5. Reducing poverty: How can local governments be catalysts for pro-poor economic development?

The last three decades have been characterized by impressive gains in living standards in most of the developing world. However, there is another group of countries that have diverged from the majority and experienced a decline in living standards in absolute terms. The financial and economic crises which started in 2008—and the ensuing drop in global demand, commodity prices, foreign investment and aid—have compounded the plight of many such least-developed countries (LDCs) and exacerbated their economic vulnerability. Persistent poverty and recurrent food crises have underlined the need to rethink approaches to promoting pro-poor growth and economic development. This need is becoming increasingly relevant in non-LDCs where regional and urban-rural (and intra-urban/intra-rural) inequalities have persisted (or deepened) as a result of global and regional economic, environmental/climatic and political events.

Economic development is an outcome which implies a positive, sustained and comprehensive change in the quality of people’s lives and a measurable improvement in their economic wellbeing. (In stricter terms, it refers to the way goods and services are produced and the equity with which economic returns are distributed.) Local economic development (LED) implies the application of these principles in a defined territory (region, province, city, district or town\(^1\)). It also entails the effective utilization of a territory’s human, natural and capital resources, and the strategic deployment and continuous development of its comparative advantages. However, since territory-based economies are linked, any effort to stimulate economic development in any territory must be pursued in a manner that ensures economic integration with its surroundings.

In contrast, economic growth (national or local) refers to a quantitative increase in the amount of goods and services produced by an economy, and to the monetary value of the transactions\(^2\) that take place within that economy. In a number of LDCs (and also in some middle income and industrialized economies where economic growth is achieved consistently), poverty continues to persist in parts of cities, towns and in rural and remote regions, and the divide between rich and poor continues to widen. Such realities

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\(^1\) LED is pursued more strategically at a regional/provincial level which is more likely to encompass a more coherent and contiguous economic entity, as opposed to a city, district, town or a lower-level territorial configuration. Mega-cities or large-scale towns represent a specially concentrated territory with a high level of integrated economic activity, and could thus be treated as a coherent economic entity. However, viewing them as integral to the region within which they are located is critical to ensure urban-rural integration.

\(^2\) Usually measured through the tracking of changes in the value of the Gross Domestic Product (GDP).
can only be addressed in a territory through an integrated and inclusive approach to economic development which attempts a balance between economic growth, equity and environmental and social sustainability.

Local economic development has come to the forefront of discussions in many localities, as each explores new arenas opened by shifting arrangements in national and global relationships (including decentralization, globalization, and democratization). These transformational processes increase the importance of local governments in the economic development process. Indeed, many local governments, with national support, have taken advantage of new opportunities to launch, foster, or support local economic activity. At the same time, democratization means that local leaders—including mayors, elected officials, private sector, and local civic leaders—must play a more important role; they also need to respond to popular pressures to influence the direction of growth, and implement local development strategies to increase local employment and welfare.

Who plays a role in the promotion of LED, and what do they do?

LED is achieved through a process by which private and public sector actors work collectively to enhance the competitiveness, diversity and productivity of a defined territory’s economy, and to ensure equitable access by its citizens to employment and economic opportunities. It is the outcome of actions of a host of actors, including national ministries, other governmental agencies, local governments and quasigovernmental and nongovernmental agencies. Such entities usually perform LED regulatory, strategic guidance and/or facilitation functions towards the promotion of economic development. In some cases, these entities provide a range of support services, and sometimes intervene to create an enabling environment in which the private sector can function more effectively. Therefore, this category of actors plays the primary role in determining the quality of the business-enabling environment. Private sector actors (whether formal or informal, micro, small, medium or large enterprises) and the labour force perform an LED production function: These represent the primary drivers of economic activity. The quality of the performance of each member of these stakeholder categories determines the extent to which LED outcomes are achieved.

What role do local governments play for promoting local economic development?

Around the world, local governments increasingly perform a pivotal LED promotion role within their localities. In both developed and developing countries, local governments provide strategic guidance to LED promoters by actively coordinating and consolidating their actions towards achieving strategic local economic development objectives. They also intervene to enhance regulatory environments and invest strategically (directly or through innovative public-private partnerships) to address their economies’ infrastructure and growth needs. Furthermore, local governments often promote responsive business development, financial services, communication and transportation services required by
a locality’s economic sectors, clusters and value chains. Occasionally, well-endowed local
governments engage directly in the provision of selected strategic business development
services and intervene to mitigate financial risk that is borne by local enterprises (or by
the financial institutions that serve them). Some invest in R&D and lobbying on behalf of
their private sector at regional, national and global arenas.

However, in the majority of LDCs and in some developing countries, local governments are
rarely able to contribute constructively to LED. In most cases, their LED promotion mandate
and functional and resource assignment is not sufficiently defined in local government
legislation, and is thus not recognized or reflected in the legal and regulatory frameworks
of other relevant sectors (agriculture, industry, trade, or vocational education). Until
such mandates are articulated, local governments are usually under-resourced. This
reality has rendered most local governments irrelevant at best, and in extreme cases they
are perceived as obstacles to the achievement of LED.

**What are the challenges that local governments face in promoting local economic development?**

Even when these policy and institutional issues are addressed, the path to successful
LED is a challenging one that requires specialized capacity and a determined mindset.
The main risk is that without adequate expertise and experience, local governments
will spend resources on business ideas that have little or no chance of success, or those
that may have a negative impact on their intended outcomes. Even if market potential
is visible, local governments sometimes do not have the business expertise to develop
the concept, manage the project or even communicate and cooperate with the local
economic actors that do. Project experience is replete with local governments—in rich
countries and poor—that have given away fiscal, tax, and other incentives needlessly
to attract investors or to compete with neighboring jurisdictions. A common request
from the private sector—that local governments “get out of the way”—stands in stark
contrast to the eager but misguided local government trying to do too much of the wrong
thing. Instead, simplifying procedures, reducing red tape, eliminating transaction costs
(including corrupt side payments) becomes the low hanging fruit for local governments
that wish to stimulate LED.

**What can be done to unleash the potential of local governments to promote local economic development?**

Transparent and efficient local governments and strong local leadership are necessary
for achieving successful local economic development, but strong local government is far
from being a sufficient condition. Experience has shown that in order to unleash the local
government’s potential in promoting local economic development; some issues that are
outside the domain of the local government must be addressed.
What is needed at the National Policy level to enable local governments to contribute?

Although national policy has proven effective in directing resources to foster national economic development and pro-poor economic growth in many locations, few countries have managed to introduce an across-the-board program of coordinated decentralization and local economic development policies. Sometimes central governments take direct action at the local level and bypass local governments, and there is little evidence that national governments encourage local counterparts to take initiative and drive the LED process from below. This is due to several factors: the reluctance of central officials to share power; central government’s fiscal balance worries; and capacity limitations of local governments. An important issue in formulating a national policy framework for LED is finding the right balance between pro-growth and pro-poor, and also between national controls and local autonomy on the other.

What is needed in terms of statutory authority?

Though local governments usually have the legal mandate to pursue LED, in reality this legal authority is often limited in scope. When problems or complications arise, local governments do not always have the means to work through to solutions. Dedicated LED promotion capacity, however limited at the initial stage, is often cited as a key requirement to making the connections needed for success. The need for a dedicated team, with professional skills, may mean that smaller or financially strapped local governments either have to count on outside agents, such as provincial, national or international actors, or make do with the single-handed efforts of mayors or one or two department heads. In many cases, selecting the proper scale for LED efforts is critical.

What is needed in terms of finance?

Local economic development financing often requires special attention. From the standpoint of LED, a new perspective on finance might be in order where local and national governments both have an interest in stimulating LED. In addition to increasing the availability of local government finances, specific LED-related financial tools could be useful for special-purpose funds (e.g. municipal finance and central government special funds) to help fill gaps in infrastructure or credit where clear payoff can be demonstrated.

What can be done by development partners?

It is critical that development partners directly engage local governments and support the development of their capacities as critical players in the effort to promote local economic development. It is also crucial that donor partners allocate financial resources to augment the limited allocations available to local governments for use in LED promotion initiatives. Development partners should be wary of the tendency to enter a local scene with an agenda that may not correspond with local needs (as defined by the community or local government itself). Forging ahead without due diligence risks engendering supply-side success simply because resources are tied to donor offers.
Discussion Questions:

1. What role should local governments play towards the promotion of local economic development? How would the scope of such a role be different in the case of under-developed LG system, an operational/evolving or an advanced one and in the case of a rural or urban setting?

2. What is needed to enable local governments to play an effective role in LED promotion? Specifically, what policies, legal and regulatory, institutional and capacity inputs as well as financing options will be needed and what are the challenges usually faced in securing them?

3. Where local governments have performed effectively towards the promotion of local economic development, what were the factors that facilitated their success? What were the factors that have contributed to ineffective performance of others?

4. What has been the contribution of sub-national economies to national economic growth? Is there coloration between level of autonomy (and other factors) on the one hand and performance and level of contribution to national income on the other?