

What is “inclusive growth”?

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1. Introduction	2
2. Why inclusive growth and why now?	2
3. Defining inclusive growth	4
Inclusive growth should reduce poverty and inequality and benefit the most marginalised	4
Inclusive Growth is about more than income.....	5
Inclusive Growth is about participation, not just outcomes.....	6
Inclusive growth requires sustainable growth.....	6
4. Important factors for achieving inclusive growth.....	7
Investment in human capital	8
Job creation.....	8
Structural transformation and broad-based growth.....	9
Progressive tax policies	10
Social protection	10
Non-discrimination, social inclusion and participation	11
Institutions.....	11
5. Case Study: How important are small businesses for inclusive growth?	12
Should small businesses be considered more in inclusive growth strategies?.....	14
6. Conclusion and recommendations.....	15
Annex: Summary of inclusive growth definitions.....	16
Bibliography.....	17

1. INTRODUCTION

Institutions, governments, donors, and NGOs are increasingly talking about 'inclusive growth'. This focus is in some ways an attempt to address the deficiencies of prioritising solely economic growth, and an attempt to ensure instead that the benefits of growth are more broadly experienced. The inclusive growth debate introduces the idea that while efforts to tackle inequality and poverty and promote growth can be mutually reinforcing, this link is not automatic. These debates are happening alongside parallel discussions on sustainability and the co-benefits and trade-offs of sustainable and inclusive growth.²

In this discussion paper we aim to present some of the thinking around inclusive growth and encourage further discussion and debate around this topic. To this end, the paper will do four things: (1) look at why inclusive growth is important within our current global context, (2) describe some important elements of inclusive growth towards a proposed working definition, (3) highlight some key ingredients which contribute to this kind of growth and (4) end by presenting a short case study considering the role that small businesses could play in delivering inclusive growth.

Based on this review we make the following recommendations to governments and donors who want their approaches to growth to be inclusive and able to tackle poverty, unemployment and inequality:

1. Have clear definitions of what is meant by inclusive growth
2. Focus on broader sustainable human development objectives rather than just increasing incomes and GDP
3. Develop proactive strategies to ensure growth is inclusive
4. Develop clear guidelines, objectives and indicators on how inclusive growth will be achieved and measured
5. Prioritise small businesses in inclusive growth strategies. Given they provide most of the employment opportunities for poor people, they play a key role in making growth more inclusive.

2. WHY INCLUSIVE GROWTH AND WHY NOW?

Inclusive growth is a buzz-word in policy circles nowadays, among developed and developing countries alike, as well as in international institutions. Its importance is increasingly being recognised and highlighted in work plans and strategies of the International Monetary Fund (IMF), G20, European Commission and the UK's Department for International Development for example.³ As a concept, it has been included as a proposed goal by the Open Working Group on Sustainable Development Goals as a part of the post-2015 development agenda.⁴

G20⁵ leaders recently recognised that:

*"Too many of our citizens have yet to participate in the economic global recovery that is underway. The G20 must strive not only for strong, sustainable and balanced growth, but also for a more inclusive pattern of growth that will better mobilize the talent of our populations."*⁶

² See: Bass, Raworth, & Wykes "[Securing social justice in the green economy](#)". CAFOD & IIED, April 2014.

³ In November 2013, the [IMF](#) set securing inclusive growth as a key priority for its 2014 annual work programme, in February 2014 [DFID](#) highlighted the importance of inclusive growth in their Economic Development Strategic Framework and in May 2014 the [European Commission](#) emphasised the role that the private sector plays in achieving inclusive growth in its Communication.

⁴ See goal 8 proposed by the [Open Working Group on Sustainable Development Goals](#).

⁵ The G20 first committed to address inclusive growth as part of its development agenda under the 2012 Mexican Presidency which set inclusive, green growth as a cross-cutting priority for this work.

⁶ G20 (2013)

In a report on inclusive growth, the Organisation for Economic Cooperation and Development (OECD) (2012) identifies three problems that even the record levels of growth of the 1990s and decade of 2000s failed to tackle: poverty, unemployment and inequality. These highlighted the need to address the quality of growth, in particular to improve its inclusiveness.

Three challenges that record levels of growth have failed to tackle:

Poverty:

Not all growth is equally effective in reducing poverty.⁷ Despite good progress in tackling extreme poverty and good growth rates globally and within many developing countries, persisting poverty remains a pressing issue. In 2011, 1.2 billion people were living on less than \$1.25 per day, equivalent to 24% of the world's population.⁸

Between 1990 and 2010 extreme poverty was cut by one half, leading some, notably the World Bank, to conclude that eradicating extreme poverty within a generation is within reach.⁹ However, it will not be a simple repetition of the previous twenty years' success to get to zero – the easiest people to help cross the poverty line have been replaced by those that are harder to reach because they are in fragile states or suffer discrimination.¹⁰ Success will depend on how much those groups benefit from growth in their economies. As Ortiz and Cummins (2011) point out, without changing the patterns of growth and distribution to make it more inclusive, it could take 800 years for the bottom billion of the global population to achieve 10% of global income.

Unemployment:

Economic growth is often tied unequivocally to a correlating improvement in employment levels.¹¹ Over recent decades however, increases in growth have not resulted in expected comparable increases in numbers of jobs. Felipe and Hasan (2006) estimated that in the 1980s it took 3% GDP growth to generate a 1% increase in employment, but in the 1990s this changed significantly and it then took an 8% cent increase in GDP to get the same result.

Worldwide, there are more than 200 million people who are out of work.¹² The World Bank has forecast that 600 million new jobs will need to be created in the next fifteen years, just to keep employment constant.¹³ Importantly, aggregate numbers hide significant marginalised groups – particularly women¹⁴ and young people.¹⁵ Even when in work, there are worrying trends in employment conditions. Jobs are increasingly seasonal and temporary and workers' share of global income is declining – down 4% in the 2000s compared to the early 1990s.¹⁶

Inequalities:

As the OECD explains, recent decades of growth have not benefited all groups equally and have been characterised by widening inequality: "Today, the gap between rich and poor is widening almost everywhere. Within OECD countries, it is now the widest in 30 years."¹⁷ Recent Oxfam (2014) analysis found that the richest 85 people in the world own the same amount of wealth as the bottom half of the world's population (3.5 billion people).

⁷ World Bank (2006)

⁸ World Bank statistics cited in Ortiz and Cummins (2011)

⁹ Ravallion (2013), World Bank (2013b)

¹⁰ Chandy et al (2013)

¹¹ For example, in a recent speech the UK Secretary of State for International Development made the statement that "It really is that simple. Growth reduces poverty through jobs" (DFID, 2014, <http://bit.ly/1fq7Mt9>)

¹² World Bank (2013)

¹³ Ibid

¹⁴ Ibid

¹⁵ OECD (2011)

¹⁶ OECD (2012b)

¹⁷ OECD (2013b)

Rising inequality matters because it affects how growth acts on well-being and poverty. Making countries more equal can boost poverty reduction efforts: a World Bank study found that a 1% increase in income can cut poverty by 4.3% in more equal countries, compared to only cutting poverty by 0.6% in the most unequal ones.¹⁸ Inequality has also been linked to increased economic instability and dampened growth,¹⁹ social unrest and political instability.²⁰

This inclusive growth debate is gaining traction in a global context of rising inequality accompanied by economic, political and social instability; high levels of unemployment; persisting poverty; increasing impacts of climate change and other forms of environmental stress and a disappointing track record of translating economic growth into sustainable human development or well-being.

So how is this concept different and what might be the distinguishing characteristics of an inclusive growth, as opposed to a straight-forward, economic growth strategy? These questions are explored in the next two sections.

3. DEFINING INCLUSIVE GROWTH

Despite the agreed urgency to achieve inclusive growth, there is surprising little clarity as to what it actually is, with important differences in approach among key institutions and governments: the World Bank, Asia Development Bank (ADB) and International Policy Centre for Inclusive Growth (IPC-IG) all have different definitions and understandings for example (see the annex at the end of this paper for a summary of these definitions). Given these differences, it is easy to share the frustration of the ADB that:

*"Some of these concepts are vague and do not lend themselves to easy quantitative operationalization, whilst others are quite specific but do not capture the essence of the concept. Further complicating matters, the World Bank defines inclusive growth in ways that are at odds with the ADB concept. Moreover the World Bank, the Organisation for Economic Cooperation and Development (OECD), the United Nations Development Programme (UNDP) and academia have all produced a range of policy documents on closely related concepts (e.g. pro-poor growth and equal opportunity)."*²¹

Even in the absence of a single shared definition, a look across the board at the initial attempts at definitions that have emerged shows some convergence in thinking on important aspects of inclusive growth.

Inclusive growth should reduce poverty and inequality and benefit the most marginalised

The relationship between growth, inequality and poverty reduction are long contested and therefore their roles in "inclusive growth" are equally unsettled. Different institutions have traditionally adopted quite different stances.

With regards to growth and poverty, the World Bank, for example, focuses on a high pace of growth as a pre-requisite for achieving poverty reduction, whereas IPC-IG avoid presuming a connection between economic growth and levels of inclusion.

¹⁸ Ravallion (2013)

¹⁹ Berg and Ostry (2011), WEF (2014)

²⁰ Oxfam (2013), Fajnzylber et al. (2002)

²¹ Klasen (2010)

Similarly there are differing opinions with regards to the connections between growth and inequality. Historically, the World Bank²² has emphasised that focusing on inequality can lead to perverse results and fewer people lifted out of extreme poverty. Recently this position has shifted with a recent IMF discussion paper highlighting that “lower net inequality is robustly correlated with faster and more durable growth” (IMF, 2014). The IPC-IG approach builds on this, emphasising that tackling inequality is fundamental to inclusive growth:

“IPC-IG’s work on [inclusive growth] starts from the premise that societies based on equality tend to perform better in development. For instance, countries with more equal income distribution are likely to achieve higher rates of poverty reduction than very unequal countries.”²³

Many, including civil society groups, question the focus on growth at all – given the deficiencies of GDP as a measure and the dangers of confusing tools and objectives.

It is beyond the scope of this paper to enter into this long-running debate.²⁴ However, it is clear that not all growth is inclusive or equally inclusive, or it would not be necessary to have a distinctive concept. With that in mind therefore, what does the concept of inclusivity add to this growth-poverty-inequality debate?

First, the inclusive growth debate extends government objectives beyond increasing GDP. Achieving high growth rates, if it does not reduce poverty and increase human well-being, is no longer the hallmark of a successful government. Growth therefore needs to be seen as an intermediate objective, or more properly a tool, in achieving wider results.²⁵

Second, inclusive growth starts from the position that the relationship between growth, inequality and poverty can no longer be assumed inevitably to be trickle down or a trade-off. The inclusive growth debate introduces the idea that efforts to tackle inequality and poverty and promote growth can be mutually reinforcing, but that this is not automatic and active government is needed to reinforce and manage this relationship – taking into account specific country circumstances.²⁶

Inclusive Growth is about more than income

When it comes to outcomes, most discussions around inclusive growth focus on patterns of income growth. Growth is deemed to be inclusive, depending on the extent to which poor men and women have benefited through increased income. However, the OECD defines inclusive growth as having happened when other indicators of improved wellbeing, aside from income, have also improved for citizens:

“We also need to rethink growth as a means and not as an end. We have to give priority to the quality of growth over the quantity of growth. For this we need new models and tools to measure progress and the quality of our lives.”²⁷

Similarly, the UNDP emphasises the importance of putting human development first. It points to the sustainable human development achievements, and indeed long-term growth, of those countries that

²² World Bank (2009)

²³ IPC-IG (no date)

²⁴ For a useful summary see BOND (July 2011)

²⁵ New thinking suggests that the usefulness of focusing on growth or inequality as a tool may evolve, depending on country conditions (Son et al, 2004). The World Bank finds that for countries with per capita income of less than \$700, growth must be prioritised as there is simply not enough wealth within that country to redistribute or to reduce poverty (Ravallion, 2009, World Bank, 2012). However, for countries with high levels of inequality, pursuing a pro-poor policy is essential as high levels of inequality will dampen growth, generate instability and mean that growth is inefficient at reducing poverty (Chandy et al, 2013).

²⁶ See for example, Commission on Growth and Development (2008)

²⁷ OECD (2013c)

have focused on human development, in comparison to the patchier track record in both human development and growth of those that have focused on growth. The 2010 Human Development Report points out that among the top ten movers on the human development ranking, seven are not high growth countries.²⁸

Clearly, wellbeing and human development outcomes depend on more than growth. Nevertheless, whether income growth can be translated into social outcomes and wellbeing are important considerations in an inclusive growth strategy.

Inclusive Growth is about participation, not just outcomes

*[Inclusive growth] ensures that everyone can participate in the growth process, both in terms of decision-making for organising the growth progression as well as in participating in the growth itself. On the other hand, it makes sure that everyone shares equitably the benefits of growth. Inclusive growth implies participation and benefit-sharing. Participation without benefit sharing will make growth unjust and sharing benefits without participation will make it a welfare outcome.*²⁹

Inclusive growth is contrasted to a “welfarist” approach or simple focus on (re)distribution. Inclusive growth occurs by increasing opportunities and improving access to these opportunities, either for the majority (according to the World Bank) or most particularly for the most marginalised (according to the IPC-IG and ADB).

This means that inclusive growth cannot be achieved through redistribution tax and spend instruments alone (although these can still be an important part of the inclusive growth formula, as discussed later). Opportunities can also be increased via job creation policies or by overcoming barriers to participation, for example, through non-discrimination policies, improved asset ownership or health and education spending.

Most institutions also emphasise that this improved participation must also be explicitly linked to improved benefit-sharing, rather than assume that this will be automatic once opportunities are increased.

Inclusive growth requires sustainable growth

To achieve inclusive growth for maximum poverty impact and an inclusive economy, environmental sustainability is an essential consideration; to date this is a little considered aspect in the literature, though there are some authors who have begun work in this area.³⁰

Sustainable growth is intimately linked to the concept of sustainable development overall. The latter is well defined as being “development that meets the needs of the present, without compromising the ability of future generations to meet their own needs.”³¹ The current scale of threats to sustainable development from climate change and other forms of environmental degradation means that economic growth now needs to be both socially inclusive and environmentally sustainable to achieve long-term human development benefits.³² In particular, economic policy makers must consider how to integrate social and environmental objectives and promote co-benefits.³³

²⁸ UNDP (2010)

²⁹ Ramos & Ranieri (2013)

³⁰ Green Economy Coalition (2014), Cook et al. (2012)

³¹ United Nations Economic Commission for Europe (no date)

³² For a further discussion, see Raworth: “[exploring doughnut economics](#)”.

³³ Bass, Raworth, & Wykes (2014)

Key elements of inclusive growth – towards a working definition

Inclusive growth is then a distinct concept from standard economic growth. Drawing on the literature, a working definition for inclusive growth is possible:

1. Have broader objectives than increasing income and GDP and require governments to proactively work to achieve those objectives, rather than assuming that positive outcomes will automatically come through growth
1. Translate into gains in human development and increased well-being
2. Benefit all groups, including the most marginalised
3. Reduce poverty and inequality¹
4. Consider participation, not just distribution outcomes¹ and therefore focus on increasing active participation in the economy and a say in how the economy is run.
5. Promote the sustainable use of natural resources and climate protection.

Given that inclusive growth can have different meanings for different individuals and institutions, it can be problematic when used without being further defined or operationalised. Definitions matter because they set the objectives that will determine policy and spending choices. A key recommendation that we therefore make in this paper is for policy makers to take up the challenge of defining inclusive growth when they use the term in plans and strategies.

Given the diffuse and varied definitions of inclusive growth, it is somewhat surprising that there is considerable consensus on how to achieve or operationalise it, as well as on the outcomes that will accompany it.³⁴ Some elements to be pursued towards achieving inclusive growth are explored in the next section. The evidence (also explored below) shows that these elements are essential for a growth strategy to be inclusive.

4. IMPORTANT FACTORS FOR ACHIEVING INCLUSIVE GROWTH

Some recipes for inclusive growth contain many familiar elements from standard growth strategies such as macroeconomic stability and economic openness. This is not surprising when some institutions and government see achieving high growth rates as the major contributing factor and prerequisite for achieving inclusive growth.³⁵

However, CAFOD would encourage governments and donors to think outside the box and consider some of the wider factors contributing to inclusive growth. In fact, the inclusive growth debate challenges many of these old orthodoxies and has thrown up some new priorities and characteristic approaches.

Key ingredients in an inclusive growth strategy

Some of the key ingredients for inclusive growth that are generally agreed upon include:

- Investment in human capital
- Job creation
- Structural transformation and broad-based growth
- Progressive tax policies
- Social protection
- Non-discrimination, social inclusion and participation
- Strong institutions

³⁴ See for example EU Green Paper on Inclusive Growth (2010) and G20 Inclusive Green Growth toolkit (2012)

³⁵ This would be the UK's current position for example – see <http://bit.ly/1fq7Mt9>

Governments or donors wishing to pursue inclusive growth goals need to have explicit strategies around these areas. 'Growth-first' agendas hoping that these outcomes will trickle down to developmental outcomes are not enough. Below we explore some of these key ingredients in more detail.

Investment in human capital

Investment in human capital is universally recognised as a key pillar of achieving inclusive growth. Investments in health and education have been statistically linked to better economic development outcomes and to how inclusive growth is in practice.³⁶ As labour is their main asset, a good level of health and education enables poor men and women both to participate in and benefit from economic growth.

In Lesotho, education and technical training have a strong influence on workers' chances of wage employment and the level of earning.³⁷ In Honduras, a male urban worker with a post-secondary degree earns approximately 100% more than a male urban worker with high school education and 170% more than a male urban worker with primary school education.³⁸ In rural economies, educational improvements have been shown to increase returns to small-scale farmers because they can more readily absorb new techniques and innovate, as well as adapt more effectively to climate change risks³⁹. In Pakistan, education is an important determinant of mobility. Ireland's and Moldova's economic transformations towards a comparative advantage in niche, high-skilled goods and services have been attributed to investment in education.⁴⁰

At the country-level, improving educational access is cited as a key determinant of Brazil's inequality success story.⁴¹ Indeed the decline in inequality in the Latin America region is primarily attributed to a more equitable distribution in labour market earnings. Studies attribute this improvement in earnings equality in part to an improvement in the distribution of education amongst workers.⁴²

Investment in health is also a key component of human capital. Inequality in health has a significant impact on economic growth, possibly through effects on labour productivity.⁴³ The cost of poor health also has significant impacts on a country's economy. Poor sanitation, for example, is estimated to cost Zambia 1.3% of its annual GDP⁴⁴ - a significant amount when one considers that mining, the most important recipient of FDI in Zambia, contributes only 2.2% to GDP.⁴⁵

Job creation

"Whether they are subsistence farmers, salaried workers or self-employed entrepreneurs, poor people derive most of their income from work. This basic fact means that the level of employment, the quality of jobs and the access which the poor have to decent earnings opportunities will be crucial determinants of poverty reduction."⁴⁶

It is not surprising that better opportunities for wage and self-employment have a significant impact on how inclusive growth is. Research shows that labour-related events (a new job or wage increase, for example) trigger exits from poverty. Conversely, a lack of job opportunities reduces the ability of

³⁶ Ravallion (2004)

³⁷ Hull (2009)

³⁸ Ibid

³⁹ Maddison (2007)

⁴⁰ Hull (2009)

⁴¹ ECLAC (2011)

⁴² Ibid

⁴³ Narayan et al (2013) citing Grimm (2011)

⁴⁴ Water and Sanitation Programme (2012)

⁴⁵ Rasmussen et al. (2014)

⁴⁶ Hull (2009)

households to improve their well-being. In the first decade of the 2000s, poverty reduction achievements were mostly related to improved labour market engagement.⁴⁷

According to 2013 World Development Report, jobs are also transformational⁴⁸ in providing household income, raising economic productivity, providing resources to invest in children's health and education, changing social and power relationships and providing a sense of dignity and well-being.

The World Bank report argues that there is a good case for countries to have explicit job strategies, rather than rely on growth strategies to provide jobs. Whilst evidence shows that growth is good for jobs (for example opportunities, benefits and wages tend to increase as economies become more prosperous) this link is not automatic. The Bank notes that there are lags and gaps in translating growth into better living standards, productivity and social cohesion; a focus on jobs can be a factor in achieving all three. Growth strategies might also neglect key jobs challenges for specific countries – for example paying insufficient attention to female employment, marginalised groups or geographical disparities. Further, whilst some jobs might contribute to growth, they might not necessarily be “good jobs for development”⁴⁹ – a jobs strategy would therefore be important in prioritising jobs with better development outcomes.

In order to help generate more and better jobs for development, job strategies would use additional tools such as fostering entrepreneurship, developing basic skills, strengthening labour institutions and mature approaches to industrial relations, as well as less conventional measures like protecting jobs when large numbers of these are at stake, and targeted support for sectors important for job creation to ensure that gains and spillovers are realised.

Structural transformation and broad-based growth

For most developing countries, the route to inclusive growth lies in shifting to more productive economic activities (structural transformation). This reduces an over-reliance on a few sectors which in turn increases stability and can generate more and better jobs. Without economic transformation, the poor will remain locked into low-return activities, and any progress will be volatile.

Whilst most commentators agree with the fact that structural transformation needs to happen, the debate on how best to achieve it and to ensure that it benefits the poorest is long-standing. There is very mixed evidence for example that the conventional prescriptions of trade openness and investment liberalisation achieve transformation or raise the incomes of poor households⁵⁰, and there are a significant number of examples where these have disadvantaged poorer countries.⁵¹

It is not the purpose of this paper to resolve this debate, but an inclusive focus does add new emphases.

First, it places the focus on tangible outcomes rather than on achieving preferred policies with the presupposition that these will lead to poverty reduction⁵², reminding policy makers that pursuing reforms is not an end in its own right. For example, the Growth Commission calls for a pragmatic and proactive approach by governments. It advocates for an experimental approach to implementation of

⁴⁷ World Bank (2013)

⁴⁸ Ibid

⁴⁹ 21 billion people globally are involved in what is euphemistically termed “involuntary work” which covers bonded labour, slavery and prostitution. In 2008, 115 million children aged between 5 and 17 were in hazardous work. (World Bank, 2013)

⁵⁰ With such mixed evidence, it would seem reasonable to conclude that the answer is not straight-forward. For example, the impact will depend on many factors such as initial conditions, composition of inward investment, types of exports, (a)symmetry of liberalisation and institutional capacity among others. See for example, Saadfilho (2010) From Washington Consensus to Inclusive Growth, UNDESA Working Paper 100

⁵¹ See Chang & Grabel (2004)

⁵² Often referred to as ‘first-best’ economic policies, these include the preferred policies promoted by economists and policy-makers, such as trade, finance and investment liberalisation

economic policies in developing countries, since the impacts of preferred policies are unknown and models do not predict outcomes reliably in those contexts.⁵³

Second, it places an emphasis on identifying direct impacts on poor men and women and the parts of the economy that are important to them, either for employment or for supply of goods and services – such as agriculture or the informal sector. It is not sufficient to increase growth, it is necessary to be mindful of costs and benefits to the poorest. Earlier approaches to liberalising economies have been criticised for ignoring the equity aspects of policies.⁵⁴

Finally, it places a much greater emphasis on stability and managing a smooth transition. Poor men and women tend to suffer most from economic instability and periods of change. As the Growth Commission notes, structural change involves “the microeconomics of creation and destruction” and it is important to protect those adversely affected by those dynamics.⁵⁵

Progressive tax policies

Tax policy has an obvious role in direct redistribution. However, its importance in inclusive growth extends beyond this. Taxation is essential to generate revenue for investments in human capital, social transfers and infrastructure necessary for pro-poor growth. Taxation can provide incentives and support for particular sectors or types of businesses, as well as barriers. How taxation systems are structured can make economies more or less pro-poor.

For example, capital flight and high tax incentives undermine the contribution of FDI to pro-poor growth.⁵⁶ Furthermore, small businesses can end up paying disproportionately more taxes than multinationals.⁵⁷ The OECD report on tax base erosion and profit shifting (BEPS) found that on average, multinational corporations pay 5% corporate tax whereas SMEs pay 30%.⁵⁸ Inclusive growth strategies need to consider the ways that tax policy undermines or contributes to pro-poor outcomes and as this case illustrates, needs to ensure that the sectors where poor people work aren't disproportionately negatively affected.

Social protection

Social protection is also a prominent policy area in the inclusive growth literature. Whilst also being a tool for promoting greater equality and poverty reduction through direct transfers and redistribution, it also has a more dynamic role to play in achieving inclusive growth.

In Brazil transfers to poor households, notably through the Bolsa Familia conditional cash transfer scheme, are credited with one third of the fall in inequality in the early 2000s of that country. This stimulated aggregate demand and consumption, creating a virtuous cycle of increased purchasing power – increased demand – higher labour demand – higher incomes.⁵⁹

Social protection, if properly designed, can also contribute to higher incomes for the poor entrepreneurs, by helping to overcome what the United Nations Conference on Trade and Development (UNCTAD, 2006) refers to as “all pervasive economic insecurity at the household level associated with generalised poverty [which] adversely affects entrepreneurship as it leads to short-termism and limits risk-taking.” Social protection can also prevent households coping with shocks by

⁵³ Commission on Growth and Development (2008)

⁵⁴ USAID (2012)

⁵⁵ Commission on Growth and Development (2008)

⁵⁶ Valpy Fitzgerald (undated)

⁵⁷ CAFOD-JCTR (2014)

⁵⁸ OECD (2013)

⁵⁹ IPEA (2010)

selling productive assets, reducing consumption or sending their children to work,⁶⁰ all of which undermine economic prospects of the household in the longer term.

Non-discrimination, social inclusion and participation

Although social exclusion is not the same as inequality, it is clear that systematic discrimination against marginalised groups has an impact on economic opportunities and outcomes, as well as prospects for poverty eradication and improving well-being. It is clear that if bolder inclusive growth ambitions benefiting all groups are to be met, then policies need to address the fact that the same groups are persistently left behind in growth and poverty eradication efforts.

Social exclusion matters for opportunities; to illustrate, African Americans in the United States were twice as likely to be unemployed during the economic crisis, and in Uganda only five per cent of the ethnic minority Lugbara and Ngakaramajong groups have access to clean water and electricity, compared to almost half of the Buganda group. Marginalised groups also have comparatively worse access to essential health and education services.⁶¹

Data shows that failing to address social inclusion leads to worse results for growth and for poverty eradication. One study found that exclusion of the Roma community cost Romania 887 million euros, whilst in Bolivia ethnic exclusion is estimated to reduce agricultural productivity by as much as 36 per cent.⁶²

Discrimination can affect participation in land, labour and credit markets. Women historically lack legal rights to land which in turn affects their access to credit and prospects as entrepreneurs. Sizeable race and gender gaps in wages are still evident globally.

Conversely, tackling social inclusion and ensuring participation of marginalised groups can have dynamic and multiple benefits. For example, education of women is not only desirable in its own right, but leads to better education and livelihoods prospects for their children, breaking intergenerational cycles of poverty.⁶³

Institutions

An inclusive economy requires an inclusive society that has the institutions, structures and processes that empower local communities so they can hold their governments accountable. It also requires the participation of all groups in society in decision-making processes.⁶⁴ This would require proactive policies for the participation of marginalised groups, such as those highly dependent on land or natural resources, who may otherwise disproportionately bear the costs of particular development decisions.

If growth is to benefit all, then governments need to be committed to uphold the rights and opportunities of all their citizens and to counter vested interests that might stand against change to make economies fairer and more inclusive.

Governments also need to be efficient and capable, for example of financing and providing essential services to all. Governments need to be able to overcome corruption which acts as a barrier to employment creation and firm productivity.⁶⁵ "Successful cases share a further characteristic: an

⁶⁰ ILO-UNDP (2011)

⁶¹ World Bank (2013c)

⁶² Ibid

⁶³ Commission on Growth and Development (2008)

⁶⁴ World Bank(2013d), Acemoglu & Robinson (2012)

⁶⁵ Hull (2009) for example finds that investment climate assessments find arbitrary application of rules a constrain on firms in Afghanistan and Ukraine, whilst in Laos "tall poppy syndrome" means that firms stay small in order to avoid regulations and inspections.

increasingly capable, credible and committed government.”⁶⁶ As has already been noted, it is not enough for governments to leave it to markets, governments need to be proactively and publicly committed to developing, implementing and monitoring inclusive growth strategies over the long term.

5. CASE STUDY: HOW IMPORTANT ARE SMALL BUSINESSES FOR INCLUSIVE GROWTH?

Small businesses play an important part in national and local development, contributing significantly to employment, economic growth and service provision.⁶⁷ They also play an important role in inclusive growth.

What do we mean when we say 'small businesses'?

For our purposes, small businesses refer to enterprises on the small and particularly the micro end of the spectrum where most poor people work. These are made up of two main groups: micro enterprises (including but not limited to petty traders, artisans, street vendors, manufacturers and home enterprises) and small-holder farming enterprises (including those involved in agriculture, pastoralists or fisher-folk). As a group, they may be formal, but are often informal or unregistered. They are often ignored in policy making. They are vulnerable, lacking safety nets, reserves and resources to withstand shocks. Women predominate in this group.

Reflecting on the working definition and the key factors for achieving inclusive growth, there is evidence clearly linking the role of small businesses to key aspects of inclusive growth including:

- **Employment and job creation:** Roughly twice as many of the working population in Africa and Latin America are employed in MSEs⁶⁸ compared to large enterprises.⁶⁹ 85% of people in Sub-Saharan Africa are involved in small businesses including home-based or micro enterprises and small-holder farming enterprises.⁷⁰ In terms of employment *creation*: some argue that most new jobs come from this sector⁷¹ whereas others argue that while important to job creation, the significant business failure in this sector means that the employment creating opportunity of small compared to large firms is essentially the same.⁷² Either way, given the agreed important role that they do play in job creation and their substantial contribution to total employment, small and micro businesses cannot be ignored. If, as the World Bank also suggests, the way to achieve growth that is broad-based is to ensure it includes most of the labour force, it is clear that small businesses have a key role to play.
- **Reaching the poorest and most marginalised:** There is good evidence that targeting MSMEs is beneficial to tackling inequality and reducing poverty. This seems logical when such large numbers of poor men and women are employed there. As a brief summary, evidence shows that: poverty reduction is higher when growth is biased towards labour intensive sectors⁷³; it is easier for poor people to benefit from growth, if growth occurs where they are located⁷⁴; the East Asian development experience suggests that targeting SMEs can reduce inequality⁷⁵; time

⁶⁶ Commission on Growth and Development (2008)

⁶⁷ CAFOD (2013)

⁶⁸ MSE: micro and small enterprises; MSME: micro, small and medium enterprises; SME: small and medium enterprises

⁶⁹ Liedholm (2002)

⁷⁰ Fox & Sohenson (2012) (see graph p9 and using CAFOD's definition of small businesses in Think Small 2 pg 7)

⁷¹ European Union (2012), De Kok et al. (2013)

⁷² Page & Söderbom (2012)

⁷³ Narayan et al. (2013)

⁷⁴ Christiaensen & Demery (2007)

⁷⁵ ADB (2012)

series and cross-section regression analysis reveal that while economic growth is generally important for poverty reduction, the sector mix of growth matters substantially, with growth in small-scale agriculture being especially important⁷⁶; growth in unskilled labour intensive sectors contributes to poverty reduction⁷⁷; and finally short statistical analysis by CAFOD found some interesting correlations between MSMEs and tackling multi-dimensional poverty⁷⁸. This link to multi-dimensional poverty supported qualitative evidence from CAFOD (2013) research where small businesses owners reported that their businesses provided them with food,⁷⁹ shelter, medical and health services, clothing and education as well as other assets (productive or otherwise) which served to increase their personal well-being, or improve their business viability through increasing productivity.⁸⁰

- **Tackling discrimination and promoting social inclusion:** Small businesses can play an important role in tackling social exclusion given the large number of poor and marginalised people employed in this sector.⁸¹ However, it is also important to take into account that marginalised groups in particular find it difficult to move into other sectors. Labour markets for poor men and especially women⁸² are highly segmented with legal, cultural and even geographical barriers preventing them from moving to other, better jobs⁸³. Just increasing jobs in non-productive sectors is not enough – pointing to the importance of fair economic participation highlighted in the previous section.
- **Providing avenues for economic participation:** If participation is taken as an integral part of inclusive growth, then MSMEs are the main conduit for poor men and women to contribute to and benefit from inclusive growth, as demonstrated by employment numbers. This is especially important given the limited other job and economic participation opportunities there are for poor people in developing countries.
- **Having benefits beyond income:** The economic participation, described above, brings significant other benefits to individuals – such as self-esteem and increased social standing, as well as resources to invest in health and education that might help to explain the link between MSMEs and multi-dimensional poverty. Maqueen (2005) finds that MSMEs play a “unique part in reducing certain elements of poverty such as insecurity, powerlessness, social inequality and loss of cultural identity”⁸⁴. He goes on to suggest that these social benefits are particularly significant for women who need flexibility, provided by MSMEs, to combine work with childcare.
- **Having a role to play in productivity and structural transformation:** MSMEs contribute up to 60% GDP in developing countries⁸⁵. Many small businesses however are associated with low levels of productivity. Achieving inclusive growth needs to consider both improving productivity

⁷⁶ Cervantes-Godoy & Dewbre (2010), World Bank (2008)

⁷⁷ Loayza & Radatz (2006)

⁷⁸ In this analysis, density of MSMEs (formal and informal) per 1000 of the population was found to be negatively associated with multi-dimensional poverty for low and middle-income countries. It must be noted that the lack of data on micro and small firms was particularly problematic in this analysis but the overarching finding of this study pointed to some interesting new connections and suggested that the link between MSMEs and inclusive growth is worth directly exploring. CAFOD data and analysis is available upon request.

⁷⁹ To grow their own food through a farming enterprise or to have the funds from the business to either purchase food or to purchase the inputs necessary to grow food.

⁸⁰ For example a cereal farmer from Kenya who was interviewed for CAFOD’s (2013) *Thinking Small 2* research explained how using business profits he was able to buy a tank to harvest rain water to improve irrigation. Others reported being able to purchase land, tractors or other machinery.

⁸¹ Commission on Growth and Development (2008)

⁸² Women tend to get stuck in the easy-entry jobs such as industrial outworkers and home workers and find it hard to move on to “upper tier” jobs such as employers or regular wage earners (Chen et al., 2005). Half of micro-enterprises are headed by women (Just Economics, mimeo, undated)

⁸³ Hull (2009)

⁸⁴ Cited in CAFOD (2013)

⁸⁵ Schneider (2006) cited in CAFOD (2013)

in these lower tier jobs, as well as overcoming barriers preventing access to better jobs. Hull (2009) suggests that a better strategy than ignoring informal firms is to develop them, highlighting the benefits of increasing the productivity of “less productive jobs”. Again the WDR on Jobs is informative here, citing success stories of developing entrepreneurship in poor communities⁸⁶. Where MSMEs are more productive they can play an important role in transforming economies through diversification. They can also help to manage this transition so that poor men and women are less adversely affected by shocks and changes.

Should small businesses be considered more in inclusive growth strategies?

According to the results of an EU consultation there is “almost universal endorsement of an enhanced focus on support for SMEs”⁸⁷ for achieving inclusive growth. Indeed, inclusive growth literature differs from standard growth literature in its acceptance and even promotion of the idea of targeting specific parts of the economy, rather than relying simply on across the board or level-playing field interventions. The World Bank inclusive growth framework⁸⁸ relies on an assessment of where in the economy energies can be best targeted to increase productivity, create jobs and reduce poverty, according to sector but also according to size.

Yet direct attention to support for small businesses is surprisingly lacking, with financial inclusion generally being the only specific measure highlighted. However, financial inclusion in the absence of broader financial and other support services and policies can be ineffective or unhelpful, as has been the experience of micro-finance in India and elsewhere.⁸⁹

Small businesses are still generally neglected in policy-making processes. The World Business Council for Sustainable Development (WBCSD) points to their relative lack of tax incentives and subsidies, whilst Christian Aid highlights that they are sometimes invited to “civil society” rather than “business” dialogues with governments.⁹⁰

Yet small businesses face different barriers than large firms, as highlighted by the OECD and World Bank, as well as CAFOD's own research.⁹¹ They rarely get access to financing for innovation, support for exports or access to public procurement tenders.⁹² They face unequal relations in supply chains that mean that costs and risks are often pushed down to them by larger firms.⁹³

It is also worth noting that many of the policy priorities identified as important in inclusive growth literature are also those identified as important to small businesses.⁹⁴ Improving rural infrastructure, increasing cash transfers through social protection systems and investing in human capital are all important aspects for both inclusivity and for supporting small businesses to succeed.

Whilst not a silver bullet, an increased focus on small businesses is clearly important and has the potential to emerge as an important consensus priority as part of the ongoing inclusive growth debate. There is a clear priority to investigate this link more directly and to support poor women and men where they are currently working for better inclusive outcomes.

⁸⁶ World Bank (2013)

⁸⁷ European Commission (2011)

⁸⁸ World Bank (2009)

⁸⁹ See for example AWID (2011)

⁹⁰ WBCSD & SNV (2007), Christian Aid (2009)

⁹¹ CAFOD (2013)

⁹² Arzeni (2013)

⁹³ Vorley, (2004)

⁹⁴ CAFOD (2013)

6. CONCLUSION AND RECOMMENDATIONS

Inclusive growth is a distinct concept from standard economic growth and is accompanied by a unique set of policy recommendations. It is often, however, included in donor approaches without much clarity about how an inclusive approach differs from the standard approaches.

In mitigating against this risk, it is important that we work towards a definition of inclusive growth and look at the key factors that would contribute towards growth being more inclusive. To this end, in this paper we have tried to identify the key elements of inclusive growth as a step towards a working definition of this concept. We have then considered in some detail the various aspects that are important for making growth more inclusive.

Based on this analysis our recommendations to donors and governments wishing to pursue inclusive growth are to:

1. **Develop clear definitions of what is meant by inclusive growth.** Definitions matter because they clarify and set the objectives that will determine policy and spending choices. This paper highlights some important areas that we believe need to be included in any definition, emphasising that links with parallel debates around sustainability must be made.
2. **Ensure that the objectives for inclusive growth are explicitly defined. These should focus on broader sustainable human development objectives** than increasing incomes or GDP, such as gains in human development, poverty and inequality reduction, increased economic participation and promotion of the sustainable use of natural resources and climate protection.
3. **Develop proactive strategies to ensure growth that is inclusive** – this does not happen automatically. This paper has proposed some key factors to consider for achieving inclusive growth which are supported by evidence. In addition, economic policy-makers should proactively aim to maximize social and environmental co-benefits.
4. **Develop clear guidelines, objectives and indicators on how inclusive growth will be achieved and measured.** This includes clearly articulating the methodology for implementation and theory of change behind a proposed approach.
5. **Small businesses – where most poor people work – play a key role in making growth more inclusive. They therefore need to be prioritised in inclusive growth strategies.** Given their importance for poor women and men the direct links between small businesses and inclusive growth should also be a focus for future research and policy evaluation.

ANNEX: SUMMARY OF INCLUSIVE GROWTH DEFINITIONS

For the **OECD**: Inclusive growth is where the gap between the rich and the poor is less pronounced and the “growth dividend”⁹⁵ is shared in a fairer way that results in “improvements in living standards and outcomes that matter for people’s quality of life (e.g. good health, jobs and skills, clean environment, community support).”⁹⁶

The **World Bank**: defines inclusive growth by its pace and pattern – growth that is sufficient to lift large numbers out of poverty and growth that includes the largest part of the country's labour force in the economy⁹⁷.

The **International Policy Centre for Inclusive Growth** (IPC-IG)⁹⁸ places its emphasis on participation – so that in addition to sharing in the benefits of growth, people actively participate in the wealth process and have a say in the orientation of that process.⁹⁹

For the **ADB**¹⁰⁰, tackling discrimination of the most marginalised groups is an intrinsic part of the inclusive growth process, as well as a key outcome. Groups that have suffered discrimination are those that have been left behind in poverty reduction and economic development efforts – helping these groups to participate in and benefit from economic activities is a cornerstone of inclusive growth.

⁹⁵ i.e. the benefits of growth

⁹⁶ OECD (2013b)

⁹⁷ World Bank (2009)

⁹⁸ A partnership between the United Nations Development Programme and the Government of Brazil

⁹⁹ Ramos & Ranieri (2013)

¹⁰⁰ Klasen (2010)

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