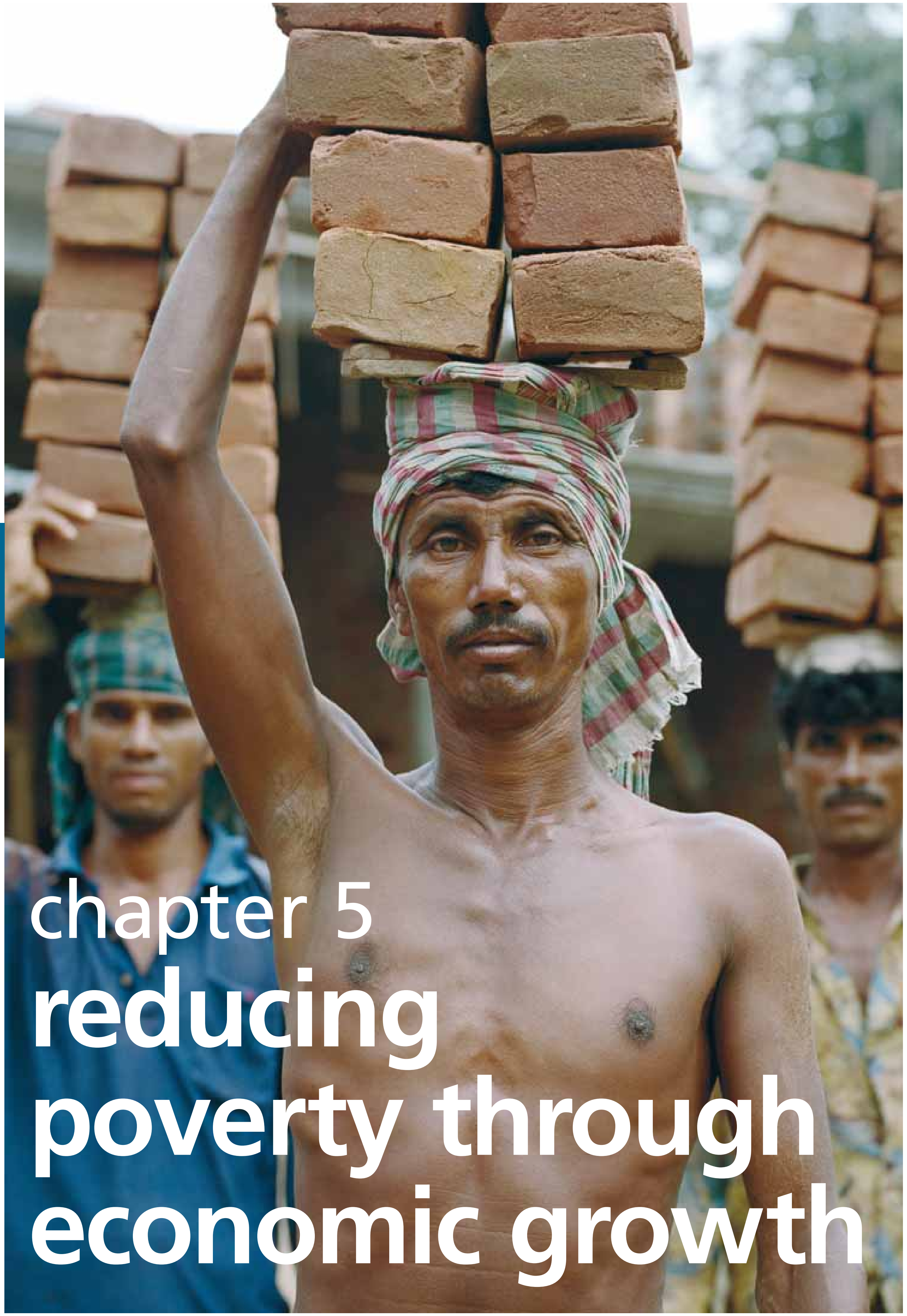


chapter 5
reducing poverty through economic growth

Economic growth is the single most powerful way of pulling people out of poverty.

Tackling inequality helps poor people participate in economic growth and trade.

Reducing poverty sustainably means ensuring that today's development successes do not become tomorrow's environmental failures.

Growth is the best way to reduce poverty…

5.1 Poverty is about lack of opportunity, not just a lack of income. The lesson from the last 50 years is that economic growth is the most powerful way of pulling people out of poverty. Economic growth creates higher incomes, which help people save, invest and protect themselves when times are hard. Higher family incomes mean children can go to school rather than have to work. And as economies grow, governments can raise the money they need for public services.

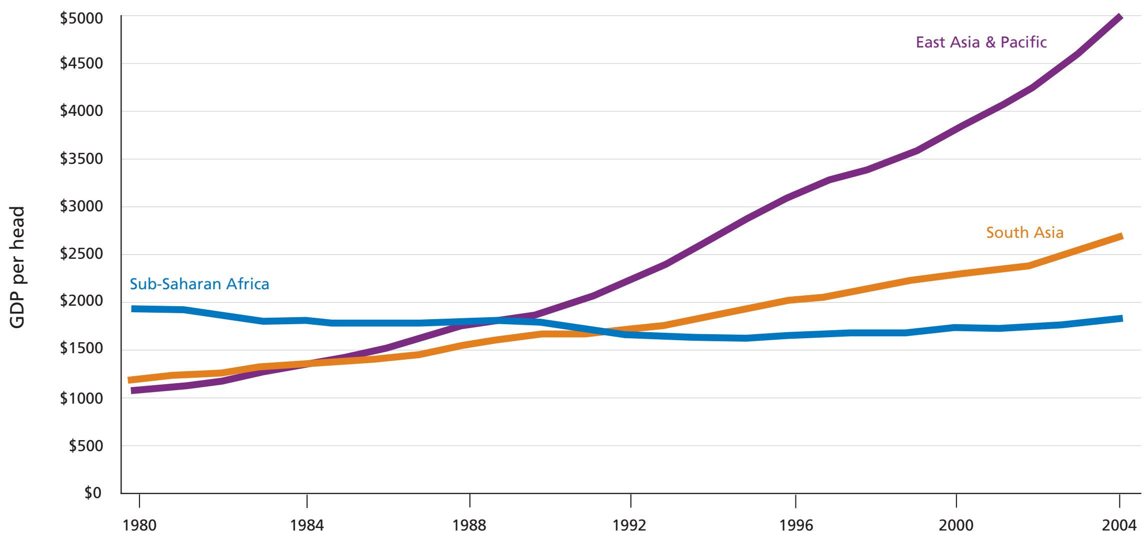
5.2 Over recent decades, Asia has seen dramatic economic growth, first in the East Asian 'Tigers' of South Korea, Singapore and Taiwan, then Thailand, Malaysia and Indonesia, and more recently in China and Vietnam. Trade and openness to the international economy have been the key to this economic success. There has also been significant progress in South Asia. In the 1990s, economic growth helped reduce poverty in the region from just over 40% to around 30%.[1]

5.3 The picture is very different in sub-Saharan Africa, though there have been some success stories. Uganda and Ghana, for example, had high enough growth during the 1990s to reduce poverty by more than 10%. But the percentage of people living in poverty in the region as a whole has increased in the past two decades. There are now over 300 million poor people in sub-Saharan Africa.[2]

Struggling to grow in Malawi

Mary Banda lives on a small plot of land in rural Malawi. She plants maize at the start of the rainy season. Mary would like to buy new seeds and fertiliser but this is the time of year when she is shortest of cash. Even in good years she relies on food aid for the hungry months. In times of drought, or when there's an illness at home, the family have to sell their possessions and livestock just to survive. It takes years to regain them. Mary needs to find work or sell something to bring in cash but few local people have enough money to start a business, and the area has poor roads, electricity and phone connections. The nearest market is eight miles away and she cannot be sure that she will be able to sell or buy what she needs there.

Which regions have been getting richer?[3]



Source: World Development Indicators 2006

5.4 We believe there are five big challenges for the future:

- First, helping poor countries to grow faster, especially those lagging behind or who have the biggest numbers of poor people.
- Second, enabling poor men and women to benefit from growth, by providing better access to economic opportunities.
- Third, ensuring that growth is based on the sustainable use of natural resources, given rising worldwide consumption and the threat of climate change.
- Fourth, successfully negotiating for a fairer international trade system from which developing countries can benefit.
- Fifth, managing migration to promote growth.

Promoting growth…

5.5 It is the private sector – from farmers and street traders to foreign investors – that creates growth. Growth is fuelled by the creativity and hard work of entrepreneurs and workers. But as the Commission for Africa emphasised, it is governments that are in a position to make markets and competition work, by taking the lead in making business easier and less expensive, and determining the level of regulation.

5.6 Some developing countries are hardly growing at all. This is often because the government is not managing the economy well. High and unstable inflation makes business difficult. And local and foreign investors take fewer risks if corruption means they have to pay bribes for licences, or if legal systems fail to uphold contracts. Growth happens faster when political and economic leaders create the right environment for trade and investment.

How did Botswana grow?

From 1965 to 1998 Botswana's economy grew at an annual rate of 7.7%. External threats during the 19th century helped unite tribal and ethnic groups. This contributed to a common interest in building a strong state following independence in 1966 to safeguard property rights, improve infrastructure, and keep up the traditional 'kgotla' or public meeting so that government listened to the needs of the community. It created the stability and confidence necessary for investment and led to policies that benefited the whole country – so that Botswana's huge mineral revenue was used to boost national development, rather than being siphoned off for the benefit of a small elite.

5.7 One of the lessons of recent decades is that there is no single path to growth. Some of the reforms that international partners pushed through during the 1980s and 1990s did not work. However, while successful countries have followed a number of different policies to suit their own circumstances, they have based these reforms on common principles.

5.8 First, governments must establish macro-economic stability. This means that central banks and finance ministries must keep public borrowing and inflation at manageable levels, interest rates affordable and exchange rates stable and realistic. This makes costs and profits for businesses more predictable, which encourages investment. A strong financial sector also helps people to invest their savings and use resources effectively.

5.9 Second, governments need to remove unnecessary barriers to business, including obstacles to foreign trade and investment. Regulation is needed to make sure that workers earn a decent wage and have safe working conditions. But this should not make it too hard or expensive for people to set up in business. While some governments regulate too little, many regulate badly or too much, placing huge costs on the private sector. For example, it takes two procedures and two days to start a business in Australia, but fourteen procedures and 153 days in Mozambique. In Singapore, it takes seven hours and two signatures to clear goods through customs but in Bangladesh, it takes seven days and 38 signatures.[4] Improved business conditions in China and India during the 1980s and 1990s meant that private investment nearly doubled. Countries which improve their regulation to the best international standards can increase growth by as much as 2.3% a year.[5]

Changing the climate for business

The Investment Climate Facility (ICF), launched in June 2006, aims to boost growth in Africa by reducing barriers to private sector investment. It will create more and better jobs, particularly in small-scale businesses and will help:

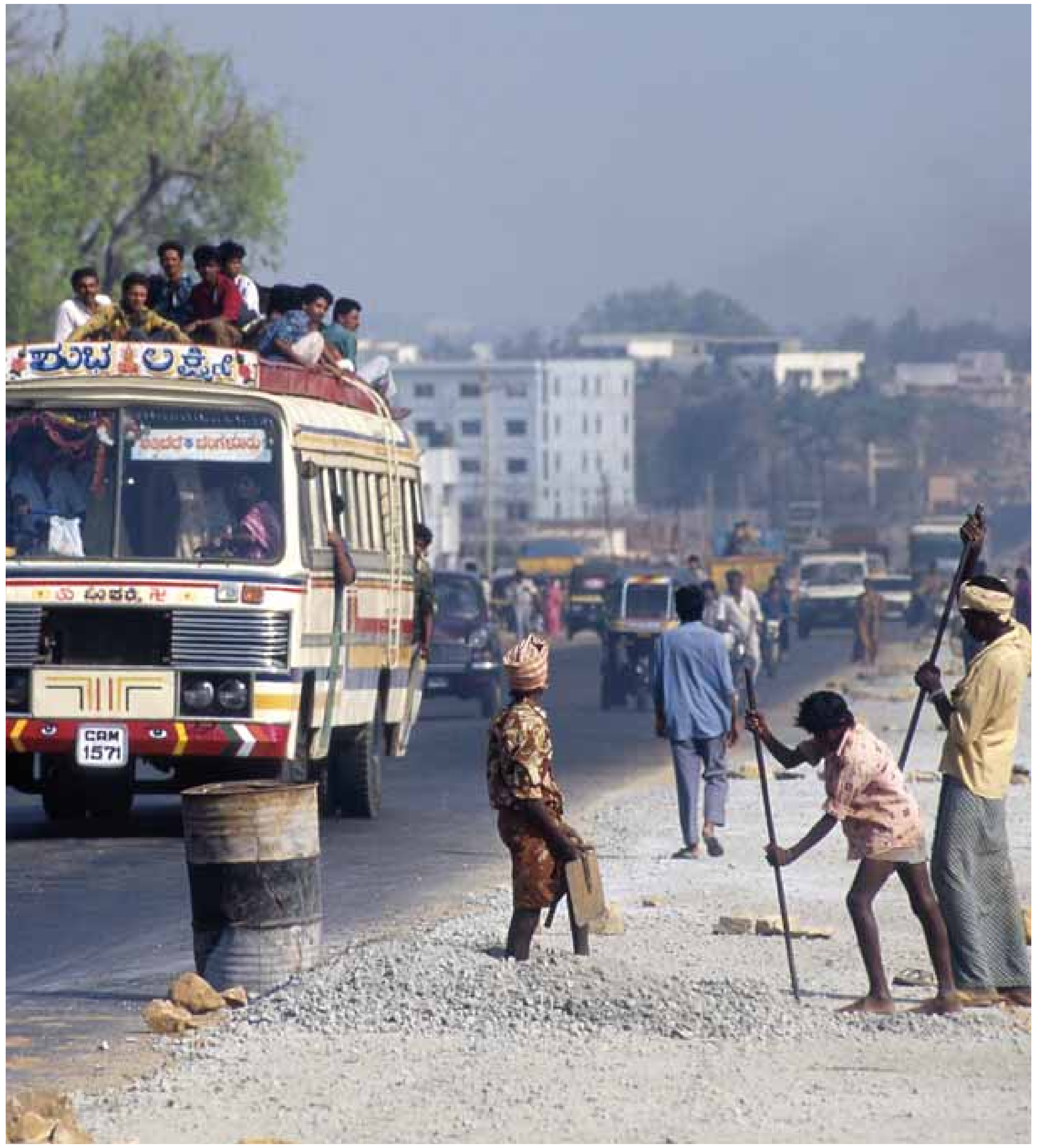
- Improve the image of Africa as a place to do business.
- Improve business regulation, including fairer and more efficient taxation and customs.
- Strengthen property and contract rights.
- Develop Africa's financial markets, and investment in infrastructure.

The ICF will work with African governments, private-sector, regional and specialist organisations. The UK has played a leading role in helping to shape the ICF. We are contributing US$30 million over its first three years.

5.10 Third, investment in infrastructure is critical. Africa in particular suffers from a lack of energy, communications and irrigation. The costs of building, operating and maintaining infrastructure in developing countries are usually between 6% and 8% of gross domestic product (GDP), but investment can bring big returns.[6] Public-private partnerships – often supported by aid contracts or guarantees – can help. However, countries will need to adapt their infrastructure to deal with the risks posed by climate change.

Getting connected

"In the past, I had to carry rice on my shoulders to the Thua market, which is 7km away," says Kieu Van Do, a member of the Duong Quang commune in Vietnam. But the road running through the commune has recently been improved, and, like everyone, Kieu Van Do is delighted. Since the road improvement, incomes in the commune have increased annually by 7% and the commune has expanded into rearing livestock and selling services. At the same time schools, health clinics, power supplies and the post office have all been modernised.



Investing in infrastructure

The Commission for Africa argued for an extra US$10 billion a year in funding for infrastructure from 2005 to 2010, and US$20 billion in the following five years. International partners are on course to meet these targets. The Infrastructure Consortium for Africa was established by the G8 to increase investment in infrastructure. The UK provided initial finance of US$20 million to help establish the Consortium. In its first year, Consortium members secured funding for ten regional projects worth US$750 million, 34 country projects worth US$1.8 billion, and agreed scoping studies that will lead to further rounds of projects. Asia's infrastructure is better developed than Africa's but the total investment needed is higher. A new Asian Private Infrastructure Financing Facility is to be launched soon. International financial institutions like the World Bank and the Asian and African Development Banks are helping to bridge the funding gaps, improve procurement and technical standards, and stimulate private sector investment.

5.11 Fourth, agriculture is central to the economies of many poor countries and the lives of many poor people. Agriculture creates jobs and income, and helps the rest of the economy to grow by boosting demand for local goods and services. For every US$1 of farm income in Zambia, a further US$1.5 of income is generated in other businesses.[7] But to expand agriculture, governments need to guarantee land ownership, make sure that regulation, standards and subsidies are appropriate, and see that land is used sustainably so it continues to be productive. They also need to invest in infrastructure (for irrigation and to get goods to market) and innovation (including adaptation to climate change); and promote access to rural financial services. The G8 is supporting national and regional initiatives under the AU/NEPAD's Comprehensive African Agriculture Development Programme.

5.12 Growth is especially important in the wake of conflict and where the state is weak. The private sector in fragile states can create jobs and provide some services when governments are unable to. But re-establishing a favourable investment climate can be difficult. Getting the timing of reforms right and rebuilding basic infrastructure is essential. Sometimes, just getting the macro-economy under control can attract large-scale investment.

5.13 The UK believes that growth is the 'exit strategy' for aid. To reduce poverty quickly, international partners need to put growth at the heart of their relationships with developing countries. Multilateral and bilateral donors can support growth and macro-economic stability by providing advice and financial support to countries, and by co-operating closely with the international and local private sector.

CDC: Boosting the private sector

CDC Group plc (a company wholly-owned by DFID) invests in poor developing countries and aims to attract private capital by showing that such investments are worthwhile. It is proving a great success. CDC has mobilised about £360 million of private investment since 2003 and its portfolio has grown by 60% to £1.6 billion. Its investment in African telecoms highlights its success. CDC was the first institutional investor in Celtel which now has telephone operations in fourteen countries, covering 30% of Africa's population. It has transformed access to telephones for more than 5 million customers.

The UK will

- Support investment climate reforms, including through the Africa Investment Climate Facility, and help identify and address constraints to domestic and foreign investment.
- Increase investment in infrastructure by strengthening partner governments' capacity to prepare, finance, implement and maintain projects.
- Increase our support to private sector investment in infrastructure by at least £40 million over the next three years. With contributions from others, this will help double the amount of private sector investment to US$3 billion.
- Work with international partners to ensure that at least US$10 billion is provided annually for infrastructure in Africa by 2010 through the Africa Infrastructure Consortium.
- Work with multilateral development banks and development finance institutions such as the International Finance Corporation, the European Bank of Reconstruction and Development and the European Investment Bank to increase investment and support to the private sector, especially in difficult environments.
- Work closely with organisations like Business Action for Africa and the Commonwealth Business Council to identify ways to support development of the private sector and employment.
- As part of doubling research funding, we will increase support to science and technology to promote growth, including on agriculture, forestry and fisheries – for example through the AU/NEPAD's Comprehensive Agricultural Development Programme.
- Encourage developing country governments, the private sector and civil society, including trade unions, to work together to promote growth and employment.

Helping poor people to benefit from growth...

5.14 Inequality – the gap in incomes and opportunities between rich and poor – is a problem in many countries. It means that even if the economy is growing fast, the poor can still be left behind. Inequality causes social tensions, and unequal access to resources can mean that powerful vested interests continue to ignore the interests of the poor.

5.15 Growing now and redistributing the benefits later does not work.[8] Governments need to increase economic opportunities for all from the start. In Chapter 6 we set out how investment in education (especially for girls), health and social protection can boost opportunities and reduce the vulnerability that most poor people face. Investment in agriculture is especially important for many poor people. Investing in rural roads to link remote regions to local and regional markets, and providing access to new technology, like mobile phones, makes trade much easier. In most countries – as successful Bangladeshi NGOs have shown – more can also be done to help women fulfil their economic potential. Women must be able to borrow capital and access appropriate technology so that they can develop their businesses. Governments need to remove legislation that discriminates against women owning land or finding a job.

5.16 Access to finance helps poor people invest in productive assets like livestock, or goods for their business. Banks and governments need to work together to make credit more widely available. The UK contributes about £30 million a year to develop microfinance and financial services schemes – just one of these has attracted a further £58 million in private

sector investment in the past five years.[9] Improved property rights are also important, as they provide collateral and encourage people to invest in the land. When rural households in Vietnam were given greater rights to farm land in 1988, it led to better and more productive land use, increased growth, and higher incomes.

5.17 Large numbers of poor people make their living as small traders and day labourers. Their ability to do this is greatly affected by local regulations like market licences and work permits. Small and medium sized enterprises account for about 40% of employment in low income African countries.[10] Governments need to help people in this sector to access business support services. As proposed by the Commission for Africa and NEPAD, an Africa Enterprise Challenge Fund is being set up to extend financial services, open markets to small producers and share skills between large and small companies.

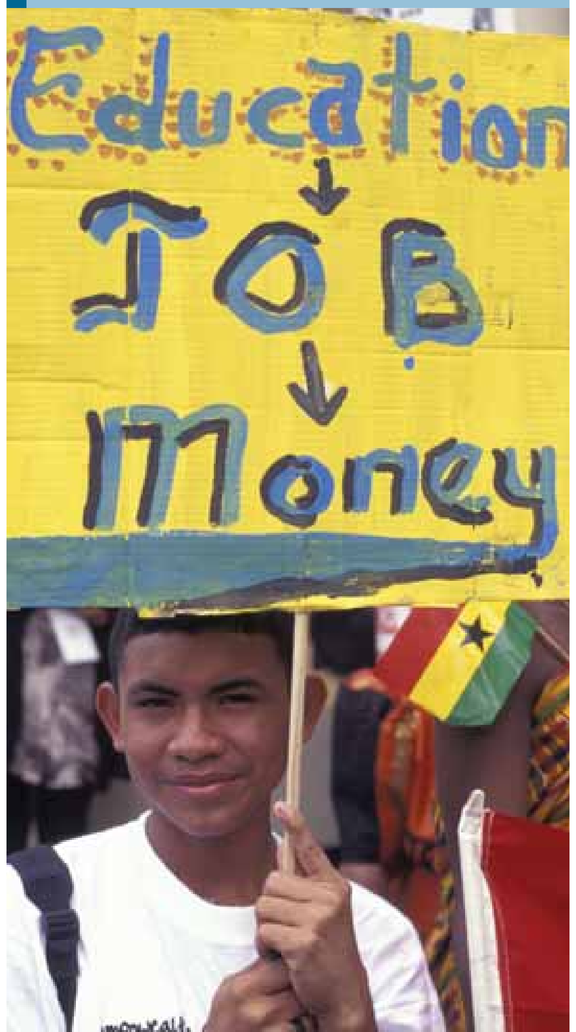
Making markets work for poor people

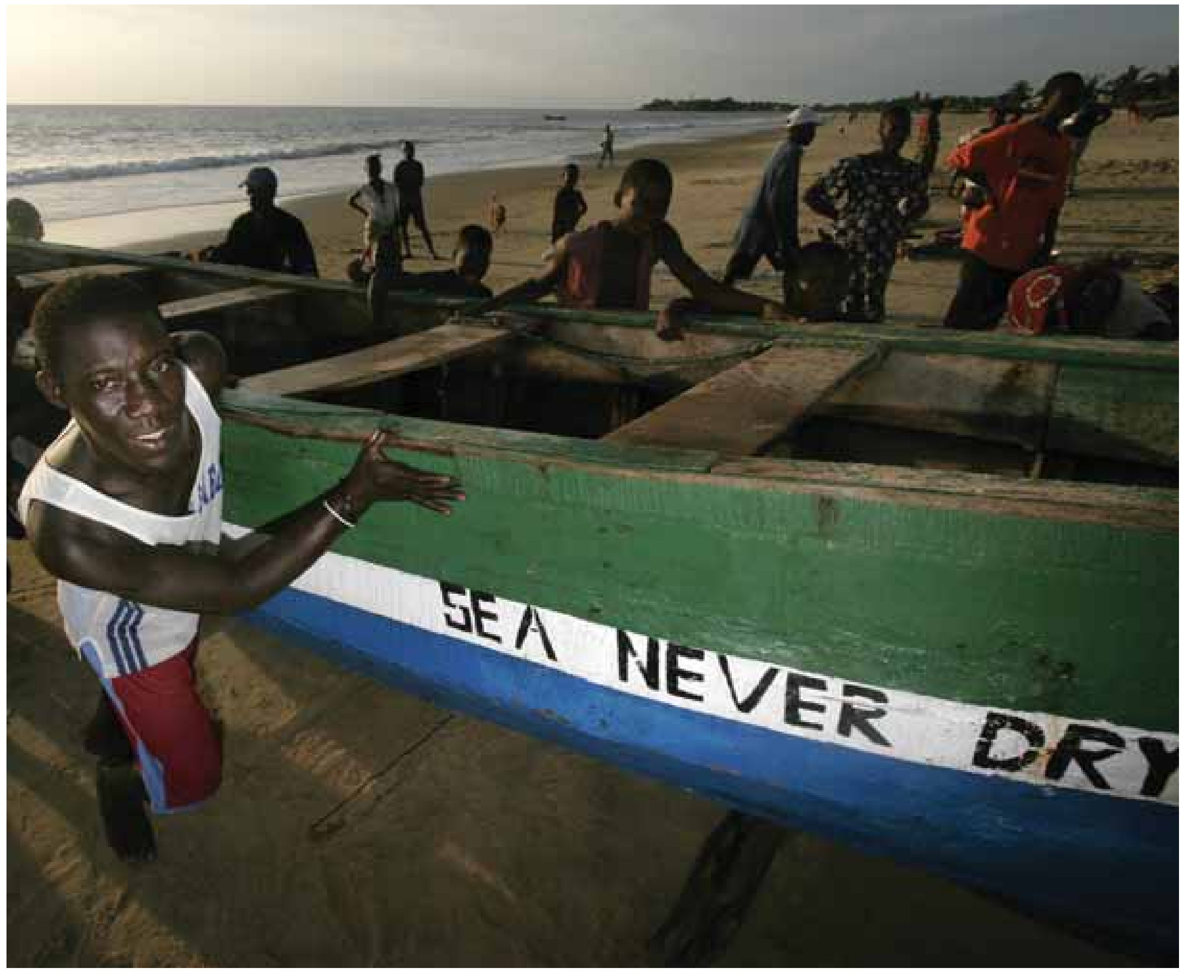
Markets work for the poor when they provide opportunities for business and decent jobs, and enable poor people to get the goods and services they value. The UK is supporting a number of initiatives to expand such opportunities, including:

- In Southern Africa, the FinMark Trust is working with financial regulators, the banking sector and policy makers to extend access to financial services. In South Africa alone, the Trust's work has helped an additional 2.3 million people access financial services.
- In Bangladesh, the KATALYST programme is helping to strengthen business services for small and medium size enterprises. In Faridpur for example, KATALYST has been working with more than 3,000 fish farmers to increase the volume and quality of their production.

The UK will

- Help to tackle the barriers that prevent poor people from gaining access to markets and financial services, including by improving property rights.
- Support microfinance initiatives, particularly in partnership with banks and regulators.
- Promote good labour standards and work to get rid of child labour.
- Support the Africa Enterprise Challenge Fund with US$20 million in its first three years, and encourage others to provide a further US$40 million.





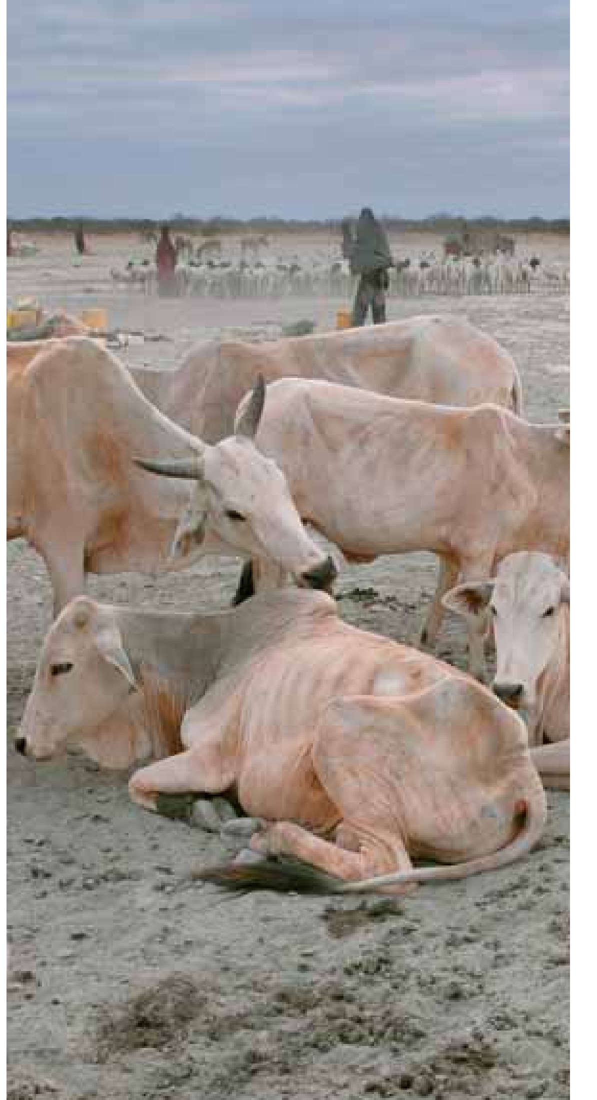
Using natural resources for sustainable growth…

5.18 A great deal of economic activity in developing countries depends on natural resources. Natural capital – which includes land, minerals, and forests – constitutes 5% of the world's wealth, but 26% of the wealth of developing countries (excluding oil-producing states).[11] But if exploitation of resources like oil, metals and timber is not regulated, or the resources are used inefficiently, it could undermine future growth. For example, Asia's rapid growth is, in some cases, being undermined by increasing consumption of natural resources and the costs and social inequities associated with it.[12] In Pakistan, build-up of salt in the soil, caused by overuse of irrigation, affects 16% of agricultural land, and contributes to the loss of over US$200 million a year in reduced crop yields.[13] And as we explore in Chapter 7, climate change will alter growing seasons and increase the risk of droughts and floods.[14]

5.19 Governments can do a number of things to make sure that natural resources are used sustainably and continue to help economies to grow. These include: removing inappropriate subsidies; regulating or taxing to discourage over-exploitation; clarifying exploitation rights; preventing illegal use; investing in innovation, such as better adapted crops and more efficient ways of using water and energy; and ensuring that these resources are priced properly. These challenges apply to developed and developing countries alike.

The UK will

- Help partner countries identify and respond to environmental opportunities and risks, for example by helping them to undertake strategic environmental assessments.
- With international partners, help countries to make efficient use of natural resources – especially water and energy.
- Reduce the impact of UK consumption, production and procurement on the global environment.
- Work with large developing countries through 'Sustainable Development Dialogues' to share experiences on managing the environmental impacts of growth.



Energy for growth

Economic growth is highly dependent on the availability and affordability of energy. Long term energy plans should aim at security, diversification and efficiency, and contain greenhouse gas emissions. For example, an energy strategy being developed by West African countries will help countries manage their energy resources, promote diversification and improve access to energy by poor people. In India, a long running programme in power sector reform, working in several Indian states, has reduced losses and improved public services and accountability.

Opening up trade…

5.20 International trade is vital for growth – as set out in the Government's 2004 White Paper on Trade and Investment.[15] It encourages competition and productivity, and helps developing countries earn their way out of poverty. But sub-Saharan Africa's share of world trade actually declined from 6% in 1980 to 2% in 2002.[16] Building trade with neighbouring countries is therefore especially important for Africa where intra-regional trade is only 5% of GDP, in contrast to East Asia and the Pacific where it is 27%.[17]

5.21 The best way of improving the access of developing countries to world markets is through a strong, multilateral rules-based trading system. The UK is working hard for an outcome to negotiations on the World Trade Organisation's Doha Development Agenda that leads to gains for all developing countries. This includes opening markets for goods like agricultural produce, industrial goods, textiles and clothing, substantially reducing all trade-distorting farm subsidies and ending export subsidies. But if it is to work, the World Trade Organisation agreement will have to meet the needs of countries at very different levels of development. Developing countries need

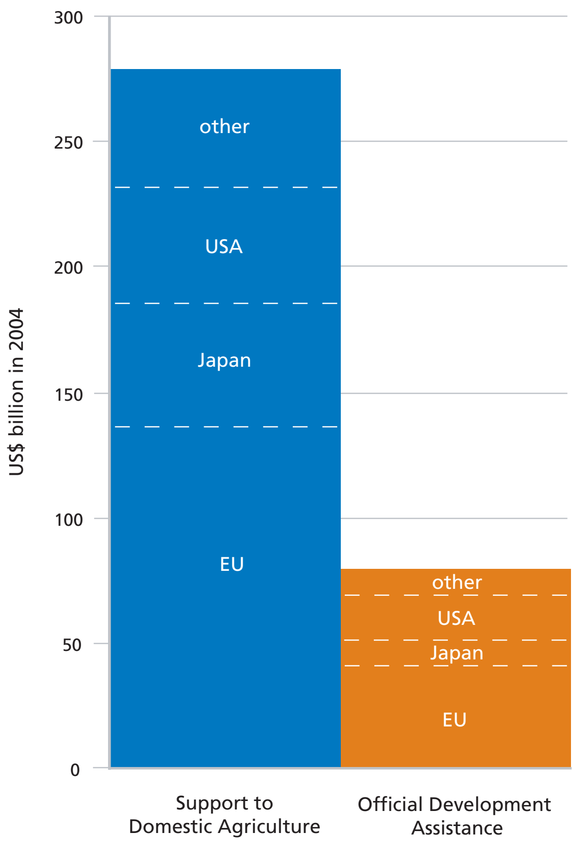
Aid for trade: helping generate growth

Aid for trade helps developing countries use opportunities for fairer and more open trade. The UK will increase our assistance to £100 million a year by 2010. Total donor commitments to date are about US$1 billion. Aid for trade could include customs reform, assistance to poor producers in meeting health and safety standards set by importing countries or supermarkets, and help with getting goods to market. For example, the UK is providing £4 million to help increase Southern Africa's exports of fruit, vegetables and other natural products by at least US$115 million by 2010. European and South African supermarkets will help small farmers find innovative ways to meet public and private product standards.

'special and differential treatment' in order, for instance, to protect vulnerable farmers from surges in food imports.

5.22 The EU has already made significant reforms to the Common Agricultural Policy. However, more radical reform will be needed, including during the 2008-09 review.[18] This should reduce agricultural subsidies which distort trade opportunities for developing countries and should encourage other OECD countries to phase out their agricultural subsidies. The EU's negotiation of Economic Partnership Agreements with African, Caribbean and Pacific countries offers another opportunity to increase trade. The UK is committed to ensuring that these agreements help reduce poverty.

A comparison of subsidies to agriculture and funding for development[19]



Source: OECD

5.23 While greater access to markets is vital, it is not enough by itself. To make the most of more open markets and regional trade, developing countries must be able to export the right goods at the right price. Developing countries need to build their ability to trade, and developed countries need to tackle the growing problem of non-tariff barriers. These include unreasonable product standards, or 'rules of origin' which prevent developing country businesses from buying raw materials from the most competitive sources.

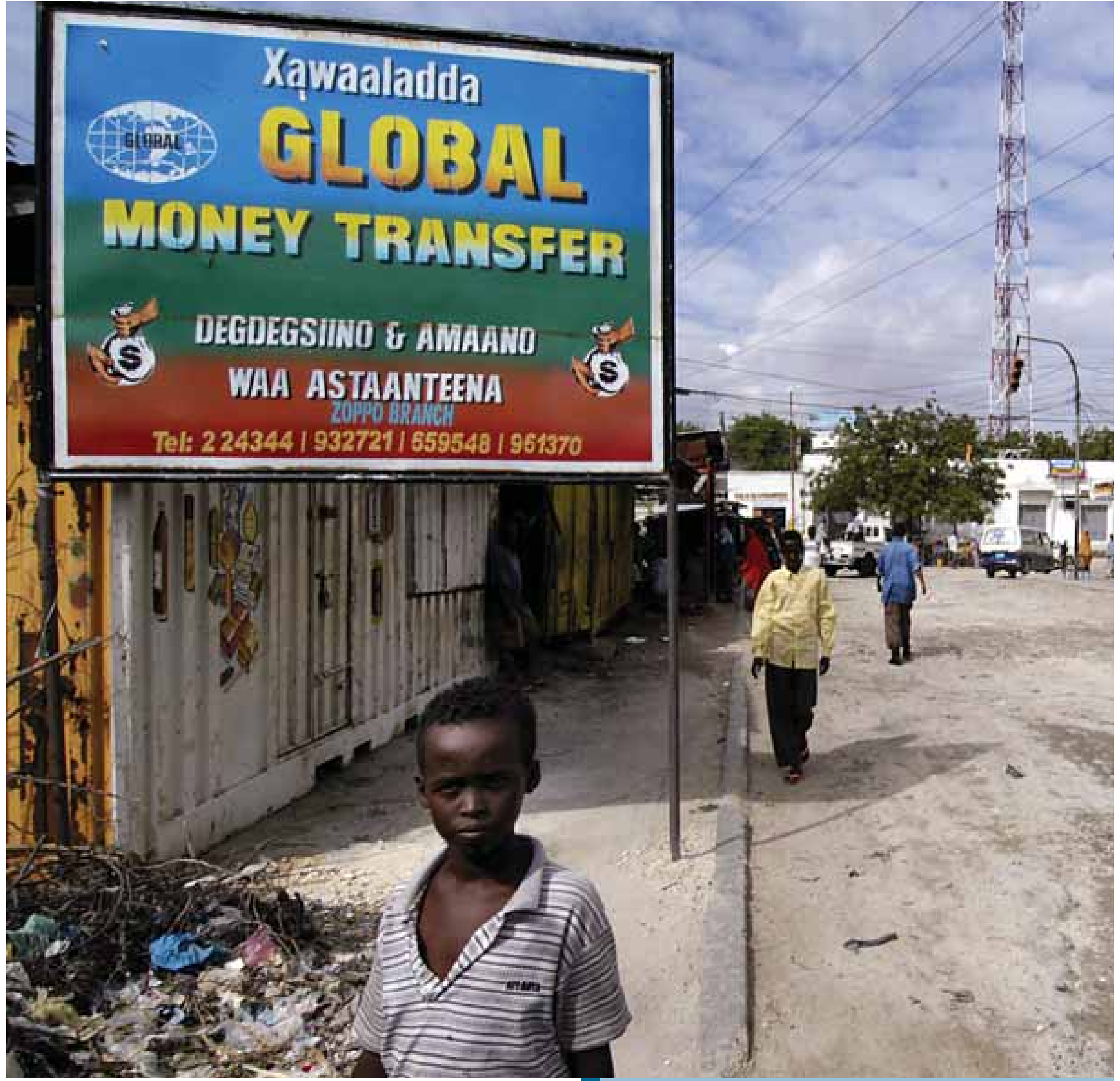
The UK will

- Work with others to seek to ensure that the Doha Development Agenda delivers gains for developing countries, including significant market opening, reductions in trade-distorting farm support and the elimination of all forms of export subsidy by 2013.
- Work with EU partners to make sure that the 2008/09 review of the EU's Common Agricultural Policy leads to significant reform that benefits poor countries, and that EU Economic Partnership Agreements help African, Caribbean and Pacific countries increase economic growth and reduce poverty.
- Meet our pledge to increase our 'aid for trade' to £100 million a year by 2010 and encourage our G8 and EU partners to meet the commitments they made during our 2005 Presidencies.

Managing migration for growth...

5.24 For many families in poor countries, migration is an important way of earning a living. Between 50-80% of rural African households are said to have at least one migrant member in their own or a neighbouring country or further afield.[20] International migration has more than doubled in the past twenty years, with an estimated 200 million international migrants in 2005.[21]

5.25 Planning for and managing migration can help both to reduce poverty and meet the demand for labour in developed countries. It can also have a positive social and political impact as successful migrants return home. Money sent back by migrants plays an important part in sustaining the local economy. These 'remittances' through formal banking channels amounted to nearly US$167 billion in 2005 – much more than the combined aid rich countries gave in the same year.[22] In Lesotho, for example, remittances



account for 26% of the country's total national income.[23]

5.26 Developed countries can help poor people make the most of migration by: helping countries plan for and manage the consequences of it; understanding better the impact of their own immigration policies on development; supporting the efforts of migrant groups to help their home communities; and helping people to invest at home by making money transfers easier.

The UK will

- Work with partner countries and international organisations to seek ways in which both developing and developed countries can benefit from migration.
- Monitor the effect of our migration policy on development, including the points-based approach that the UK announced in March 2006.
- Work with the private sector and partners in the EU to make it easier for people to send remittances to help developing countries.
- Help partner governments to develop policies that help poor people to benefit from internal and international migration.

How change happens: Reducing poverty in Vietnam

In 1986 the Vietnamese Government approved a sweeping series of reforms known as doi moi to improve economic performance and combat poverty. Since then, Vietnam has made the transition from a centrally planned to a market-based economy. The result has been remarkable.

Since doi moi began, Vietnam has had one of the fastest growing economies in the world. Growth has averaged almost 7% over the entire period, and 7.6% for the last five years. Trade has driven much of this – exports increased by 19% a year during the 1990s. As a result, poverty has fallen at a breathtaking pace – from 65% in 1993 to 19% in 2004.

The Government has dedicated an increasing share of public expenditure to fight poverty and improve social welfare. Aid of over US$5 billion over the past ten years has financed about a third of total state investment. It has helped improve access to transport services, power, water and telephones, and is financing ambitious reforms, for example in banking and state-owned enterprises.

Aid also helped Vietnam to increase social sector spending fast and to reach its MDG targets early. Schooling in remote and poor regions has improved – reaching ethnic minority and other marginalised children. Access to safe water grew from 26% in 1993 to 49% in 2002, and electricity from 51% in 1996 to 88% in 2004. This has helped to underpin economic growth.

Of course, challenges remain. Corruption for one. Democratisation for another. But aid and growth are continuing to improve the lives of millions of people.