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MAKING MARKETS WORK FOR THE RURAL POOR

**AN AGENDA TO ADVANCE
BROADLY BASED, SUSTAINABLE RURAL ECONOMIC GROWTH
IN LATIN AMERICA AND THE CARIBBEAN**

Bureau for Latin America and the Caribbean

U.S. Agency for International Development

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FOREWORD

The enclosed document, "*Making Markets Work for the Rural Poor*," presents an agenda to guide the U.S. Agency for International Development (USAID) in programming its assistance to advance broadly based, sustainable rural economic growth in Latin America and the Caribbean. This foreword puts the document in context by defining both its character and its scope.

Nature of the Document

Why is the document called an "*agenda*"? Perhaps the best way to explain its character is first to clarify what the document is not and then to spell out, positively, what it is intended to do.

Put negatively, the enclosed document is neither a strategy nor a plan, since it does not delineate the specific actions that the Agency's Bureau for Latin America and the Caribbean shall take to achieve specified objectives. Nor is it a concept paper, since it goes beyond broad statements of intent to suggest certain kinds of program actions that the Bureau and its field Missions in fact might consider to advance economic growth in rural areas throughout the region. Thus, the agenda lies between the extremes of a blueprint, on the one hand, and of general guiding principles, on the other.

Positively, the document challenges what have become conventional ways of looking at the economic growth process, and traces out some practical implications of a shift in focus. In short, *the agenda reexamines how we look at rural growth and attempts to see where, in programmatic terms, that reexamination takes us*. Much of the document's content is the product of an evolution of thinking over years, if not decades. In some instances, in fact, the document resurrects development paradigms that were formulated thirty years ago and that are especially germane to the task of addressing the pervasiveness of rural poverty in Latin American and Caribbean countries today.¹

Substantively, the "agenda" takes on three tasks. First, it defines a "vision," that is, what the Agency's support for rural economic growth in the region is intended to help accomplish. Here the agenda places the Agency's concern for the economic well-being of rural poor people front and center. Second, the agenda spells out a way of thinking about the growth process -- and, especially, how rural poor people can participate actively in that process. At this point, the

¹A prime example of the legacy on which the agenda builds is John W. Mellor, The Economics of Agricultural Development (Ithaca: Cornell University Press, 1966).

paradigm of lowering the "costs of doing business" -- that is, the "transaction costs" -- of the rural poor is introduced as a filter for making choices among competing claims on USAID development assistance resources. And, third, the agenda offers examples of the kinds of program actions that appear to offer promise for reducing such costs -- and, thus, might fit well in the development assistance programs of the Bureau and its field Missions.

The agenda does not propose that field Missions necessarily attach more attention to growth in rural areas than to growth elsewhere. When Missions do decide to promote rural economic growth, however, the agenda offers them both a way to look at the development problem and an approach to address it.

Scope of the Document

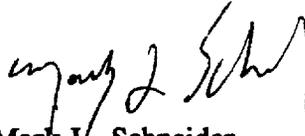
In development, it is commonplace to assert that everything is related to everything else. Never has that saying been so applicable as in the preparation of the agenda. As the document was subjected to the rigors of vetting both within and outside the Agency, a common theme of reviewers was, "Why does the document not take such and such a topic into account?" In the final analysis, it was impossible to do justice to all the linkages between rural economic growth and activity in other sectors. In short, *the agenda attempts to make its main message as clear as possible and to stick to essentials so as not to dilute that message.*

Geographically, the development of the agenda has its roots in a concern for the well-being of rural people. Thus, although the agenda underscores the significance of a country's overall policy environment, argues that rural growth is heavily dependent on economic activity elsewhere, and calls for openness to income generation opportunities for rural poor people regardless of sectoral source, the focus of the document's attention is largely rural. The absence of a major foray into the linkages between rural areas and market towns and cities is not to discount their importance, but simply a recognition that discussion has to be cut off somewhere.

In a similar vein, the agenda goes to some pains to trace out what appear to be key linkages between rural economic growth and responsible stewardship of the environment, the growth of local democratic institutions, the development and maintenance of a policy climate conducive to free trade, and expanded access to primary education, particularly for girls. The discussion of these linkages is by no means complete, but at least it highlights their importance. Linkages with other sectors, including the very real linkages that exist between rural economic growth and basic health services, admittedly receive relatively little attention.

Various reviews of the agenda suggest that the analytical approach of transaction costs reduction may be applicable to all economic activity, not just to economic activity in rural areas, and that it also may be of use in other sectors, especially education and health. At this point, the Bureau withholds judgment on this hypothesis, but sees it as a fruitful line of future inquiry.

Last but not least, I personally welcome feedback on the programmatic directions proposed in the agenda. The enclosed document is not the last word. Rather, it is an attempt by the current administration to rethink how the Agency can marshal the limited resources at its disposal to help attack rural poverty in the region most effectively.



Mark I. Schneider
Assistant Administrator
Bureau for Latin America and the Caribbean
U.S. Agency for International Development

ABSTRACT

MAKING MARKETS WORK FOR THE RURAL POOR

**AN AGENDA TO ADVANCE
BROADLY BASED, SUSTAINABLE RURAL ECONOMIC GROWTH
IN LATIN AMERICA AND THE CARIBBEAN**

The objective of USAID support for rural economic growth in Latin America and the Caribbean is:

**To increase the incomes of rural poor people
in a manner that is sustainable
economically, environmentally, and institutionally.**

The distinguishing features of the agenda can be summarized as follows:

In the past, development assistance has tended:	In the future, the Bureau proposes:
To equate the growth of the rural sector with the growth of agriculture.	To ensure that its agenda includes all economic activity in and supporting rural areas.
To view agriculture as something agriculturalists do and natural resource management as something done primarily by environmentalists.	To build in responsible natural resource management as part and parcel of all rural growth programs.
To view park protection as an activity independent of rural growth.	To support biodiversity conservation within a framework of rural poverty alleviation.
To view development as a production problem.	To view development more appropriately, first, as an incomes problem and, second, as a production problem.
To view development either as an exercise in "getting prices right" or as directing resources preferentially to the "poorest of the poor."	To recognize that both elements are essential and that the key is to make markets work for the rural poor.
To view poverty as largely a structural problem requiring targeted, subsidized assistance.	To recognize that the rural poor are part of the "private sector" and, as such, respond to market signals.
To predetermine what is profitable.	To encourage governments to create an economic environment conducive to decisionmaking by private parties on what to produce and where to invest.
To support expansion of exports in an <u>ad-hoc</u> way.	To promote trade liberalization as a cornerstone of country development strategies.
To stress macroeconomic policy reform to the extent of underrating the contribution of other ingredients essential for growth.	To reaffirm the importance of appropriate macroeconomic policies, but to focus attention on conducive sectoral policies and other enabling conditions.
Either to minimize the importance of a participatory approach to development or to view participation as an end in itself.	To embrace participation as a key element in increasing the access of the rural poor to markets.
To assume that organizational inputs are all that a development organization requires to accomplish its mission.	To support an approach to organizational development that focuses on delivery of services required by the organization's clients.

The agenda's approach to raise the incomes of the rural poor is:

**To reduce their "costs of doing business,"
that is, their "transaction costs."**

In practice, USAID program actions will be directed to create three enabling conditions:

**Participation
Conducive Policies
Effective Organizations**

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MAKING MARKETS WORK FOR THE RURAL POOR

AN AGENDA TO ADVANCE BROADLY BASED, SUSTAINABLE RURAL ECONOMIC GROWTH IN LATIN AMERICA AND THE CARIBBEAN

Bureau for Latin America and the Caribbean

U.S. Agency for International Development

1. Introduction

Throughout Latin America and the Caribbean, the "lost decade" of the 1980s gradually is giving ground to economic recovery. Most countries are putting the debt crisis behind them and, though haltingly in some cases, have embraced market economics and democracy as their creed. The painful first steps of opening up their economic and political systems largely have been taken. Growth rates still are somewhat uneven, but the turnaround is unmistakable and augurs well for future economic and political development. At the same time, the region's awareness of the challenges posed by its natural resource base has grown markedly, as witnessed by the Environmental Earth Summit in Rio de Janeiro in 1992.

Still, the picture is far from rosy. Although there has been progress, the evidence suggests that it not always has been broadly based. Many social indicators improved during the 1980s, but incomes generally did not. Despite modest advances since 1990, poverty remains a significant problem, especially in rural areas. So too does the degradation of the region's natural resources. Thus, juxtaposed with good news on one front are serious questions about the sustainability of the region's recent growth, both economically and environmentally.

Indications that rural poverty remains widespread throughout Latin America and the Caribbean include the following:

- ◆ Although the region as a whole is predominantly urban, more than 122 million people lived in rural areas at the end of the 1980s -- and, of that number, more than 62 percent lived in absolute poverty.
- ◆ Throughout the region, the majority of people in utter destitution live in rural areas. Rural inhabitants are less likely than urban residents to enjoy access to schools, health services, markets, communications, etc. Their children also are more likely to suffer from malnutrition and to die prematurely.

- ◆ In Latin American and Caribbean countries in which the U.S. Agency for International Development (USAID) currently has active development assistance programs, almost half of the population is rural. At the end of the 1980s, 71 percent of that population -- or more than 27 million people -- was poor.
- ◆ From 1965 until 1988, the number of rural poor people in most of those countries grew both in absolute and in relative terms. In other words, for more than two decades, their rural people living in poverty grew faster than the rural population as a whole.¹

The persistence of rural poverty suggests that the time may be ripe for USAID to take stock of its approach to encourage broadly based, sustainable rural economic growth in the region. This document reflects that taking of stock. The agenda presented here is the outgrowth of a lengthy process of strategy development that the Agency's Bureau for Latin America and the Caribbean initiated under the previous administration and that has continued to evolve under the current administration. Not only does the agenda embody the programmatic emphases contained in the current administration's *"Strategies for Sustainable Development"*²; it is one of the major ways the Bureau proposes to translate those programmatic emphases into action.³

The remainder of this document is organized as follows. Section 2 defines the agenda's "vision," that is, what it proposes to help accomplish. Section 3 summarizes how the agenda differs from development strategies prepared by the Agency and the Bureau in the past. Although the agenda proposes to promote growth with equity, it is not old wine in new bottles. Section 4 discusses the central importance given to reducing the "costs of doing business" -- that is, the "transaction costs" -- of the rural poor. In contrast to strategies that present lists of development constraints and corresponding programmatic responses, the paradigm presented in this section has an internal logic to it that can be used to help set priorities among competing claims on development assistance resources. Finally, Section 5 discusses the kinds of program actions that the Bureau expects to undertake to facilitate three interactive sets of "enabling conditions" -- participation, conducive policies, and effective organizations. As a practical matter, it is here that the task of lowering transaction costs presents itself and that the Bureau proposes to direct future attention.

2. Objective of USAID Assistance

The objective of the future assistance that USAID will direct to the encouragement of rural economic growth in Latin America and the Caribbean can be stated simply:

OBJECTIVE OF USAID SUPPORT FOR RURAL ECONOMIC GROWTH

**To increase the incomes of rural poor people
in a manner that is sustainable
economically, environmentally, and institutionally**

Like most compact statements, this vision of what the Agency proposes to help accomplish is meaningful both for what it says and for what it does not say. It may be useful, therefore, to highlight the import of key words:

- ◆ **Incomes** The measure of success of USAID assistance will not be production, employment, or similar variables; rather it will be the well-being of people. Looked at from that perspective, it is immaterial whether agriculture, forestry, micro-enterprises, or other economic activities are the source of well-being. Although access to public goods and services -- health, education, and safety nets, for example -- is a major determinant of success in alleviating poverty, this agenda addresses primarily economic phenomena. To measure progress in attacking poverty under it, therefore, well-being will be approximated, not by social indicators, but by the economic yardstick of income.
- ◆ **Rural** Although USAID assistance is to have an impact in rural areas, it may be that some program actions -- conducive policies, for example -- will be called for elsewhere.
- ◆ **Poor** Although others will stand to benefit, USAID assistance will be directed preferentially to raising the well-being of the poor. Thus, the rural growth discussed here is necessarily broadly based rural growth.
- ◆ **People** Not only will future USAID support of rural economic growth be judged primarily for its impact on people, including minorities and women; future programs also will be "people-first" programs. Those involved will be less beneficiaries and more participants and decisionmakers.
- ◆ **Sustainable** Future USAID-supported activities are not to be one-shot affairs; they must continue after USAID support terminates.
- ◆ **Economically** Economic sustainability implies absence of external subsidy. Ultimately, activities must stand economically on their own.

- ◆ Environmentally Environmental sustainability implies renewability, which in turn implies responsible natural resource management.
- ◆ Institutionally As discussed below, institutional sustainability implies continuity of supportive laws, regulations, procedures, etc., as well as of effective support organizations.

3. Distinguishing Features of the Agenda

Over the years, USAID and other donors have prepared numerous development assistance strategies. As a result, much of the terminology used in this document is not new, which may suggest to the casual reader that the agenda is not new either. In fact, the agenda reflects a number of significant shifts in thinking both about the process of development in rural areas and about how USAID can be supportive. Some of the shifts are dramatic in character; others are more evolutionary. In both cases, the shifts are real and distinguish the agenda from analogous exercises in the past. Before describing the agenda itself, therefore, it may be useful to highlight some of these principal distinguishing features. For ease of exposition, this task is performed with a series of dichotomous contrasts in what follows.

RURAL GROWTH IS MORE THAN AGRICULTURAL DEVELOPMENT	
<p>In the past, development assistance has tended:</p> <p><i>To equate the growth of the rural sector with the growth of agriculture.</i></p>	<p>In the future, the Bureau proposes:</p> <p><i>To ensure that its agenda includes all economic activity in and supporting rural areas.</i></p>

There are two reasons for thinking of rural growth as more than agriculture. First, although primary agriculture continues to be important in its own right, it is its significant backward and forward linkages -- that is, the extent to which it demands goods and services from other sectors and the extent to which other sectors depend on it in order to prosper -- that take on increasing importance over time. Together, primary agriculture and its linkages backward and forward -- many of them with market towns and cities -- can make up half of a country's total economic activity, even at relatively advanced stages of development. The second reason to look beyond agriculture is that it is only one of several primary sectors. In many countries in the region, forestry, fisheries, and mining make major contributions to the economy. In Latin America and the Caribbean as a whole, 60 percent of land lies under forest cover.

**RURAL GROWTH DEPENDS ON NATURAL RESOURCE MANAGEMENT
AND VICE-VERSA**

In the past, development assistance has tended:

To view agriculture as something agriculturalists do and natural resource management as something done primarily by environmentalists.

In the future, the Bureau proposes:

To build in responsible natural resource management as part and parcel of all rural growth programs.

Not only does the Bureau propose to support only those land and water use programs that are sustainable environmentally; it also recognizes that rural growth and natural resource management are mutually reinforcing. Rural growth obviously depends on natural resources, and for growth to be sustainable, natural resources need to be managed responsibly. Interestingly, though, the causality also runs the other way. Throughout the region, rural environmental degradation is largely a poverty problem. On top of policies that undervalue the natural resource base, the pressure of poor people on land makes eking out a living -- often at virtually any environmental cost -- first priority. *For the rural resource base to be sustained, therefore, it is essential that rural poverty be alleviated -- or, in other words, that rural economic growth take place. If rural economic growth is to take place, however, resource use must be intensified. The concern, obviously, is that intensification take place in ways that are responsible and sound environmentally.*⁴

A concrete example will serve to highlight the tradeoffs, the interrelationships, and the need for incentives conducive both to conservation and to generation of income. As the Organization for the Rehabilitation of the Environment expressed it in its 1990 annual report on its activities under the Targeted Watershed Project in Haiti:

From the beginning it was clear that the three objectives of soil conservation, soil fertility and increased revenue are closely interrelated and that one cannot be achieved without the support of the others. Farming hillside slopes without soil conservation quickly results in loss of soil and crops, and the land rapidly becoming infertile and useless; at the same time soil conservation hedgerows require a certain level of soil fertility without which they do not perform well; and without an increase in the revenue from their land it is hard for the farmer to justify the cost of establishing and maintaining hedgerows, and they remain under pressure to continue destructive agricultural practices.

This example from Haiti also points up the disproportionate concentration of rural Latin American and Caribbean poor on the region's most marginal and environmentally vulnerable lands, which in turn points up just how the problems of poverty and environmental degradation are closely linked.

CONSERVATION OF BIODIVERSITY IS DEPENDENT ON RURAL GROWTH

In the past, development assistance has tended:

To view park protection as an activity independent of rural growth.

In the future, the Bureau proposes:

To support biodiversity conservation within a framework of rural poverty alleviation.

The Bureau proposes to continue its support for conservation of biodiversity through park protection, sustainable forest management, and similar programs. Experience suggests, however, that it may be hazardous to view biodiversity conservation in isolation from rural growth. Empirical evidence mounts that park protection will be successful only if reserves and their surrounding areas are managed so as to provide a living for the people residing there. Parks, like other land uses, are not immune from the pressures of poverty in the rural sector at large -- and will be fully protectable only when that problem is addressed.

A recent review of "integrated conservation-development projects" suggests that practitioners have not progressed very far along the learning curve of designing and implementing park schemes that combine successfully the dual objectives of conservation and development. Nevertheless, the review does identify what appear to be key determinants of success: "(a) a good understanding of the local context and the interactions between local populations and the environment; (b) emphasis on local participation in the design and implementation of the projects; (c) support or collaboration among governments, donors and executing agencies; (d) knowledge of and an ability to influence the broader policy environment which affects projects; and (e) long-term commitment of financial and technical support."⁵

**RURAL GROWTH HAS TO DO PRIMARILY WITH RAISING INCOMES
AND ONLY SECONDARILY WITH RAISING PRODUCTION**

In the past, development assistance has tended:

To view development as a production problem.

In the future, the Bureau proposes:

To view development more appropriately, first, as an incomes problem and, second, as a production problem.

In the past, it has been common to choose development interventions for the contributions they make to increasing output. Still, the fundamental rationale for such programs is not production per se, but the degree to which they lead to higher real incomes. The introduction of unit-cost-reducing technology is a classic case in point. Not only does it provide higher returns to producers; through lower retail prices, it also translates itself into higher real incomes for consumers. Although development interventions often lead to production increases, their ultimate justification lies in the contribution they make to generalized growth in real disposable incomes.⁶

FOR BROADLY BASED GROWTH, MARKETS MUST WORK FOR THE POOR	
<p>In the past, development assistance has tended:</p> <p><i>To view development either as an exercise in "getting prices right" or as directing resources preferentially to the "poorest of the poor."</i></p>	<p>In the future, the Bureau proposes:</p> <p><i>To recognize that both elements are essential and that the key is to make markets work for the rural poor.</i></p>

Over the years, donor agencies have oscillated in the emphasis they have given to market solutions to development problems and to the direct delivery of goods and services to target beneficiaries. The agenda presented here pulls the two strands together. It recognizes the power of markets and focuses on the obstacles that the rural poor face in taking full advantage of them.

THE RURAL POOR NEED TO BE SEEN LESS AS CONSTRAINTS AND MORE AS PRODUCTIVE ECONOMIC AGENTS	
<p>In the past, development assistance has tended:</p> <p><i>To view rural poverty as largely a structural problem requiring targeted, subsidized assistance.</i></p>	<p>In the future, the Bureau proposes:</p> <p><i>To recognize that the rural poor are part of the "private sector" and, as such, respond to market signals.</i></p>

In the past, it has been common to distinguish between the "private sector" and the "disadvantaged." Although handy for some purposes, the distinction creates the impression that the rural poor fail to respond to market signals as "productive" economic agents and, in effect, ignores the opportunities that the rural poor population offers as an untapped source -- and, indeed, potential engine -- of

economic growth. *In the future, the Bureau proposes to view the rural poor, not as constraints, but as agents of the economic growth process.*⁷

IT FALLS TO PRIVATE PARTIES TO MAKE PRODUCTION DECISIONS; IT FALLS TO GOVERNMENTS AND DONORS TO FACILITATE THEM	
<p>In the past, development assistance has tended:</p> <p><i>To predetermine what is profitable.</i></p>	<p>In the future, the Bureau proposes:</p> <p><i>To encourage governments to create an economic environment conducive to decisionmaking by private parties on what to produce and where to invest.</i></p>

Development assistance strategies often delineate specific kinds of productive activities they shall support. This agenda does and does not. It does in the sense that it proposes to assist in the creation of conditions conducive to private sector initiative, some of which may stimulate investment more in one set of sectors than in another. For example, provision of information on international markets can be expected to lead to investment in tradable more than in non-tradable products. Similarly, policy analysis may lead to the adoption of policy options that favor labor-intensive over capital-intensive production techniques or that, all other things being equal, increase opportunities for women to earn and control income. The agenda does not try to pick winners, however. It leaves final determinations of profitability -- and production and investment decisions -- to private parties. *Again, the intent is not to substitute for markets, but to help make them work evenhandedly.*

The rationale for the focus on enabling conditions rather than on particular products is to facilitate the flow of productive resources to their most profitable uses. The intent is to be open to opportunities for income generation, regardless of source, and, thus, not to rule any licit economic activity out of court on a priori grounds. As a case in point, in recent years development practitioners have debated the advisability of continuing support for non-traditional agricultural export promotion activities begun in the 1980s. The criterion proposed here is empirical: if non-traditional exports continue to represent a promising source of income for the rural poor, the answer is yes; if not, the answer is no. In either case, though, it is ultimately private parties that will make the governing decision. What governments, USAID, and other donors must do is see to it that enabling conditions -- trade policies, environmental protection and health regulations, physical infrastructure, information on international markets, development support organizations, etc. -- are in place so that non-traditional export opportunities can be stacked up nonprejudicially against competing investment alternatives.

**RURAL AREAS MUST LOOK TO EXPORT MARKETS
AS AN ENGINE OF GROWTH**

In the past, development assistance has tended:

To support expansion of exports in an ad-hoc way.

In the future, the Bureau proposes:

To promote trade liberalization as a cornerstone of country development strategies.

The debate on the advisability of future support for promotion of non-traditional exports is only the tip of a much more profound development iceberg. In many countries in the region, domestic markets simply are too small to absorb significant increases in local production of goods and services, be those goods and services traditional or non-traditional. Consequently, much of the demand required to fuel future income growth -- not just in rural areas, but in the economy as a whole -- typically must be looked for outside the economy itself. In other words, *for many countries, the only viable engine of substantial growth in incomes in the future is entry into export markets. As a left-of-center political leader in El Salvador commented recently to a USAID official, "Why do donors always want us to produce basic grains? Why can't we produce high-value products for export and purchase some of that corn you produce so much of in the United States?" This remark is symptomatic of growing pressure throughout the hemisphere to broaden membership in the North American Free Trade Agreement (NAFTA). In coming years, the Bureau proposes to assist countries not only to meet the eligibility requirements to gain accession to NAFTA (or NAFTA-like agreements), but also to create an environment domestically in which entrepreneurs currently of limited means can take advantage of a liberalized trade regime.* On the former score, primary attention will be paid to environmental safeguards, commercial standards, and workers' rights. On the latter, attention will be paid to the creation and maintenance of macroeconomic policies -- especially exchange rate policies -- that do not discriminate against labor-intensive export industries, a regulatory environment that discourages rent-seeking by privileged groups, and programs that address the financial, management, market information, and technical bottlenecks to vigorous market entry by microenterprises and small farmers.⁸

**MACROECONOMIC POLICY REFORM IS NECESSARY
BUT NOT SUFFICIENT FOR BROADLY BASED RURAL GROWTH**

In the past, development assistance has tended:

To stress macroeconomic policy reform to the extent of underrating the contribution of other ingredients essential for growth.

In the future, the Bureau proposes:

To reaffirm the importance of appropriate macroeconomic policies, but to focus attention on conducive sectoral policies and other enabling conditions.

During the 1980s noteworthy progress was made in "getting prices right," that is, in creating an economic environment in the region in which goods and services are valued in accordance with their economic scarcity. Still, *conventional market reforms, by themselves, cannot solve the fundamental problem of limited market access for much of the rural population.* Although market liberalization and structural adjustment programs have set the stage -- and, in fact, are basic preconditions -- for the rural poor to participate more actively in the economy, further enabling conditions still must be put in place.

**ORGANIZATION IS ESSENTIAL FOR THE RURAL POOR
TO GAIN ECONOMIC POWER**

In the past, development assistance has tended:

Either to minimize the importance of a participatory approach to development or to view participation as an end in itself.

In the future, the Bureau proposes:

To embrace participation as a key element in increasing the access of the rural poor to markets.

In the real world, the ability of the rural poor to access markets often requires organization. Economic power typically is concentrated in groups rather than in individuals. In the future, the Bureau's rural growth agenda will include support to the rural poor to organize themselves to engage as active participants in a market economy. The approach will emphasize *inclusion* and encourage the participation of individuals and groups often excluded due to their ethnicity, race, class, or gender. Examples of organizations to receive support include indigenous non-governmental organizations, resource user associations, and local governments.

Promoting participation in organizations of this kind also can be an excellent form of local democracy building. As noted below, participation can be looked at both as an end and as a means.

Most discussions of democracy building focus on participation as an end: the involvement of people in political processes is important and good in and of itself. In this discussion, participation in development organizations is seen more as a means to bring about broadly based rural economic growth. To say that participation is a means, however, is not to belittle its significance. On the contrary, *it is precisely the access to economic resources that local development organizations furnish to rural poor people that gives them the incentive to participate in them actively. Consequently, to the extent that a participatory approach to development respects local initiative, authority, and control of economic resources and allows local communities to set and execute their own priorities, it can contribute not only to "economic empowerment" but also to instilling democratic attitudes and practices in much the same way as "political empowerment."*

A CLIENT ORIENTATION IS ESSENTIAL FOR DEVELOPMENT ORGANIZATIONS TO BE SUCCESSFUL	
<p>In the past, development assistance has tended:</p> <p><i>To assume that organizational inputs are all that a development organization requires to accomplish its mission.</i></p>	<p>In the future, the Bureau proposes:</p> <p><i>To support an approach that focuses first and foremost on delivery of services required by the organization's clients.</i></p>

The conventional approach to organizational development has concentrated on the provision of organizational inputs. Implicitly, the assumption has been that if an organization has office space, equipment, trained people, budget, etc., then the organization's mission will take care of itself. In practice, this focus on inputs has begged fundamental questions of definition of mission and led to a failure to develop a client base to sustain the organization financially over time. In the future, the Bureau proposes to support a client-driven approach. Characteristics include direct participation of members in the organization's definition of mission, an operating style driven first and foremost by delivery of services to meet client needs, and cost-effective internal management.

**THE PARADIGM THAT PULLS VARIOUS ELEMENTS TOGETHER
IS REDUCTION OF TRANSACTION COSTS**

In the past, development assistance has tended:

To program resources in accordance with checklists of permissible program actions.

In the future, the Bureau proposes:

To use the paradigm of lowering transaction costs as a filter for choosing among alternative program actions.

A promising approach to raise the incomes of the rural poor -- and, conceptually, a paradigm that ties much of the discussion above together -- is the reduction of their "costs of doing business." Lowering such "transaction costs" is proposed as the centerpiece of the Bureau's rural growth agenda and is discussed in the following section.⁹

4. Increasing Market Access for the Rural Poor: Reducing Transaction Costs

The development literature on Latin America and the Caribbean is replete with references to the structural rigidities that stand in the way of broadly based rural growth.¹⁰ The most obvious example is the limited access of the poor to land: the distribution of land in Latin American and Caribbean countries is among the most skewed and dualistic in the entire world.¹¹ But land is not the only resource to which the rural poor lack ready access. The same is true of financing, market and technological information, transport, legal protection, etc. -- in other words, the various underpinnings of a smoothly functioning economy. Consequently, the disenfranchisement of the region's rural poor goes beyond conventional factors of production; it goes to the heart of their capacity to participate effectively in a market economy.

In recent years, evidence has mounted regarding the significance of the structural obstacles that segment markets and limit the access of rural people to productive resources. Different studies use different terminology, but, to express it simply, *the transaction costs of effective market entry are prohibitively high for much of the rural population. In other words, the rural poor's costs of doing business -- securing financing, obtaining information, transporting goods, etc. -- offer them fewer economic opportunities than many other participants in the economy. Even in countries that have instituted major macroeconomic reforms, the economic playing field typically remains tilted away from those with the smallest initial resource base. Consequently, development interventions are called for, not to distort markets to skew benefits artificially toward the poor, but to make markets work more effectively and, thus, provide rural people the same wherewithal as others to respond to market signals. To put it succinctly, if the 1980s were the decade of getting prices right, the 1990s must be the decade of getting transaction costs down.*

What are instances of transaction costs that are higher for the rural poor than for others? Examples include:

- ◆ Financing. When they can get bank loans at all, small rural entrepreneurs typically qualify only for modest-sized loans, which means that the fixed costs of loan processing must be spread over a smaller base, thus increasing the effective rate of interest lenders charge. In fact, many urban-based banks are unwilling to lend to small rural borrowers at virtually any rate of interest, thus relegating them to informal lenders or to limited lines of credit at state banks. To receive agricultural loans from state banks, small farmers often must adopt preidentified technological practices, thus reducing incentives for innovation and opportunities for profit. In at least one country in the region, the state agricultural bank promotes overuse of pesticides, with negative environmental effects.
- ◆ Marketing systems. The lack of transparent marketing instruments -- deposit certificates, warrants, bonded warehouses, storage receipts, commodity exchanges, futures markets -- keeps marketing margins artificially high, effectively limiting competition and reducing potential profits, not only of small rural middlemen and women, but also of small farmers.
- ◆ Market information. Many rural middlemen and women have knowledge only of a limited number of national markets and virtually no knowledge at all of international markets. For their part, small farmers are even more isolated informationwise. Typically, the costs of acquiring market information are prohibitively high, which means that, all along the marketing chain, agents are unable to sell to the highest buyer. As the region inserts itself more aggressively in international markets, the lack of broadly based access to market information will become even more serious a problem.
- ◆ Transport. Limited market information frequently is exacerbated by poor roads, which raise unit marketing costs -- and, again, restrict market entry both for producers and for marketing agents.
- ◆ Access to imported inputs. Large-scale producers frequently have the economic wherewithal to pay the "fees" required to expedite the processing of imported inputs through customs, or they wield enough economic clout to jawbone down the amounts demanded. As a rule, the same is not true for small rural entrepreneurs.
- ◆ Access to external markets. In many countries in the region, well intentioned but misguided government trade policies prohibit the sale of "strategic" products to external, more lucrative markets, thus cheapening their value domestically. The policies in question are especially pronounced in raw forest products. Those relatively well endowed frequently circumvent these restrictions, typically by engaging in contraband trade. Small producers often are not in a position to capitalize on such "opportunities."
- ◆ Contract enforcement. Even with signed contracts, growers of non-traditional agricultural exports may lack the power organizationally to enforce payment from the purchasers of their

produce, may enjoy only limited protection under the law, and, in any case, may be unable to pay the fees required to take legal action.

- ◆ **Land transfer.** Somewhat ironically, the land reform legislation in force in many countries in the region places more restrictions on the sale and rental of the property of land reform beneficiaries than of other producers in rural areas, thus making the costs of land market transactions higher for the one group than for the other.

These examples illustrate the severity of the impacts that high costs of doing business can have on the rural poor. The examples also suggest a framework for the Bureau to adopt in setting priorities for its support of rural growth in the future. The approach proposed is qualitatively different from common practice in the past. *In the past, the standard procedure has been to list constraints to development, and then assess programmatic responses to them. Although there are certain similarities, the approach suggested by the paradigm of transaction costs involves a process that is inherently more analytically focused, namely, to figure out what costs of doing business most limit the income opportunities of the rural poor, and then assess which are most amenable to programmatic support by USAID. Since different transaction costs affect different groups of the rural poor differently, the assessment must distinguish among potential program options by the degree to which they are likely to have different impacts on different groups -- for example, groups distinguished from each other by ethnicity, race, class, or gender. The comparative advantages of the Agency and the intentions of other donors must enter the calculus as well. The process is not a magically mechanistic one, but one that requires both empirical information and good judgment. In contrast to prescriptions for getting prices right, realistic program options for lowering transaction costs must be highly historically and geographically specific. In short, the framework described here, though "universal" in theory, must be recrafted each time to meet the peculiar institutional contexts and patterns of behavior of different countries.*

The following section describes the kinds of program actions that the Bureau expects typically will emerge from bringing such analysis to bear in specific country situations. As a preliminary word of caution, however, it is important to note that *lowering transaction costs is not the "silver bullet" to raise the incomes of the rural poor. As imperative as the task is, lowering transaction costs, like the maintenance of a conducive macroeconomic framework, is a necessary, but not sufficient, condition for making a major dent in rural poverty throughout the region. The existing distribution of productive assets -- again, land is the prime example -- plays a fundamental role in affecting the extent to which rural poor people in Latin America and the Caribbean can take advantage of market opportunities.* Although the Bureau attaches high priority to support for smoothly functioning land markets -- through the establishment of secure and conveyable property rights, for example, such support is likely to have only limited impact in the short run. The same goes for programmatic responses to the skewed distribution of other key assets: human capital -- education, skills, experience -- and transportation infrastructure are obvious examples. In the absence of wholesale resource transfers, the more dualistic the distribution of assets in an economy, the longer the time frame that rural poor people will require to accumulate wealth. Still, for virtually all underlying asset distributions, high transaction costs stand as major impediments to sustainable

growth in incomes of rural poor people. Further, in contrast to the distribution of productive assets in a number of countries, they typically are amenable to effective programmatic action.

5. Program Actions to Create the Enabling Conditions for Broadly Based, Sustainable Rural Economic Growth

In general, three interactive sets of conditions can be distinguished as essential for broadly based, sustainable rural economic growth. The three conditions are participation, conducive policies, and effective organizations. In practice, lowering transaction costs for the rural poor involves creating one or more of these enabling conditions.

The first enabling condition, participation, means involvement of the poor in rural growth not only as beneficiaries, but, more importantly, as active agents. The second and third conditions both are institutional. Policies are institutions in the sense that they consist of the rules, regulations, procedures, etc., essential for the smooth functioning of an open, inclusive market economy. Development organizations also are referred to commonly as development institutions. In the agenda's vision statement, institutional sustainability includes both senses of the term, "institutional."

The subsections below contain examples of program actions that the Bureau proposes to take to support broadly based, sustainable rural economic growth in Latin American and Caribbean countries. The program actions illustrate a broad range of possible options, but they are not exhaustive. The exact form that USAID support for rural growth will take in an individual country program will emerge from analysis of the differential incidence of transaction costs as discussed above.

5.1. Participation

There is nothing more basic to the development process than participation. This is a lesson we have learned over the years, but it is one that we have not fully appreciated in all of its implications.

First, broad access by people to their country's economy and participation in their society's decisionmaking processes are results we seek to support; they are fundamental to sustained development; and

Second, our support is more likely to lead to these results if the development programs are relevant to people's needs, and for this there needs to be broad participation by people in defining development priorities and approaches.

Participation, therefore, describes both the end and the means; both the kinds of results we seek, and the way that we, as providers of development and humanitarian assistance, must nurture those results.¹²

This statement of participatory development principles by the USAID Administrator furnishes a contextual framework for the role of participation in the Bureau's rural growth agenda. For broadly based rural growth to take place, the rural poor must enjoy broad access to markets. To enjoy effective market access, individuals generally will have more clout if they organize in groups. In short, participation in organizations often is essential for the rural poor to gain and exercise economic power.

The forms in which the rural poor can organize themselves to engage as active participants in a market economy are multiple and often overlapping. They include community organizations, municipal governments, producer associations, marketing cooperatives, public service non-governmental organizations, etc. In each case, experience suggests that the relevance, effectiveness, and sustainability of participatory approaches depend directly on the degree to which they address four organizational problems:

- ◆ Inconsequentiality: participants are engaged in an endeavor that they believe makes or can make a difference;
- ◆ Cost of organization: participants perceive the cost of participation to be reasonable;
- ◆ Free riding: participants identify incentives for beneficiaries to provide effective support; and
- ◆ Assurance: participants believe in the organizational framework within which decisions are made.

The principal tools at the Bureau's disposal to support participation for rural economic growth are technical and organizational assistance and training. In furnishing assistance, the Bureau proposes to heed two major lessons from past experience. The two lessons, apparently contradictory at first blush, both have applicability: first, define objectives modestly and clearly, and keep the focus on results; and, second, adopt an operating style that facilitates and engenders accountability, but does not control. Characteristics of such a style include tolerance of a degree of openness in program design, patience with consultative processes, long-term commitment, willingness to make mid-course adjustments, and openness to the unexpected.

Examples of program actions that the Bureau proposes to take to promote participation of the rural poor in organizations to increase their economic power appear in Figure 1. In addition to the individual examples, two overarching programmatic emphases merit special mention:

Figure 1.

ENABLING CONDITION: PARTICIPATION

EXAMPLES OF PROGRAM ACTIONS

- ◆ Support non-governmental organizations to conduct analysis, to sponsor informed public debate, and to lobby constructively for economic and environmental policy reforms;
- ◆ Support decentralization of political power to municipal governments so that the rural poor can participate more directly in decisionmaking on revenue generation and allocation of local infrastructure budgets;
- ◆ Support the formation of credit unions as an outlet for rural savings and as a source of lending for the rural poor;
- ◆ Promote the use of group lending and rotating funds as mechanisms for reducing the costs of financial intermediation in rural areas;
- ◆ Assist small entrepreneurs in organizing themselves to acquire training in marketing, accounting, and other business skills;
- ◆ Develop workable mechanisms to involve the rural poor -- indigenous people and women, in particular -- as active participants in the development and implementation of natural forest management initiatives;
- ◆ Broaden the voice of local communities in the management of forest reserves and the buffer zones bordering protected areas;
- ◆ Encourage involvement of *campesino* and *campesina* groups in the formulation of agricultural, environmental, etc., legislation;
- ◆ Promote the evolution of producer organizations into providers of services for their members, including technology generation and transfer, marketing assistance, and lobbying services;
- ◆ Assist water users in organizing themselves to price and manage water efficiently, equitably, and sustainably; and
- ◆ Encourage producers and businessmen and women involved with agricultural exports to organize themselves to enforce and certify compliance with phytosanitary regulations.

- ◆ Participation by women. As a rule, women in Latin America and the Caribbean face higher and more intractable transaction costs than men. Examples include: legal and regulatory barriers to land tenure, inheritance, cooperative membership, and credit; labor markets that skew employment opportunities and earnings toward men; and home obligations that constrict women's mobility, time, and energy, and reduce their latitude to take advantage of economic opportunities. Programs to expand effective access to productive resources through *campesino* groups, cooperatives, and user organizations frequently fail to represent women's interests. The participation of women in development organizations cannot be treated as a tag-along activity; on the contrary, it often requires special organizational arrangements.

- ◆ Primary education. In recent years, *evidence has mounted worldwide regarding the high economic returns to investments in broadly based primary education. Interestingly, the evidence suggests that the return on investment in primary education for girls at least equals and may exceed that for boys.* In the medium term, education is the tool for promoting participation par excellence. Not only does it provide literacy and numeracy and enhance the marginal productivity of labor; it also gives people more wherewithal to take charge of their own lives. In the future, the Bureau proposes to look to broadly based primary education as a fulcrum of its approach to advance rural economic growth in the region.¹³

5.2. Conducive Policies

Cumulative development experience in Latin America and the Caribbean and in other regions of the world highlights the indispensability of appropriate policies, broadly defined, for sustained economic growth. Accordingly, the Bureau attaches highest priority to the formulation, implementation, and maintenance of policies, laws, and regulations conducive to growth that is open, inclusive, and broadly based.

During the 1980s, most countries in the region introduced market liberalization measures that reversed prevailing trends and made the economic playing field more level for rural economic activity. In the 1990s, the challenge is twofold: first, to avoid backsliding; and, second, to consolidate existing reforms with complementary sectoral and microeconomic measures. To a large extent, the measures in question will have to do with lowering the costs of doing business and broadening the scope for participation in the economy of those who, until now, have enjoyed limited economic opportunities.

Figure 2 contains examples of program actions that the Bureau proposes to take to encourage adoption and implementation of conducive policies.

Figure 2.

ENABLING CONDITION: CONDUCTIVE POLICIES

EXAMPLES OF PROGRAM ACTIONS

- ◆ Support policy analysis that examines the incidence of policy alternatives on different segments of the rural poor;
- ◆ Support the creation of a policy environment that encourages -- or, at a minimum, does not inhibit -- free association for all, including the rural poor;
- ◆ Encourage shifts in public expenditure toward broadly based primary education;
- ◆ Promote maintenance of market liberalization policies put in place over the last decade;
- ◆ Support initiatives for increasing the scope of free trade -- for example, incorporation within the North American Free Trade Agreement -- and measures, including simplification of import and export procedures, to enable the rural poor to diversify their economic activity and gain effective entry to expanded markets;
- ◆ Encourage amendment of commercial codes to guarantee enforcement of contracts in rural product and factor markets and to increase access to legal protection for the rural poor;
- ◆ Support policy initiatives to price water, forest products, and other natural resources in accordance with their economic scarcity values;
- ◆ Support measures -- land taxation, for example -- to liberalize land markets to encourage rational land use;
- ◆ Encourage policies that reduce costs of financial intermediation and promote lending wherever it is potentially profitable, including both non-agricultural and agricultural activities;
- ◆ Promote investments by both public and private sectors in rural areas -- rural access roads and agroprocessing plants, for example -- that tie rural households into broader markets in which they can amplify their sources of economic livelihood beyond agriculture;
- ◆ Encourage removal of policies and regulations that block market entry for small firms; and
- ◆ Develop effective compensatory schemes -- targeted food programs for vulnerable households, for example -- to alleviate the burden of structural adjustment and related policy reforms on the poor.

USAID's role in policy reform is to encourage, support, and cooperate with host country governments to bring about and maintain in force policy changes conducive to broadly based, sustainable rural economic growth. In practice, USAID support can take many forms, including technical assistance, training, applied research, and direct policy dialogue.

5.3. Effective Organizations

Development organizations often are indispensable to lower transaction costs for rural people. In effect, taxes do not get collected unless there are tax agencies, water rights do not get established and enforced in the absence of water use organizations, price information does not get disseminated in the absence of price information services, the exigencies of foreign markets do not become internalized without export certification programs, consumers do not enjoy protection from pesticide abuse without appropriate regulatory agencies, rural savings do not get mobilized in the absence of local savings institutions, the rights of the rural poor do not receive protection unless there are legal services organizations, etc. Consequently, the Agency's commitment to broadly based rural economic growth carries with it the need to make organizational development a focal point of attention.

The discussion of participation above looks at organizations from the perspective of how they can help the rural poor gain broader access to markets. This subsection looks at effectiveness, that is, how development organizations can do well what they are supposed to do, whether the rural poor participate directly in them or not.

Although there have been some notable successes, the task of nurturing development organizations and making them sustainable has proven to be arduous, and the Agency's track record admittedly has been mixed. A recent review of the Bureau's experience in supporting agricultural policy analysis units, agricultural research and extension agencies, and non-traditional agricultural export promotion institutions in the region suggests three operational lessons for increasing the efficacy of its organizational development support programs in the future:

- ◆ Pragmatism in dividing responsibilities between public and private sectors. The 1980s witnessed a dramatic shift of development activity toward the private sector, including civil organizations. On the whole, the shift has been healthy. In certain instances, though, the goods and services provided may be of such a public-goods character that the public sector cannot shed its responsibility to fund the functions in question -- though, even then, it still may be advisable to contract with the private sector to perform them. *In the future, a more pragmatic approach toward whether to lodge responsibility for development organizations in the public or private sector appears in order. In the final analysis, the guiding criterion needs to be what will work.*¹⁴
- ◆ Client-orientation. Traditionally, organizational development has concentrated on the provision of organizational inputs. In practice, this approach has begged fundamental questions of definition of mission and led to a failure to develop a client base to sustain the

organization financially over time. This trend has been exacerbated by the knowledge that, when push came to shove, USAID could be counted on as a reliable donor of last resort. This is not to say that the Agency should abandon fledgling organizations prematurely, but *mechanisms clearly need to be developed to promote attitudes of self-reliance and more of a market-driven, client orientation.*

- ◆ Internal management. Continued reliance on external funding has made it natural for development organizations to fail to take a hard look at themselves, to define their clientele and their products clearly, and to organize themselves in a cost-effective, businesslike fashion to accomplish their agreed upon mandates. *In the future, the internal management of development organizations merits additional attention.*

Examples of ways the Bureau proposes to learn from these lessons and provide organizational development support in the future are presented in Figure 3.

Figure 3. ENABLING CONDITION: EFFECTIVE ORGANIZATIONS

EXAMPLES OF PROGRAM ACTIONS

- ◆ Assist indigenous non-governmental organizations in the development and use of sound management practices;
- ◆ Strengthen the capacity of cooperatives, resource management and user associations, producer groups, and credit unions to provide services effectively to their members, and expand the access of women to the services provided by such organizations;
- ◆ Increase the coverage, suitability, and professionalism of organizations providing technical and management training for microenterprises;
- ◆ Assist government agencies in developing personnel practices that reward service to marginalized clientele;
- ◆ Support the creation of market information services that enable the rural poor to make more informed marketing decisions;
- ◆ Develop an organizational framework for the introduction of transparent marketing instruments such as deposit certificates, warrants, etc.;
- ◆ Develop programs to privatize public input-supply stores, commodity-marketing agencies, and agroprocessing facilities, and, to the extent possible, assist clients to take them over and manage them;
- ◆ Encourage the development of cost-effective land registration and titling systems to provide secure property rights for small holders, facilitate market-based land transactions, and promote rational land use;
- ◆ Support the design of operational mechanisms to enable small farmers to articulate their views and affect the budget allocation decisions of public research and extension agencies;
- ◆ Strengthen public and private organizations to formulate and to meet the recurrent requirements of policies and regulations affecting property rights, pesticide use, pollution control, and natural resource management and protection; and
- ◆ Assist local organizations in creating and responding to "green markets," that is, markets that place a premium on products produced in an environmentally friendly manner.

ENDNOTES

1. This brief profile of the rural poor in the region is taken from Roberta van Haefen, "Rural Poverty," LAC TECH Bulletin No. 3, Washington, 1994, which in turn is derived largely from Idriss Jazairy, Mohiuddin Alamgir, and Theresa Panuccio, The State of World Rural Poverty: An Inquiry into Its Causes and Consequences (New York: New York University Press, 1992). The USAID-assisted countries included in the analysis consist of Bolivia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Nicaragua, Panama, and Peru.
2. See U.S. Agency for International Development, "Strategies for Sustainable Development," Washington, 1994.
3. The landmark events in the evolution of the agenda include: (1) the December 1992 LAC TECH Project Workshop, which looked seriously at the disturbing trends cited in the text and the extent to which the Agency's then current "Strategic Guidelines for Programming Assistance for Agricultural Development and Natural Resource Management: Latin America and the Caribbean" responded adequately to them; (2) the April 1993 concept paper entitled, "Rural Growth and Sustainable Development: A Proposal for Guiding A.I.D.'s Assistance to Latin America and the Caribbean," in which the Bureau's Rural Development Division summarized the major conclusions of the LAC TECH Project Workshop; and (3) the September 1993 Regional Workshop for Agricultural Development and Environmental Officers, which traced out operational implications of the Rural Growth and Sustainable Development proposal.

The Bureau is indebted to Alain de Janvry of the University of California-Berkeley for his expert intellectual guidance throughout the evolution of the agenda. Responsibility for the agenda's final content lies entirely with the Bureau, however.
4. Interestingly, a recent cross-national study suggests that the greater a country's intensification of agriculture, the less land is subjected to clearing. See Douglas Southgate, "Tropical Deforestation and Agricultural Development in Latin America," Discussion Paper 91-01, London Environmental Economics Centre, University College, London, 1991.
5. Katrina Eadie Brandon and Michael Wells, "Planning for People and Parks: Design Dilemmas," World Development, XX (No. 4, 1992), 567.
6. The Appendix provides a fuller explanation of how growth in rural incomes feeds on itself. It also summarizes the potential contributions of agriculture, forestry, and non-farm income generation to that process.
7. The proposal to view rural poor people as active economic agents is not to deny the need for measures to mitigate the negative short-term effects of structural adjustment, natural disasters, etc., on vulnerable groups of poor people; nor is it to ignore the need for safety-net programs for the chronically poor. To say that the rural poor respond to market signals is not to say that each can be a Horatio Alger.

8. For an empirical assessment of conditions under which the rural poor can benefit from non-traditional agricultural export promotion, see Michael R. Carter *et al.*, *"Agro-Exports and the Rural Resource Poor in Latin America: Policy Options for Achieving Broadly-Based Growth,"* University of Wisconsin-Madison, 1993.
9. Economic theory distinguishes two ways of lowering transaction costs: first, through the improvement of existing market performance; and, second, through the emergence of organizations that allow transactions to be made at lower cost "outside" the market. The agenda's slogan, "making markets work for the rural poor," includes both of these ways of reducing transaction costs.
10. For example, see Carter, *op. cit.*; and Jazairy, Alamgir, and Panuccio, *op. cit.*
11. The region's land problem typically is cast in terms of the inability of landless poor and small farmers to acquire land. In fact, the inability of small farmers to cash in their assets and invest them elsewhere may be equally as important. In some countries, land reform legislation, passed decades ago to protect beneficiaries from eviction, now acts effectively as a straitjacket to their and their children's mobility. In other countries, land markets are so fragmented that small farmers often can liquidate their holdings only at firesale prices.

The aspiration of a typical small farmer is not to continue as a small farmer; it is either to become a larger farmer or to move out of farming entirely. Land markets must allow him or her to do the latter as well as the former. Over time, a typical economy will experience growing urbanization, on the one hand, and consolidation of farm enterprises, on the other. The flip side of consolidation is that many small farmers eventually get out of farming. Currently, labor markets in the region do not always allow rural poor people to dispose of their holdings when and as they want to. In other words, the land problem of the rural poor is one not just of access, but, more fundamentally, of choice.

12. J. Brian Atwood, *"Statement of Principles on Participatory Development,"* USAID Forum on Participatory Development, Washington, November 16, 1993.
13. The evidence on the high returns to investment in primary education is summarized in: Nancy Birdsall, David Ross, and Richard Sabot, *"Inequality and Growth Reconsidered,"* draft manuscript, 1994; George Psacharopoulos, *"Returns to Investment in Education: A Global Update,"* Policy Research Working Paper, The World Bank, 1993; and Lawrence Summers, *"Girls' Education: The Most Influential Investment,"* *Scientific American* (August, 1992), 132.
14. For paradigms to think through the appropriateness of different divisions of responsibilities between the public and private sectors, see Kerry J. Byrnes, *"Public, Private, and Independent Sectors in Sustainable Development,"* LAC TECH Bulletin, Washington, forthcoming.

APPENDIX

To amplify the context in which the agenda is conceived, this appendix offers a brief discussion of the contributions that agriculture, forestry, and non-farm income generation can make to broadly based, sustainable rural economic growth. Although additional primary sectors could be highlighted, there are four reasons that forestry is singled out to complement agriculture and non-farm income generation. First, 60 percent of the region lies under forest cover; second, in many countries in the region, forestry is a major productive sector; third, Latin American and Caribbean forests are home to what arguably is the richest store of biodiversity in the world; and, fourth, how forests are managed has direct effects on other natural resources, especially watersheds and soil quality.

1. Agriculture

Very briefly, there are four key ways in which agriculture contributes to economic growth:

- ◆ Agricultural development typically *reduces real food prices* and thus distributes benefits broadly to consumers. Much of the benefit is translated directly into improved nutrition among low-income groups. Low real food prices also ease pressure on wages, which increases the competitiveness of domestically produced goods and services internationally.
- ◆ As agriculture grows, it *generates substantial backward and forward linkages*. The linkages involve not only agricultural input industries and the processing, marketing, and transport of agricultural products, but also sectors beyond agriculture per se. Thus, agriculture can be a major engine of overall economic growth not only initially but throughout development.
- ◆ Agriculture typically employs -- directly or indirectly -- a sizable proportion of a country's poor. Thus, growth in agriculture normally *has a salutary equity effect*.
- ◆ Successful agricultural development is sustainable development, that is, one that *strikes a balance between enhancement of the productivity of the natural resource base and protection of the environment*.

Most observers readily acknowledge the critical role of agriculture in early stages of development. As the contribution of agriculture to the national economy declines in proportional terms over time, however, there is a tendency to conclude that agriculture's job is done and that -- in most Latin American and Caribbean countries, for example -- attention can be shifted wholesale to other sectors. Such a conclusion ignores agriculture's significant backward and forward linkages, that is, the extent to which agriculture demands goods and services elsewhere

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and the extent to which other sectors depend on agriculture in order to prosper -- and that these linkages, far from diminishing, become increasingly important over time.

As agriculture takes on less of a subsistence and more of a commercial character, demand increases for manufactured products and related agricultural services. Farmers need improved seeds, agrochemicals, and processing, storage, and transportation services. Farm households enjoy higher real incomes and demand a wider variety of consumer goods and services. Initially, demand expands for local, labor-intensive services -- transportation, restaurants, hotels, and housing construction, for example. Reduced food prices benefit low-income consumers and reduce pressures on non-farm wages. As incomes continue to grow, demand for manufactured consumables increases, which in turn leads to expansion of facilities that are dependent, in some cases, on agricultural inputs for processing and, in others, on agricultural exports for the foreign exchange to support industrial growth.

Continuing economic growth leads to additional structural change. Rising incomes bring about changes in diet, as people eat fewer cereals and more meat, fish, fresh vegetables, and fruit. Declines in human consumption of cereals often are matched or exceeded by increases in the demand for cereals as livestock feed. Changing diets encourage regional specialization and increased investment in agroprocessing industries, and interregional and international trade in food and feed commodities takes on increased importance.

What is the relative order of magnitude of the economic importance of agriculture, taking into account this array of backward and forward linkages? Taken together, primary agriculture and its linkages backward and forward can make up half of a country's total economic activity, even at relatively advanced stages of development. In El Salvador, for example, agriculture contributes approximately 24 percent to Gross Domestic Product, and agroindustry contributes another 12 percent, where agroindustry is defined to include food products, drinks, and tobacco. If one were to add other agricultural processing, agricultural input industries, and the utilities, transport, storage, communications, marketing, financial, public sector, and personal services associated with agriculture, the total contribution to the economy of the combination of agriculture and its backward and forward linkages probably would constitute close to 50 percent of El Salvador's economic activity.

A note on non-traditional agricultural exports. Although markets for non-traditional primary agricultural products are not ample enough to accommodate the production potential of the rural sector at large, sufficient evidence now has been amassed, particularly during the past decade, to suggest that the satisfaction of selected niche markets can be lucrative for farmers, generate sizable export earnings, and bring dynamism to a broadly based rural growth strategy. Despite the common perception that the benefits of promoting non-traditional agricultural exports accrue to a small number of elite producers, the evidence is not so clearcut. In fact, available data suggest that there are instances in which large numbers of small farmers engage in production of non-traditional products as a risk-diversification device. Moreover, there appear to be conditions, amenable to policy intervention, under which the employment benefits of non-traditional agricultural export growth can be quite diffuse. The multiplier effects of production

can be substantial, forward as well as backward. Indeed, women often are the principal beneficiaries of the creation of new jobs, especially where small processing plants are established.

In a similar vein, widespread concern has been expressed about the fertilizer- and pesticide-intensity that typifies production of a number of non-traditional agricultural exports. Although there have been abuses, again, the empirical record suggests that environmental and health concerns not only can be mitigated, but can be addressed effectively with appropriate policy interventions.

2. Forestry

Forestry and forest-based economic activities rarely receive high priority in development planning, but their contribution to rural growth can be substantial. Forest resources constitute a foundation on which sustainable domestic and export industries can be built. They provide common goods and services, including watershed protection, soil erosion control, and a home for countless numbers of plant and animal species. In some cases, they also offer opportunities for ecotourism.

Although Latin America and the Caribbean contain more than half of the world's remaining tropical forests, the rate of deforestation in the region is about 1.3 percent annually -- the highest in the developing world. The consequences are profound. Land degradation, soil erosion and loss of fertility, watershed deterioration, siltation, and degradation of coastal resources all result from forest conversion and loss.

Latin America and the Caribbean also contain a wealth of biodiversity largely unparalleled elsewhere in the world. Conversion of tropical forests and human encroachment on other critical habitats -- dry forests, wetlands, grasslands, mangroves, and coral reefs -- threaten these rich and still largely undescribed flora and fauna. Species extinction is taking place virtually everywhere in the region and at unprecedented rates likely to increase in the future.

Forestry, like agriculture, is a derivative of natural resources -- soil, water, and air. Trees either are managed as crops, protected in parks, or converted to other uses, typically crop cultivation or grazing. Although forests often are natural, they are a resource to be managed just like other resources, and will continue to be vulnerable until they are put on the same footing as agriculture and other economic pursuits.

As a rule, the policies that have "gotten prices right" in agriculture have passed forestry by. More than that, many national policies -- the bias of land tenure legislation against forestry, for example -- actually have discriminated against rational land use and promoted cropping in areas unsuitable for repeated harvesting. A bad situation has been made even worse by well intentioned trade policies designed to protect fledgling domestic wood processing industries by guaranteeing them a cheap source of raw materials. The net effect of the overall policy mix has been to restrict countries' access to the world's most profitable timber markets, discourage

production of non-timber products, and cheapen the value of forests and logs domestically. As one indicator of the magnitude of the loss incurred, forest product trade imbalances in USAID-assisted countries in the region now total more than \$500 million per year. Change clearly is called for to remove distortions in scarcity signals and to allow market forces to furnish incentives to manage forests responsibly and sustainably.

Green markets offer a promising outlet for private enterprise to internalize environmental costs and share them with conscientious consumers. Certification of pesticide-free and environmentally friendly export produce is making inroads in the United States through retailers such as Fresh Fields and producer certification such as the Rainforest Alliance's Smart Banana Program. The recent proliferation of independent groups offering verification of timber and forest products emanating from sustainable forest management practices expands the green markets concept. It remains to be seen how far the expansion can be pushed in the absence of broad-scale timber trade liberalization. Nevertheless, in the absence of strong political will and regulatory capacity, consumer-driven green markets may offer one of the more attractive program options to get forestry prices right and furnish strong market incentives for more sustainable agriculture and natural resource management practices.

3. Non-Farm Income Generation

Non-farm economic activity, including microenterprise development, has proven an effective, and increasingly important, mechanism for alleviating poverty and raising the incomes of rural poor people in the region. Facing slow growth of labor absorption in farming and the risks inherent in agricultural pursuits, rural farm households frequently look to non-farm economic activity as a way to augment and stabilize their incomes. Non-farm activity is especially consequential both for households with small land holdings and for households with no land at all, which typically is the portion of the rural population most difficult to reach effectively through development assistance programs. Overall, studies have shown that the majority of Latin American and Caribbean rural households obtain a substantial proportion of their income -- between 30 and 60 percent -- from non-farm sources.

Although non-farm income generation and microenterprise development typically are not themselves an engine of growth, they can be a significant component of a people-oriented rural growth strategy. In addition to increasing income and reducing poverty among participants, non-farm economic activity in rural areas can be instrumental in supplying goods and services to rural and urban markets, in stemming migration to cities, and in improving living conditions in rural areas themselves. Microenterprise development also appears an effective mechanism for raising the incomes of women and, more generally, for reducing rural income inequality.¹

¹For lessons learned in non-farm income generation and microenterprise development programs, see John Magill, *Strategies for Microenterprise Development in Ecuador*, "GEMINI Project Report, Washington, 1994; and James T. Riordan and Amy Kim Buckner, *Rural Non-Farm Income*, "LAC TECH Bulletin, Washington, forthcoming.