DEVELOPMENT FOR TODAY’S MARKETS: ALIGNING PRACTICES WITH ECONOMIC TRANSFORMATION

EXECUTIVE SUMMARY

We are at an important juncture in international economic development. Globalization has led to an era of unprecedented interconnectivity of commodity and financial markets. The world’s developing economies are in the midst of significant structural transformations, as agriculture slowly cedes its share of gross domestic product (GDP) to manufacturing and services across every continent. Incomes around the world are rising and the global middle class is growing.

These dynamics have influenced (and have been influenced by) significant changes in where and how we live. Globally, humans became a majority urban species more than 10 years ago. Africa’s share of the world’s urban population is forecast to nearly double by 2050, but this is a slightly outdated distinction: increasingly, city and countryside blur together into a rural-urban continuum with constant migration between the two. Africa’s population continues to grow, leading to the much-discussed youth bulge.

But what do these dynamics mean for economic development practitioners like us who work on these issues daily? Through this paper, we try to provide a brief—and necessarily incomplete—answer to these questions in three parts:

1. We sketch out the broad contours of developing countries’ structural transformation and how it differs from the structural transformation pathways1 followed by today’s developed economies.
2. We look at how livelihood strategies are evolving in the midst of these transformations.
3. We outline several implications for our work as economic development specialists.

Audience: This paper is intended primarily for development practitioners and policy makers who don’t often get the opportunity to look up from their professional niches and consider the implications of larger macroeconomic, demographic, and other dynamics. Our findings draw from recent research on these topics. Our objective is to synthesize key elements of this research in a way that is accessible for development practitioners, enabling us to gain a better understanding of what structural transformation could mean for our work.

1 By pathways, we mean the magnitude and sequence of growth across the agricultural, manufacturing, and service sectors, as well as their cumulative developmental impacts, over time.
HOW ARE ECONOMIES TRANSFORMING?

For decades, economic development paradigms have looked to the histories of currently developed countries to create a roadmap for developing countries today. The impulse is understandable: the wave of structural transformation that began with the Industrial Revolution in 18th century North America and Europe created economies and societies that are economically complex and diverse, have educated and relatively healthy populations, and a substantial middle class. Indeed, we are seeing several positive echoes of these past successes in developing countries today (see text box on next page).

Globally, populations and economies are getting wealthier and moving off the farm. Across Africa, those living in extreme poverty

Across Africa, those living in extreme poverty (at or below US$1.75/day) dropped from 54.3 percent to 44.5 percent. Globally, the middle class more than doubled in size from 2000 (1.5 billion people) to 2016 (3.2 billion people) (Karas, 2017). In Africa, the middle class grew from 24 percent of the population in 1990 to 33 percent in 2008, more than doubling from 119 million to 271 million people in that period. Looking ahead, nearly 90 percent of middle class growth from now to 2022 is forecast to be in Asia, with the vast majority in China and India (ibid).

Populations and economies are diversifying out of primary agriculture into more productive
Africa’s share of the global urban population is expected to nearly double by 2050.

Sectors of the economy (see Figure 1). Services and manufacturing benefit from proximity to consumers, infrastructure, and production inputs known as agglomeration effects. As these sectors grow, they become a key driver of urbanization. Africa’s share of the global urban population is expected to nearly double from 11.3 percent in 2010 to 20.2 percent in 2050 (Awumbila, 2017). Asia’s population is forecast to become majority urban in the latter half the 2020s (UN ESCAP, 2013). As incomes rise and populations urbanize, their diets are becoming more diverse, both in composition (more meat, fish, dairy, fruits and vegetables, and processed foods) and origin (imports, particularly for dry goods, displacing local production) (Crush, et al., 2011; USDA, 2015; Masters, et al., 2016).

But there are many reasons to put these historical roadmaps aside. In spite of the unprecedented wealth expansion and other benefits created by the first wave of structural transformation, they also had significant downsides. After a period of reduced inequality in the mid-late 20th century, wealth inequality and barriers in economic mobility have been rising in developed economies for the past several decades (Saez, 2008; Milanovic, 2014; Piketty, 2014). The first wave of structural development also built much of its wealth through appalling social, economic, and environmental exploitation. Slavery, sweatshops, and colonial imperialism provided cheap labor and primary inputs that unlocked the capital needed for industrialization. The first era of modernization saw the rise of farming and environmental practices that led to ecological disasters and greenhouse gas emissions that have led to potentially catastrophic and irreversible climate change, the potential extinction of one in six species by 2100, and the potential extinction of humanity as well (Urban, 2015; Ripple, et al., 2017; Gutierrez, 2018) (Wallace-Wells, 2017).

But even if they wanted it, there are three reasons the old pathway to development is unavailable to currently developing countries:

1. The manufacturing ladder to development is being replaced by services

Manufacturing was a critical part of early structural transformations, driving unprecedented increases in productivity and (eventually) distributing those productivity gains broadly. Manufacturing, particularly in its earlier forms, absorbed large numbers of unskilled labor, pulling farmers out of fields. This labor dynamic was a key factor in agricultural productivity growth. Shrinking labor pools in agriculture stimulated agricultural productivity through innovation to compensate (Barrett, et al., 2017). The new ranks of employees in cities became new markets, further driving agricultural transformation to meet growing demand (Temin, 1999; Rodrik, 2018; Barrett, et al., 2017). Manufacturing

Figure 2. Share of manufacturing jobs in emerging market and developing economies vs. advanced economies

Source: World Bank Open Data
intrinsically creates tradable goods—physical commodities that could ship anywhere. In contrast to non-tradable goods, like education, healthcare, or retail services, the potential markets for tradable goods is much larger, and countries that contain commensurately more room for potential growth (Rodrik, 2015).

Manufacturing also tended to encourage growth trajectories that are more inclusive. Manufacturing concentrated similar workers in the same buildings, shop floors, and city sectors, enabling the collective bargaining that was historically a big driver of inclusive growth (Mandel, 2017; Rodrik, 2018). This was particularly true for women—their trade unions became drivers for the suffrage movement and a key force in opening the public sphere to women (Eschner, 2017). Urban spaces built around manufacturing tend to cater more to worker needs in housing, public goods, and other amenities (Gollin, et al., 2016). In cities stimulated through nontradable sectors (otherwise known as consumer cities, including most African service sectors), spaces and subsectors tend to cater to elite preferences, and are associated with more slums, less public goods, and greater inequality (ibid).

Unfortunately, manufacturing is an unlikely pathway for currently developing countries today. Productivity gains from technology and globalization have largely eliminated the manufacturing stepping-stone towards broad-based development (Rodrik, 2015). Technology has enabled startling productivity per worker and globalization has integrated billions of workers and firms into a global marketplace with unprecedented competition and low prices for manufactured goods (Alpert, 2013). As a share of GDP, manufacturing has flattened or declined across both developed and developing economies, while agriculture continues to contract in developing economies. Where the share of the manufacturing labor for most countries in the Organisation for Economic Co-operation and Development (OECD) peaked at or around 30 percent before its decline, currently developing countries in Sub-Saharan Africa (SSA) and South Asia’s manufacturing labor peaked at less than half that, around 14 percent (see Figure 2) (IMF, 2018).

Globally, services are expanding to fill this employment gap left by agriculture and manufacturing (IMF, 2018). Much of this expansion is in services with lower growth prospects: construction and local commercial trading, for example, comprise a large percentage of service sector growth across Africa, but these sectors have limits to scale—they are highly location specific. A local construction or informal trading firm in Accra, for example, is unlikely to compete internationally. These sectors are also less likely to bring large numbers of workers together in the same way as manufacturing, making collective bargaining and job quality gains more difficult.

There are, however, service subsectors that have greater potential for exportable trade and job creation for low- and moderately-skilled workers that are showing promise, particularly in Africa. Tourism, transportation, high value horticulture, and ICT are key elements of structural transformation across the continent (Page, 2018).

2. Demographic change

For Africa in particular, it is not clear that the current transformation pathway will create sufficient job gains to keep up with population growth. Africa stands out as the only continent with a population forecasted to continue growing by the end of the century (see Figure 3). This rapid growth has meant that, even in the face of net urban migration and expanding economic opportunities, the number of extremely poor is still growing in absolute terms.
Over the past 30 years, the total number of people living in extreme poverty in Africa has still increased from 276 million to 389 million over the same period (Barrett, et al., 2017).

### 3. Natural resource depletion and climate change

The developing world is facing serious legacy challenges largely driven by the first wave of developers: natural resource depletion and climate change. In 1961, there were 0.37 Ha of arable land per person globally; by 2015 this had shrunk to 0.194 Ha/person due to both population growth and climate change issues (World Bank, 2018).

Sixty percent of all land across SSA is at risk of desertification (Benson, et al., 1997). The IMF has estimated that for countries with average temperatures of 25°C or higher (including large parts of SSA and South Asia), a 1°C increase in temperature will reduce per capita output by 1.5 percent (IMF, 2017). Climate change will drive increased variability in weather, temperatures, floods, and droughts (Stephenson, et al., 2010). The particular vulnerability of rain-fed crops—which comprise the backbone of food security for the most poor around the world—to shifting rainfall patterns will continue to slow structural transformation by wiping out assets and surplus foodstuffs (Wheeler & Braun, 2013). Duku et al. estimate that anywhere from 50 to 95 percent of agroecological zones that currently reap two rain-fed harvests per year will be reduced to just one harvest by shortened or altered rain patterns (Duku, et al., 2018). These burdens are most acutely born by women. Women tend to have less access to viable lands, and when land, water, and other resource pressures increase, are the first be displaced or have access otherwise reduced (USAID, 2016).

**HOW ARE LIVELIHOODS ADAPTING?**

* Becoming more diversified

People are responding to these challenges and opportunities by diversifying their livelihood strategies. This includes retaining subsistence...
agriculture, even in peri-urban and urban settings (on smaller plots, or through land rental). In urban Uganda, for example, the lowest income quintile still derives 25 percent of their livelihoods from staple crop production (Djido & Shiferaw, 2018).

In rural areas, where agriculture dominates, the growing reach of the cash economy has opened up new options. In a meta-analysis of their multi-country household economy analysis datasets, the Food Economy Group found that, even in rural areas, the cash economy—both labor off-farm and cash food purchases as a share of food sources—is growing. Across the countries in the study, which included Burkina Faso, Ethiopia, and Zimbabwe, the majority of poorer households met their food security needs from sources other than their own production (Boudreau, 2013). This included diversification within agricultural production to include multiple crops for income and home consumption, livestock as assets, and off-farm wage labor. In Nigeria, Djido and Shiferaw found that all income quintiles in rural and urban areas earned a majority of their livelihood through off-farm sources (Djido & Shiferaw, 2018). In Ghana and Uganda, the Mastercard Foundation studied a nonrandomized sample of 127 youth and found that they were engaged in between seven to 12 different livelihood strategies concurrently (Williams, 2018). In part, this diversification reflects the growing proximity of urban or peri-urban markets in towns and secondary cities. As these urban spaces grow, they creep further into previously cut-off rural areas, making cash cropping or off-farm employment options more accessible (Vandercasteelen, et al., 2018).

Increasingly mobile

Many of the above-listed livelihood opportunities—agricultural production, off-farm work, rearing livestock—do not all exist in one place. Migration, particularly temporary movement between cities and rural areas, is a common reality and a means of diversified livelihood. In Bangladesh, a recent survey found remittances from migrants in urban centers and abroad were the largest source of rural household income (Ahmed, et al., 2015). Surveys of rural households in Mali, Nigeria, Tanzania, and Ghana show that 50 to 65 percent of rural households have at least one migrant sending back remittances (Awumbila, 2017). In many places, this predominantly male mobility has led to increasing household responsibilities for women, as well as increased engagement in the rural employment sector. While this can contribute to empowerment, it also adds to women’s labor and drudgery (Demetriades & Esplen, 2010). In parts of the world with limited women’s rights to land, male migration can make it difficult to retain customary control over productive land when men migrate (Laudazi, 2003). Climate change is also increasing the frequency and range of migration, particularly in arid and semi-arid regions (Raleigh, et al., n.d.).

Remaining at persistent risk of impoverishment

While the youth bulge in Africa holds opportunities at the macroeconomic level, it puts livelihoods at risk for individuals and households. A USAID-funded study of three- and four-wave household panel data in Ethiopia, Uganda, and Bangladesh found that smaller households were more likely to experience sustained poverty escapes across all cases; larger households were more likely to return to poverty even after escaping at some point (Diwakar, 2016). More broadly, women’s economic empowerment is highly correlated with lower birth rates (Upadhyay, et al., 2014). As shocks from climate change increase in frequency, they also pose increased risks to
household assets and income sources (Boudreau, 2013).

**IMPLICATIONS FOR DEVELOPMENT PRACTICE**

The risk is that the above challenges lead to a future where emerging economies transform either too slowly or in ways that will leaving hundreds of millions of people without pathways to escape poverty. Structural transformation may bypass productive, tradable service subsectors with high potential for inclusive job creation. Instead, growth may concentrate in capital intensive resource exports and manufacturing, leading to jobless (or at least, ‘job-light’) growth. Population pressures and climate change will continue to squeeze smallholder farmers, whose livelihoods will grow increasingly more fragile, without urban job growth to pull them out of poverty.

The economic development sector must respond to these challenges by nudging developing economies’ transformation pathways in a direction that promotes economic inclusion and productive livelihood diversification.

Broadly, development practitioners need to respond to these changes by accepting that developing economies and societies are becoming more complex, urbanized, and less concentrated on subsistence agriculture. In the face of the growing risks from climate change, the world’s poor will continue to adapt through mobility and diversification. Often, these adaptation strategies involve tradeoffs between risk and security, and short-term and long-term objectives. Not all diversification strategies, for example, will build resilience. Our goal should be to catalyze capacity building, the provision of services, and capital, as well as other support that will help households, market, and food systems build resilience and incomes. Potential approaches to this include:

**At project planning:**

**Target services and agro-industries that mimic the structural transformation effects of manufacturing**

ICT, tourism, and transport are fast growing components of the service sector that mimic several of the structural transformation effects of manufacturing in past growth cycles. Combined with labor intensive agro-industries like horticulture, they are proving to be highly tradable, generate significant productivity gains per worker, and (with the exception of ICT), have the capacity to absorb lots of reserve labor from farm fields (Page, 2018).

Practitioners can strengthen these sectors through:

- Expanding the focus from value chain to market system development activities to strengthen supporting sectors like transportation.
- Strategically coordinating value chain interventions with infrastructure investments: As new roads and high-speed internet come online, they can make high value horticulture, transport, ICT, and tourism sectors significantly more competitive. Identify where these investments are completing, and target support to these sectors in the geographies.
- In labor intensive sectors, focus on improving job quality and security as well as the number of jobs.

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Footnote: For more information on integrating job quality and security into project design and implementation, see this USAID LEO Brief, “The Importance of Wage Labor for achieving agricultural market development objectives.”
Better integrate urban and rural livelihood support activities

As urban and rural spaces increasingly blur, and ICT and road infrastructure continues to improve, there is an opportunity to innovate new programming paradigms that engage this more complex reality and do away with strictly ‘rural’ or ‘urban’ conceptions of beneficiaries. Activities should use systems-based analytical and implementation approaches to understand how rural and urban food systems interact.

For example, in contexts where migration and remittance geographies are well known, pair agricultural livelihood development activities in rural areas with urban market and entrepreneurship development activities that would leverage social ties between urban youth and their home villages to strengthen food system channels.

Prioritize regional markets for export opportunities

Particularly in Africa, regional trade has grown substantially over the past two decades across all major tradable sectors (Hallward-Driemeier & Nayyar, 2018). Particularly as regional markets become more integrated, and global markets increase quality, food safety, and traceability requirements, the relative proximity and similarities in consumer tastes and quality requirements in regional markets can act as a useful stepping stone to global market competitiveness. This means:

- Prioritize regional export markets in value chain and market system opportunity analyses.
- Support regional export facilitation services, including cross-border trade groups/associations and intra-regional trade policy harmonization.

During implementation:

Strengthening resilience means treating risk mitigation and growth as a dual mandate for development

Recognize the value of risk management, even if it may come at the expense of income. Too often, development projects focus on encouraging risk-taking by farmers and entrepreneurs. We need to recognize that, particularly in the context of the challenges we’ve listed above, development institutions should see their goal as supporting market systems by both protecting households from the worst downsides of shocks and stressors in addition to encouraging them to take risks to potentially increase incomes.

This means:

- Before recommending technologies for adoption, look beyond just the potential yield increases from the technology in good production years. Understand what would happen if the crop failed, as well.
- Prioritize crops, technologies, and practices that are less resource intensive for farmers to adopt.
- Encourage productive diversification. Some diversification strategies are better than others at building resilience, and there is a role for development projects to help households optimize their livelihood strategy mix to diversify risk and potential returns. For example, agricultural programs should not automatically encourage specialization in specific crops if time and money would be better spent in other activities that could complement agricultural activities. Research under USAID’s Leveraging Economic Opportunities (LEO) activity, for example, found that off-farm employment was a critical component of households escaping poverty and not backsliding into it (Diwakar, 2016).
Deploy different enterprise development support programs for firms with high growth and formality potential as well as those that are likely to remain small, informal, and part of a larger livelihood strategy

Several studies have highlighted that there are two forms of entrepreneurs: those voluntarily chasing business opportunities with a mindset and resources to pursue growth (opportunistic entrepreneurs), and those engaged in business out of necessity (subsistence entrepreneurs). The subsistence entrepreneur’s business is often part of a diversified livelihood strategy and unlikely to grow past one or two employees (Amin, 2010; Schoar, 2010). The needs and development impact of these two types of entrepreneurs are different and should be engaged with differently.

Recognizing that the majority of opportunistic entrepreneurs’ impact tends to come from the highest performers, their support should be deeper than it is wide, with business accelerators, service providers, grants, and capital directed towards firms demonstrating success. It should catalyze further specialization where necessary. Ensuring these approaches are sensitive to women’s different needs will be important—research from the Global Accelerator Learning Initiative (GALI) found that cohorts of accelerator entrepreneurs that focused on women and minority applicants tended to have better outcomes across the whole cohort (GALI, 2018). This means:

- Where there are workforce capacity challenges for these firms, it will likely be more efficient to support firms to develop their own in-house specialized training for new employees than to deploy large-scale workforce training for these firms, which can quickly overshoot labor demand in specialized sectors (Fox and Kaul, 2017).
- Support to subsistence entrepreneurs should put more emphasis on developing skills that are broadly transferable across sectors and roles (as employees and entrepreneurs) and enabling adaptation and productivity improvements across the full livelihood portfolio. This would include support in soft-skill development like critical thinking, problem solving, and time management (Fox and Kaul, 2017), as well as basic business skills. While subsistence entrepreneurs may be less likely to create the next Google, a significant number of them will have no formal employment alternatives. Particularly in the context of Africa’s youth bulge, even extraordinary job growth in the formal sector will only provide employment for a fraction of today’s youth (Fox and Kaul, 2017). Helping them improve productivity and resilience across informal and supplemental livelihood strategies will be critical to helping them profit from structural transformation.

Support financial innovation to bridge the formal and informal

Even in the context of high rates of growth, the informal sector will remain a core livelihood strategy for a majority of the world’s poor for decades to come (Fox and Kaul, 2017). Yet formal and informal economies are not distinct but tend to blur together. Formal firms consistently rely on less formal firms for key inputs (such as textiles) and end market services (such as street hawkers). Development practitioners should:

- Leverage these formal/informal connections to extend financial coverage in value chains to include informal supply and distribution nodes. ICT-based transaction platforms and mobile money are generating data for historically opaque informal actors and are increasingly being used for credit scoring and financial access (Cheney, 2016). It will be critical to support innovations to
ensure they address women’s needs equally in these regards.

- Continue to build on promising innovations in financial technology and products to leverage the formal-informal continuum and build financial access for informal firms. Blended finance schemes can layer first-loss philanthropic and development finance with private and commercial capital to extend financial coverage in value chains to include informal supply and distribution nodes as well as formal firms.

CONCLUSION

Today’s developing economies are transforming in new ways, forging new pathways towards structural transformation. While the world has seen remarkable advances in poverty reduction and middle-class growth, several barriers, including the decline of manufacturing, population growth in Africa, and environmental challenges increase the risk that the current wave of structural transformation leaves hundreds of millions of the world’s poor behind, stuck in a poverty trap driven by low productivity farming and fragile informal markets.

Our job as development practitioners is to update our practice to these ever-changing challenges and opportunities. We need to design activities that engage households across the full range of their livelihoods, adapting to opportunities to strengthen productive diversification to build household resilience and prevent backsliding into poverty. This means catalyzing innovation in new approaches to entrepreneurship, workforce development, and business development and finance that can spread resilience and livelihood growth further.

To expand on practical ways to respond to these trends, this paper will be followed by several case studies of ACDI/VOCA projects successfully leveraging these dynamics to drive inclusive growth and poverty alleviation.

Founded in 1963, ACDI/VOCA is an international development nonprofit organization. We have fostered broad-based economic growth in 146 countries. We empower people to succeed in the global economy by building inclusive, resilient market systems. Learn more at www.acdivoca.org.

Lead Writer: Daniel White | dwhite@acdivoca.org


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