be made to work for the poor.** Support for policy and institutional reforms, investment in public goods, addressing market failures and supporting the processes of competition and innovation in the private sector to improve market access, help to make markets work better and more fairly. There

is strong evidence that improving the functioning and fairness of markets for the factors of production (land, labour, finance) increases growth and the incomes of the poor. Investing in the maintenance and expansion of infrastructure; increasing productivity in agriculture and manufacturing and service sectors that are labour intensive; and addressing markets for food and other basic necessities also provide strong pay back in terms of pace and pattern of growth.

10) MMW4P programmes have proved effective in addressing a range of markets that matter for growth and the incomes of the poor. To date, MMW4P programmes have mainly addressed the functioning and fairness of markets for agricultural commodities, labour intensive manufacturing, business services and finance. Recently, programmes have been launched to address labour and land markets. There is scope for using the framework more extensively to address labour and land markets. The framework has not been applied operationally to infrastructure to which it is well suited.

11) MMW4P help to bring about systemic change so its outcomes are sustained and its impacts are larger. Because MMW4P aims to change the incentives provided to market participants, the outcomes it brings about are more likely to be sustained. And, because the whole market is affected, provided the markets selected for intervention are well chosen, the impacts delivered are likely to be large. For example, in South Africa, the government wished to see a more inclusive financial sector and a legitimate and credible stakeholder in the Banking Council was determined to respond to this demand. The members of the Banking Council, through a new basic bank account (Mzansi), have helped to provide bank accounts for 3 million of the previously un-banked, with the FinMark Trust playing a catalytic and supportive role. ComMark has supported stakeholders in Lesotho's garment industry meet the challenge of losing preferential access to world markets and thus safeguard the future of the country's largest source of formal employment and exports. In Bangladesh, Katalyst[i] has supported suppliers of farm inputs and fingerlings to provide information and advice to over 60,000 farmers increasing productivity by 10%-12%. In South Africa, the Presidency, the private sector and organised labour have come to recognise their common concerns and agendas in the contested area of labour market reform, resulting in the Economic Adviser to the President calling it one of the most effective programmes of donor assistance in his 30 years in development.

12) Using the 'lens' of the market provides a favourable framework to implement complementary reforms that promote shared growth. Because MMW4P addresses both the attitudes of policy makers and the behaviour of private actors and promotes dialogue between them, it provides an opportunity to implement complementary measures that help to improve the pace and pattern of growth. It may provide a favourable context for; implementing investment climate reforms; improving governance; stimulating productivity growth and increasing competition to promote competitiveness; operationalising aid for trade by making export markets work better for the poor; addressing discrimination on the basis of gender or membership of social groups, improving environmental sustainability; and reducing risk and vulnerability of the poor. Most importantly, it helps to empower the representatives of the poor and provides a favourable context to overcome opposition from vested interest, increasing the likelihood that policies needed to promote shared growth are implemented. The framework incorporates drivers of change analysis and empowers constituencies in favour of pro-poor change to use evidence based dialogue to influence policy processes and demonstration and communication to overcome resistance to change.

What are the implications for donor assistance?

13) Growth should be given greater prominence in country led poverty reduction strategies and donor assistance in support of them. Despite its crucial role in pulling people out of poverty, poverty reduction strategies currently give limited attention to how faster, shared growth will be achieved. Donors need to engage in the prs process to ensure sufficient prominence is given to the shared growth agenda. Their support for implementing prs's should ensure an appropriate balance between economic and human development.

14) Greater consideration should be given to markets within all growth work. All donor interventions designed to stimulate shared

[i] FinMark is a DFID programme addressing access to finance in Southern Africa. ComMark addresses commodity markets in Southern Africa. Katalyst is a joint Swiss Agency for Development Cooperation, Sida and DFID programme addressing rural livelihoods and urban employment in Bangladesh.

growth should be based on an understanding of markets - how they are functioning, what is constraining their growth, and how they can be made to include and benefit the poor on a sustainable basis. Governments should be encouraged to identify and address markets that are particularly important for growth and poverty reduction. Donors should not only have particular projects that are based on markets and called MMW4P, they should consider markets in all growth interventions. Hence, investment climate reforms, interventions to improve productivity and competitiveness, aid for trade and the reduction of risk and vulnerability should be informed by an analysis of how well and fairly key markets are functioning.

15) MMW4P programmes should form a part of scaling up growth portfolios. The scaling up of support for growth should include MMW4P programmes. Because these interventions aim to broker policy and institutional change and harness the capabilities of the private sector, they are not suitable for budget support or SWAps. Basket funding arrangements and programmatic aid are more appropriate. Designing these programme is time intensive but advisers may wish to contract out some of the more laborious processes whilst retaining control of key decisions. It is possible to establish basket funding mechanisms that help to deliver substantial volumes of aid and effective donor co-ordination, as evidenced by newly designed programmes such as PROSPER in Bangladesh. Because they seek to empower legitimate and credible stakeholders, once up and running, they should represent relatively light touch instruments.

16) Greater emphasis needs to be given to ensuring 'governance for growth' is in place, that vested interests are overcome and that governments are held accountable for making markets function effectively and with fairness. Implementing policy and institutional reforms to make markets work better for the poor is not just a matter of implementing the right technical solution. To succeed, effective mechanisms are needed to enable private sector stakeholders, especially those who represent the interests of the poor, to exercise governance over the reform process. This should help to hold government accountable for ensuring that markets function well and fairly. Pro-reform organisations and individuals from the public and private sector need to form constituencies in support of pro-poor change to overcome opposition from vested interests. Governance for growth is particularly important in post conflict situations as it helps to re-establish the contract between the state, the private sector and civil society that is essential for sustaining shared growth.

17) DFID has built up intellectual capital, through lesson learning, and should now use it to influence related aid programmes. Although MMW4P is still at the pilot stage, DFID has built intellectual capital and learned valuable lessons from it. The framework can help to influence other donor and IFI programmes in support of private sector development so that they contribute to systemic change and the beneficial participation of the poor in markets. Currently, the World Bank and other donors are scaling up support for the development of small enterprises, policy loans in support of investment climate reforms and competitiveness and improving the functioning of value chains. These interventions are likely to be more effective in contributing to shared growth if they are informed by the MMW4P framework.