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Where Should Donors Place Their Monetary and Trade Incentives to Encourage Developing Countries to Implement Balanced Pro-Rich/Pro-Poor Development Programs?

By

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Abstract

It can be said that since the green revolution up to the year 2000 when the Millennium Development Goals Declaration came into existence, Donors have been trying to achieve poverty reduction goals in developing countries by investing heavily in a supply led development model driven by better technical capacity and productivity. Donors expected all this time this model to trickle down to the poor, but it never happened, leading to a new global commitment to development in the year 2000.

It can be said too that during the Millennium Development Goals Declaration period(2000-2010), Donors have been trying to achieve poverty reduction goals in developing countries by investing heavily in the same old supply led development model, but this time driven by better legal and institutional governance. Donors again were expecting to see this adjusted supply friendly model to trickle down to the poor, but it is not happening by 2010. In both instances, Donors have followed an indirect approach to poverty reduction; and reached the same outcome, no poverty reduction and more inequality.

Perhaps it is time for Donors to consider the implementation of different approaches to poverty reduction. One of the main goals of this paper is to propose a possible sustainability approach to poverty reduction in developing countries that Donors could use to encourage balanced pro-rich and pro-poor development programs.

Introduction

a) The general nature of markets in developing countries

Two general characteristics of markets in developing countries are: i) They have a strong supply/production sector and they have a weak demand/consumption sector; and ii) The components of the supply side of the market, government institutions and formal private sector are better organized and trained; and therefore, easier to support than the components of the demand side of the market: social groups and informal private sector.

b) Traditional sources of market development discourse in developing countries

From the characteristics of markets in developing countries indicated above, two types of development advocates come alive: the economic activist, who promote supply side development; and the social activist, who ask for demand side development. Below there is a general description of the general nature of these two types of development discourse.

1) The rational behind the economic activist's support for supply friendly development

The economic activist's view, locally and internationally, is that investment should go to where the potential for profitable development is higher or where investment risk is lower. This logic suggest that since the supply side in developing countries is well organized and better trained, investing on its development is less risky and therefore more profitable than investing on demand side development; and therefore supply side investment is a better investment strategy.

For this reason, economists advocate for directing government funds, aid, loans, debt forgiveness, and so on and trade incentives to expanding as much as possible the supply side of the market in developing countries; and then wait for the trickle down effect to reach the poorest segment of society one day. Hence, economic activists advise donors to establish an indirect link to poverty reduction by making investments in improving technical capacity and productivity to stimulate supply side development; and wait for the trickle down effect to work its magic sooner or later.

2) The rational behind the social activist's support for demand friendly development

Social activists, local and international, on the other hand, believe that social well-being is more important than profits and therefore, demand side development should be the priority if we really want to fight directly the poverty and environmental degradation generated during the working of the market. Social activists believe so because it is known that the majority of the poor people work within the informal private sector and live in the most degraded environments. Hence, it is expected that demand based development will generate an immediate lift up the ground effect in favour of the poor, which would be beneficial for the economy as a whole.

For this reason, social activists advocate for directing/conditioning government funds, aid, loans, debt forgiveness, and so on and trade incentives: a) To the development of the demand side of the market to address root poverty and to invest in the people and their organizational structures; and b) To the advancement of other causes such as better governance and transparency. Therefore, social activists advise donors to establish a direct link to poverty reduction by making sure social groups and the informal private sector have access to donor's funding.

c) Linking Market development discourse with general development periods in developing countries

The two types of development discourse mentioned above can be used to reflect the evolution of market development in developing countries, where calls for supply friendly development took place first; and later it was the turn for calls for demand friendly development as described below. In this paper, the period of supply friendly development advocated by economic activists will be known as the Pre-Millennium Development Goals Declaration period(From the green revolution to the year 2000); and the period of demand friendly development advocated by social activists will be known as the Millennium Development Goals Declaration period(2000-2010).

The green revolutions is believed to have started in 1947(Ganguly 1998); and The Millennium Development Goals Declaration was signed on September 08, 2000(UN 2000).

d) Linking the donor's poverty reduction response to development discourse and market development periods in developing countries

Donors have been historically involved through investment, aid, and trade in the fight against poverty in developing countries, and their response to evolving development discourse gives them a direct role on how things have actually turned out on the ground. Below is a detailed account of the response of Donors per period and its impact on poverty reduction.

1) Donor's investment role during the Pre-Millennium Development Goals Declaration period

Donors apparently followed the economist's advice by the book during the Pre-Millennium Development Goals Declaration period as they fully invested in implementing the supply friendly development model driven by improvements in technical capacity and productivity, while ignoring the demand side of the market. Donors were hoping to break the poverty problem in developing countries by fully counting on the expected trickle down effect from their investments as advised by economic activists; and therefore, Donors were aiming at poverty reduction through indirect means from the beginning of the period to the end. For example, loans and trade and capacity incentives were focused on expanding the supply side of development. The 2004 global monitoring report(WB 2004b) highlights that a lot of time and money has been spent by international organizations on improving deeply the policies and institutions of developing countries needed to improved their development prospects.

One implication of the above is that Donor countries and international organizations, knowingly or not, had during this period a direct role in sustaining long-term a supply based development model in developing countries; and a direct role in establishing a policy of indirect links to poverty reduction. As the rich dominates the supply side of development, investment in the supply side is associated with pro-rich growth. The more Donors invested, the more the benefits accruing to the rich from the pro-rich growth were, and some of these benefits were supposed to trickle down to the poor as they assumed equality conditions on the ground. It has been shown recently that under extreme inequality conditions the trickle down assumption does not work(Muñoz 2009); and hence, it should not be a surprise to see that the investment of Donors on supply friendly development has not led to expected positive impacts on poverty reduction: more Donor investment, less poverty. Just recently, an international assessment of the working of the traditional agricultural development model during the last 50 years or so found among other things that it has not been a good mechanism for equality, poverty reduction, and environmental quality indicating the need for some sort of model redirection(IAASTD 2009).

And therefore, the coming of the Millennium Development Goals Declaration in 2000 signalled the official recognition that the previous trickle down based supply friendly development model did not work as expected(UN 2000), apparently for two reasons: Because it did not have a direct link to poverty reduction and because trickle down effects under extreme inequality should not be expected to happen.

And this weak to no connection between more donor investment and less poverty is consistent with some important lessons learnt from the 2004 annual review of development effectiveness(WB 2005): a) Not much progress in poverty reduction has been made despite efforts made being more consistent with client needs; b) Efforts have been focused on supporting the corporate/business investment model, good governance, and private sector development to poverty reduction, yet their expected impacts on poverty reduction are not very clear . The European Commissioner in charge of Development and Humanitarian Aid in 2004, Louis Michel, expressed full confidence that with proper cooperation and the help of the European Union the millennium development goals, including poverty reduction, would be reached by 2015 as planned(Michel 2004). Yet recently, the United Nations has indicated in the Millennium Development Goals 2009 report that we may not be able to meet them as planned(UN 2009). And hence, the first expected wave of trickle down effects did not materialize, and Donors fell under the pressures of the social activist's discourse.

2) Donor's investment role during the Millennium Development Goals Declaration period

Donors apparently followed the social advocate's advice backwards during this period as they did not invest in direct links to poverty reduction as advised by social advocates. Donors chose another indirect way to poverty reduction perhaps believing that the trickle down effect did not work in the previous period as expected because the system was operating under bad legal and institutional governance. This time, Donors decided to invest in implementing an adjusted supply friendly development model now driven by improvements in legal and institutional governance, while again ignoring the demand side of the market.

Donor were hoping for the second time to break the poverty problem in developing countries by fully counting on the expected trickle down effect from investing in supply friendly development markets that now operates under good legal and governance rule and therefore, Donors were again aiming at poverty reduction through indirect means. See here, that Donors probably were thinking that good legal and institutional governance was going to open space for the trickle down effect to work this time and reach the poor.

Social advocacy groups appeared to be having some successes in global opinion which was being heard apparently by global leaders by the end of the Pre-Millennium Development Goals Declaration period when Donors decided not to go the direct way to poverty reduction, but to follow a new indirect good legal and governance way. For example, President Bush linked the need to provide debt relief and additional aid to poor countries with the need to eliminate corruption while the Danish Prime Minister Rasmussen indicated that he also wanted to see investments in the people(Routers 2005). The need to use aid to strongly induce good governance, accountability, transparency, and the rule of law in developing countries has been also strongly highlighted in the 2005 survey of democratic governance by Freedom House(FH 2005); and this need is clearly reflected among the main issues/agreements listed in the report of the chair of the G8 Gleneagles Summit(G8GS 2005) in relation to African Countries and Aid.

Social advocates had highlighted the fact that more needed to be done in direct ways to ensure that the poorest of the poorest countries were not left behind and to avoid complete failure or to curve increasing pressures to do better, and the United Nations and others appeared to be listening. For example, Kofi Annan, the previous UN Secretary-General, had strongly pointed out that a clear plan to address the Millennium Development Goals, including poverty reduction goals, was needed to go beyond simply setting targets; and to ensure this way that the poorest countries do get development benefits(UNS 2005). This feeling appear to be consistent with views expressed by officials at the World Bank in 2004(WB 2004a) related to: a) Failures to deal with poverty reduction issues, partly, are the result of the failure by developed countries and developing countries to deliver on their north-sought development commitments; b) That this failure is leading to the creation of lagging regions; and c) and all together is leading to increasing pressures to do better faster. And recently, Ban Ki-moon, the new Secretary-General, United Nations call on all global leaders not to forget the weak and the poor; and encouraged them to meet their commitments to reaching the millennium development goals as planned(Ki-moon 2009). Hence, the second wave of trickle down effects is now failing or not expected to materialize;

Again, this new approach to poverty reduction is not working; and apparently for the same two reasons as in the period before: Because the model still has only an indirect link to poverty reduction; and because as indicated above trickle downs under extreme inequalities should not be expected to work whether they are operating under good governance or not. And now another different investment approach for donors still seeking to solve the poverty issues in developing countries needs to be found.

e) The need for a sustainability approach to poverty reduction

Today, there is a view based on sustainability grounds that we must use financial and trade tools to promote both supply side development and demand side development at the same time in order to create more stable development conditions. In other words, there is a need to integrate social issues with economic and environmental issues to make development consistent with sustainability rules(Muñoz 2003).

Donors so far have not followed sustainability rules when dealing with poverty reduction as both the funding approach used in the Pre-Millennium Development Goals period and the funding approach used in the Millennium Development Goals period were focused only of the supply side of the market; and therefore, those funding approaches had only an indirect link to the issue. Even if Donors would have followed the advise of social advocates for the Millennium Development Goal Declaration period and focused their funding only on the demand side of the market and making the direct links to poverty reduction, the resulting program would not have been consistent with sustainability rules either. This is because sustainability requires both, attention to the supply and the demand side of the market at the same time; and therefore, it requires attention too to indirect and direct links to poverty reduction at the same time.

It seems that Donors are searching for a sustainability approach to poverty reduction, but the "how to do that" part appears not to be yet clear to them as it can be seen in poverty reduction related policy statement. For example, The European Commission development policy statement 2000 is "*The overall objective of EC development policy is the reduction and eventual eradication of poverty. Support to sustainable economic, social and environmental development, promotion of the gradual integration of developing countries in the world economy, and combating inequality, are indispensable elements to achieve this objective'*(EC 2004), which is in essence a sustainability statement. In other words, the European Commission development policy statement above can efficiently be met through a sustainability approach to poverty reduction.

And hence, there is a need for identifying possible sustainability approaches to poverty reduction in developing countries to aid Donors in their goals; and this paper aims at pointing out one that balances pro-rich and pro-poor development.

Objectives

This article has three goals. One goal is to describe the demand and supply structure of an ideal development/market model that balances pro-rich and pro-poor strategies. The second goal is to point out that development programs in developing countries are unbalanced in favour of pro-rich growth as they direct most of their funds to promoting the supply side of the market. The last goal is to stress that to in order to ensure that pro-poor development is not left behind in developing countries donor countries and international organizations must condition financial and trade actions to ensure that governments now implement balanced pro-poor/pro-rich development program.

Methodology

First, a framework is introduced showing that an ideal balanced development model/market has two parts that should be equally funded and promoted, a supply side and a demand side. Second, a framework pointing out that because of lack of funding/limited resources and/or lower perceive investment risk, developing countries focus their attention on supporting only the supply side of the market leaving the demand side practically abandoned. And finally, the structure of the targeted balanced development market that can be created if donor countries and international organizations condition financial and trade help to the provision of the support needed to fully develop the demand side of markets in developing countries is presented.

Terminology

G = Government	OTT = Organizing Technical Teams
DF = Development Funds	ONTT = Organizing Non-Technical Teams
S = Supply	FPSD = Formal Private Sector Development structure
D = Demand	IPSD = Informal Private Sector Development structure
M = Market	DTDF = Donor Targeted Development Funds

Integrated/balanced development model

Markets reflecting sustainability concerns should be able to balance supply and demand interactions as shown in Figure 1 below:

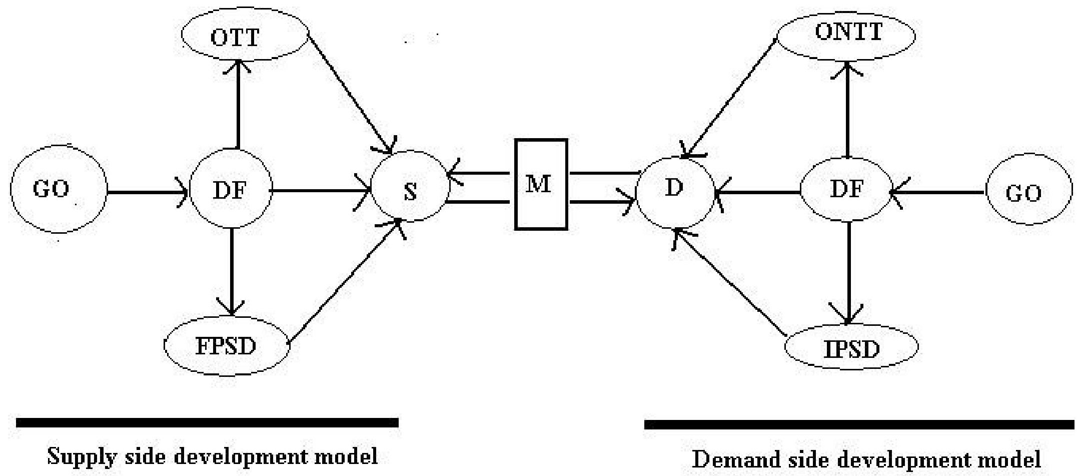

Figure 1 Integrated/balanced development model: Governments(GO) are able to raise and provide the development funds(DF) needed to support the development of the supply(S) and demand(D) side of the market(M) at the same time.

Figure 1 above points out the idea that a balanced development model should reflect a market(M) where the supply and demand sides receive attention and support from governments. The continuous lines/arrows in the figure on both sides of the market(M) indicate that funding/support flows to both supply and demand sides.

Figure 1 above also shows that the components of the supply side of the market(M) are: government(GO), development funds(DF), organized technical teams(OTT), and formal private sector development(FPSD) structure. This means that governments should direct funds(DF) to the promotion of efficient government technical structures(OTT) and to supporting formal private sector development(FPSD) structures to stimulate supply side development(S).

Figure 1 above indicates too that the components of the demand side of the market(M) are: government(GO), development funds(DF), organized non-technical teams(ONTT), and informal private sector development(IPSD) structure. This means that governments should also direct resources(DF) to the promotion of efficient non-technical structures(ONTT) and to supporting informal private sector development(IPSD) structures to induce demand side development(S).

By promoting both, supply and demand growth, governments are implemented a more sustainable development model, one that balances pro-rich and pro-poor concerns reflecting or addressing or meeting, in that way current principles of sustainability. This model reflects good social, economic, and environmental governance and transparency and cooperation across the market.

Non-integrated/unsustainable development model

Unsustainable markets are not able to balance supply and demand interactions and they exist when one or both of them are being left totally or partially unfunded. In other words, if the supply side or the demand side or both are not properly supported/funded, the market should be expected to be unsustainable. This situation can be seen in Figure 2 below:

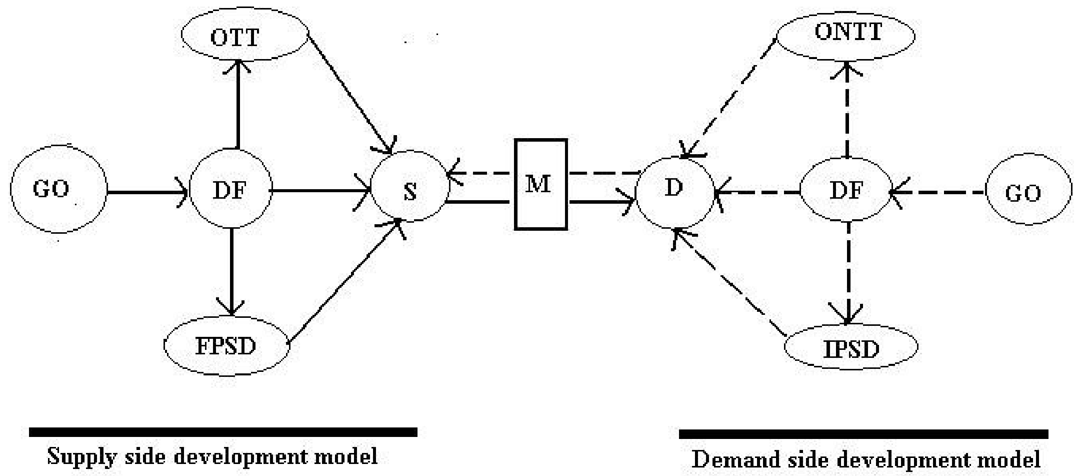

Figure 2 **Non-integrated/unsustainable development model: Goverments(GO) are not able to provide the development funds(DF) needed to support the demand side(D) of the market(M) leaving all their development efforts focused only on the supply side(S).**

Figure 2 above points out the idea of one possible non-integrated development/ market model(M), that where only the supply side(S) of the market is supported/ developed while the demand side(D) is left unattended. The continuous lines/arrows in the figure on the supply side(S) of the market(M) indicate proper support and funding while broken lines/arrows on the demand side(D) of the market(M) show no support/no funding.

Figure 2 above also shows that the components of the supply side of the market are: government(GO), development funds(DF), organized technical teams(OTT), and formal private sector development(FPSD) structure. But in this case, all government funds(GF) are directed towards the development/support of the supply side(S) of the market(M) as indicated by the continuous lines/arrows in the right side of the figure. In other words, developing the government organized technical teams(OTT) and the formal private sector(FPSD) is the priority.

Figure 2 above also indicates that the components of the demand side of the market are: government(GO), development funds(DF), organized non-technical teams(ONTT), and informal private sector development(IPSD) structure. But here, no funding is directed towards the promotion of efficient non-technical structures(ONTT) and towards supporting informal private sector development(IPSD) structures as indicated by the broken lines/arrows in the left side of the figure. Hence, organizing non-technical teams(ONTT) and supporting the informal private sector(IPSD) is not a priority.

By promoting only supply side growth, we are implementing development structures expected to be unsustainable in the long-term because they are heavy on pro-rich impacts and empty on pro-poor concerns. Such supply based market development is the one commonly found in developing countries as the supply side gets most of local and non-local funding and trade benefits as a result of being considered a less risky venture than investing in demand based development.

Hence, donor countries and international institutions have been, knowingly or not, directly contributing to discrimination against demand side development or to supporting unsustainable development. Notice that this model does not reflect good social, economic, and environmental governance and transparency and cooperation across the market(M).

Targeted integrated/balanced development model

As described in the introduction, local and global sustainability concerns made relevant by social and environmental groups are putting pressure on global leaders/developed countries to find ways to redirect wealth, aid, debt forgiveness, and trade initiatives to ensure that current levels of social/poverty and environmental degradation are reversed and if possible eradicated, concerns included in the millennium development goals(MDGs). And the two dollar question is "How can it be best done or where should the money in Donor's hands be invested to ensure that pro-poor growth is fully accommodated in traditional development plans in developing countries?". Figure 3 below attempts to provide one solution to this question. Figure 3 below shows that an integrated/balanced market solution is available to donor countries and international organizations to ensure this time that demand based development is for once supported/accommodated with supply based development in developing countries.

Figure 3 below also highlights that if donor countries and international organizations target their funding, including aid/grants, loans, and debt relief outlays, in the form of demand targeted development funds(DTDF) to ensure the support and organization of non-technical teams(ONTT) and the support of informal private sector development (IPSD) structures while encouraging governments to continue with their supply side development strategies, they can induce a targeted integrated/balanced development solution capable of dealing with both pro-rich and pro-poor concerns at the same time. Notice that both sides of the market(M) in Figure 3 below have continuous lines/arrows, but most of the funding intervention of donors is on the demand side of the market while developing countries continue their supply based efforts.

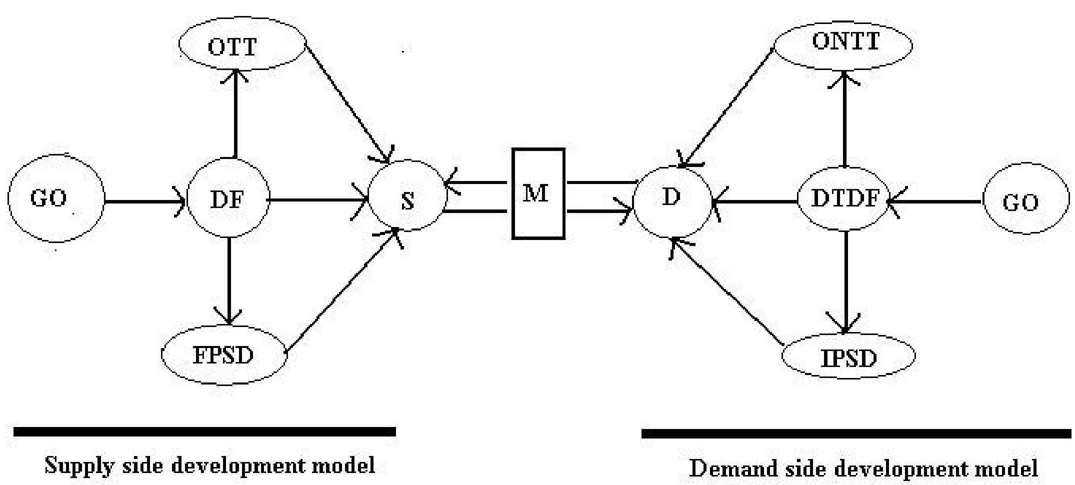

Figure 3 Targeted Integrated/balanced development model: Governments(GO) receive demand targeted development funds(DTDF) from donors so they can implement demand side development programs now besides supply side ones eliminating so demand induced market failures.

By promoting supply side growth through development funds(DF) and demand side development through demand targeted development funds(DTDF), donor countries and international organizations are inducing the implementation of sustainable strategies that are both pro-rich and pro-poor friendly at the same time in coordination with governments in developing countries. Such a balanced approach is needed to address head on the issues of poverty and environmental degradation reduction and/or eradication and the concerns of the rich.

In other words, Figure 3 above clearly shows what donor countries, international institutions, and local governments, but specially donor countries, can do: they must condition financial and trade support to the implementation of development programs that balance supply side(S) and demand side(D) development with the strongest emphasis on providing a higher proportion of support in the short and medium term through demand targeted development funds(DTDF). See that the targeted/balanced model below does reflect good social, economic, and environmental governance and transparency and cooperation across the market(M).

Conclusions

First, it was highlighted that balanced development/market approaches require the support/funding of supply and demand programs at the same time. Second, it was also pointed out that developing countries, for lack of/limited funds or not, focus their development efforts on the supply side of the market only and therefore, they operate(usually with the help of donors) under an unbalanced development model. Third, it was indicated that donors, knowingly or not, contribute through their funding to supporting a system that discriminate against demand based development, which clearly indicates that donors can have a direct impact on what happens on the ground.

And finally, it was stressed that if donors want to ensure that developing countries move towards implementing development programs that balance pro-rich and pro-poor goals, they must target/condition their wealth, aid, debt relief, and trade incentives to ensure that developing countries have the demand targeted development funds(DTDF) needed to cover the cost of fully developing the demand side of the market. If this is done, then the seeds of a system capable of dealing with poverty and environmental degradation while having the rich on board may be on the horizon.

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