

Synthesis Report

Inclusive and sustainable economic transformation



ODI Global

Ways forward in low- and middle-income countries

Vidya Diwakar, Tony Kamninga, Tim Kelsall, Sam Pickard, Sherillyn Raga and Andrew Shepherd, with Foqoruddin Al Kabir, Hamidah Busyrah, Balgis Inayah, Fahmida Khatun, Mizan R. Khan and Elvin Nyukuri

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Abstract

Realising the vision of the Sustainable Development Goals requires pursuing not just rapid growth, but we call inclusive and sustainable economic transformation (ISET) – that is, moving labour and capital from less to more productive firms, activities and sectors – and in a way that benefits all people, while minimising environmental harm. This report synthesises in-depth research on enablers of and barriers to progress towards ISET, at the national level and within sectors. It shows there is no single formula for success, but countries with effective governance, relatively low-risk profiles, and strong public voice and accountability have tended to do better. Key barriers to ISET policy-making and implementation include institutional siloes, conflicting policies, lack of coordination, and a range of political-economy issues, including opposition from powerful interests. Crises, social movements, and external pressures from global value chains, standards or trade agreements can accelerate ISET progress. International finance, especially climate finance, and technical support are crucial as well, and need to be enhanced. A greater understanding of and support for people in informal economies is also essential to achieving inclusive outcomes.

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About this publication

This report is a short version of ‘Inclusive, sustainable economic transformation: Ways forward in low- and middle-income countries’, an ODI Global report by Andrew Shepherd, Vidya Diwakar, Tony Kamninga, Tim Kelsall, Sam Pickard and Sheryllin Raga. This short version was produced by Marion Davis, with substantial input from the author team. Roo Griffiths copy-edited both versions of the report, and Angela Kolongo supervised the process.

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1 Introduction

When world leaders adopted the Sustainable Development Goals (SDGs) in 2015, they formalised a high-level global consensus on the ideal future for all countries: broad-based peace and prosperity on a healthy planet, and an end to poverty, deprivation and suffering.

For developing economies in particular, realising the vision of the SDGs requires pursuing not just rapid growth, but we call inclusive and sustainable economic transformation (ISET). For lasting results and real impacts on poverty, they must move labour and capital from less to more productive firms, activities and sectors – and in a way that benefits all people, including the poorest and most vulnerable, and avoids or at least minimises environmental harm.

In principle, many governments already embrace ISET in their policies and strategies, even if they do not call it by that name. Yet in practice, ISET is clearly not yet the norm, as evidenced by deepening inequality within countries, rising greenhouse gas emissions and widespread environmental degradation.

This report synthesises the results of more than four years of research and analysis commissioned by the Swedish International Development Agency (Sida) to understand the factors that support or hinder ISET, globally and through case studies of specific countries, sectors and development finance providers.

We start from economic transformation because it is crucial to achieving most

low- and lower-middle-income countries' development ambitions. It can help lift people out of poverty by creating job opportunities in more productive and better-paid sectors than, for example, smallholder agriculture. Such transformations are not inherently inclusive, but can be made so through complementary investments in human development and economic policies. Environmental sustainability, meanwhile – long seen as in tension with economic growth – has gained priority as the climate crisis has worsened and many countries have struggled with air, water and soil pollution, resource depletion, and other serious problems.

ISET aims to align economic, environmental and social objectives, while recognising that development priorities, trade-offs and potential synergies all depend on the country context. An early output of this project, focused on greenhouse gas (GHG) emissions, suggested that in principle, ISET could achieve decent living standards for all.¹ However, the emissions of high-income countries and of wealthier people in middle- and low-income countries would have to be reduced drastically, and developing countries would need to avoid emulating the fossil fuel dependency and excessive consumption of today's wealthier nations.

The next section briefly takes stock of progress to date on moving towards ISET, from a global perspective and

in individual low- and middle-income countries. Section 3 dives deeper into the experience of Bangladesh, Indonesia and Kenya.

Recognising that trade-offs and synergies can vary considerably across sectors, Section 4 examines ISET

issues in three sectors and in informal economies. Section 5 focuses on the role of development finance – especially climate finance – in supporting ISET. Section 6 concludes with a synthesis of key findings and recommendations for policy-makers at the national and international levels.

2 Taking stock of progress on ISET to date

Although the SDGs were meant to be treated as an interconnected set, to maximise synergies and deliberately manage trade-offs,² to a great extent they have been pursued separately, in line with prevailing institutional structures and communities of practice. Perhaps as a result, progress on the SDGs overall has been slow and uneven. A 2023 UN report found that at the global level, about half of the targets for which data were available were ‘moderately or severely off track’, and over 30% showed either no progress or a regression from 2015 levels.³ Far too little has been done to address the drivers of climate change, biodiversity loss and pollution, and the Covid-19 pandemic, price inflation linked to Russia’s invasion of Ukraine, and many countries’ heavy debt burdens have all stifled progress.

As another UN report bluntly noted: ‘We must change course.’⁴ But what, precisely, must change? As the next sections highlight, one of the biggest barriers to achieving ISET is that decision-making and planning still occur mainly within the siloes of existing institutions, sectors and disciplines. Results, too, are assessed narrowly. More holistic and cross-sectoral approaches are urgently needed. Achieving this will not be easy, as it requires deep changes in mindset in both the public and private sectors, supported by policy and regulatory reforms and realigned incentives.

Implementation is also a serious issue: good policies are often approved, but not or only partly implemented. Removing harmful subsidies has been a particularly large challenge, as efforts to reduce or remove subsidies on fossil fuels and chemical fertilisers, for instance, have been thwarted by protests and social impacts.⁵

At the same time, the need for integrated approaches is increasingly recognised around the world. UN agencies, the World Bank, and various other international actors have laid out frameworks for advancing social, economic and environmental objectives together. Examples include the UN’s Synergy Solutions report;⁶ the World Bank’s concept of ‘green growth’⁷ and its post-Covid update, ‘green, resilient and inclusive development’;⁸ the African Union’s Agenda 2063;⁹ the United Nations Industrial Development Organization (UNIDO)’s vision to ‘eradicate poverty through inclusive and sustainable industrial development’;¹⁰ and the concepts of ‘doughnut economics’¹¹ and ‘wellbeing economies’.¹²

These are steps in the right direction, but all of these frameworks tend to pay closer attention to some objectives than others. None fully explores synergies and trade-offs between economic transformation, social inclusion and environmental sustainability, nor how to manage them

effectively. Interviewees from the African Union and the World Bank suggested that such strategies are beginning to change investment patterns, but their implementation is constrained by national government priorities, and at least so far, the impacts on the ground have been limited.

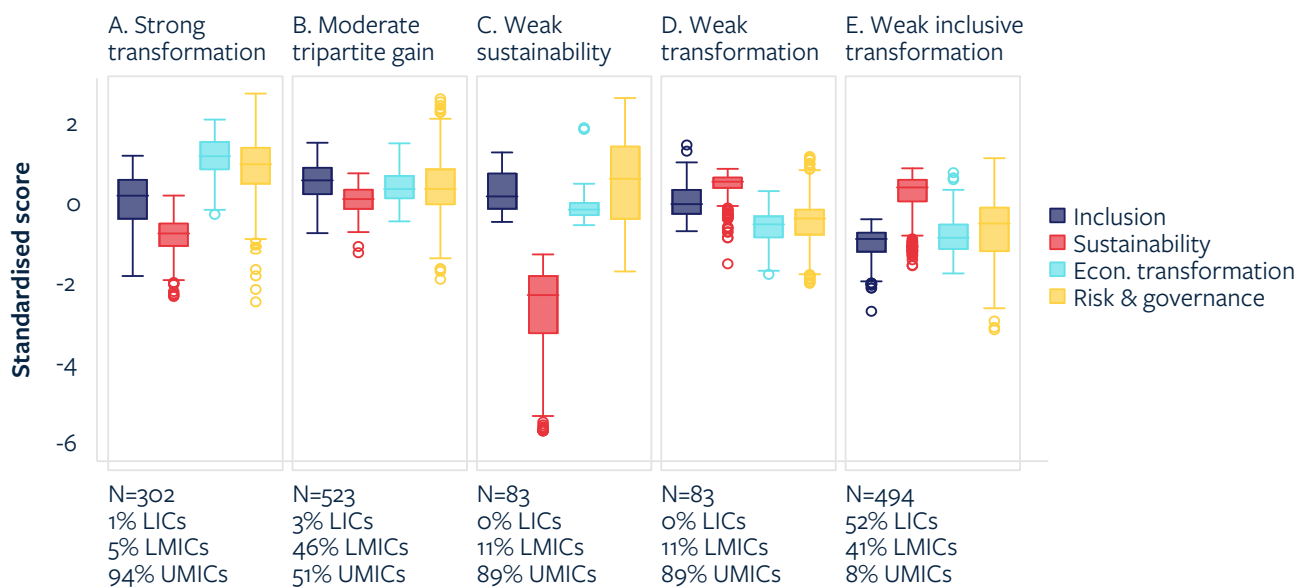
Even if political leaders want to pursue ISET, there are real-world factors that can create significant barriers, including vested interests likely to resist major changes that would affect their business income or livelihoods; established gender or community norms that may limit e.g. women's ability to pursue economic opportunities and become independent; weak social safety nets making it difficult to break poverty cycles; and knowledge gaps.

2.1 Which countries have done best on ISET?

Cross-country data comparisons provide some insights on progress towards ISET outcomes.¹³ In order to identify low- and middle-income countries (LICs and

MICs) that have performed relatively well in terms of ISET, this project focused on a limited set of available economic, social and environmental indicators, looking at data for 2000–2018:¹⁴ poverty headcount ratio, inequality in the bottom half of the distribution, GHG emissions per capita, material footprint per capita, labour productivity, and the economic diversification index.¹⁵

We then grouped countries into five clusters based on their performance along those three dimensions, as well as indicators of risk (or its opposite, peace and stability) and good governance. Figure 1 summarises the results. The strongest performers on economic transformation (cluster A) tended to score lower on environmental sustainability. Some countries (cluster B), mostly MICs, scored moderately well on all three dimensions, particularly on inclusion, even if they were not the top performers on other dimensions. We also found that some countries moved from lower-performing to better-performing clusters over time.

Figure 1 Grouping countries by performance on key indicators, 2000–2018¹⁶

Note: ‘Transformation’ refers to ‘economic transformation.’ The numbers under each figure refer to observations in our pooled country-year database, which included a total of 1,908 observations after removing high-income countries and those without adequate data. The same country can appear in different clusters over time. The box-and-whisker plots reflect the quartile spread of the standardised scores, with the dots being outliers. Source: Diwakar (2023).

We focused our next round of analysis on countries that stayed in cluster B for the entire 2000–2018 period: Albania, Algeria, Costa Rica, Egypt, Gabon, Jamaica, Jordan, Morocco, Philippines, Sri Lanka and Tunisia. We also looked at the Dominican Republic, which remained in cluster B for all but one year over the timeframe. These countries are geographically diverse and have relatively low poverty rates (ranging from less than 1% in Jordan to an average of 10% in the Philippines), generally low GHG per capita emissions (except for Gabon), and average to high labour productivity for their respective country income groups.

Overall, the upper-middle-income countries (UMICs) in this group showed

greater progress on ISET than the lower-middle-income countries (LMICs). For example, Costa Rica, Gabon and Jamaica all decreased their GHG emissions between 2000 and 2018, and Jamaica and Jordan decreased their material footprints over the same period. These findings suggest that having relatively higher incomes has enabled countries to progress more easily on all three dimensions of ISET – even on sustainability. Next, we considered how aspects of risk and governance may have affected progress.

2.2 Risk and progress on ISET

We examined risk levels in the cluster B countries by several different measures.

Looking at the Index for Risk Management (INFORM),¹⁷ for instance, we determined that cluster B countries typically had lower risk scores than others in their income group. To the extent that they faced climate-related risks, for instance, they may have worked proactively on disaster risk reduction or insurance to build resilience. The strength of coping capacity in the latter instances was thus often related to more effective governance. Global Peace Index data also show these countries tend to be more peaceful than average, with some exceptions (e.g. Sri Lanka, the Philippines and Egypt).¹⁸ This suggests that peace (and not just absence of violence or of vulnerable groups) may facilitate ISET.

2.3 Government effectiveness and accountability

A country's governance arrangements and the effectiveness of its institutions also affect its ability to mitigate risks and, more broadly, to implement measures that promote ISET outcomes. The government effectiveness scores of cluster B LMICs on the Worldwide Governance Indicators (WGI)¹⁹ have generally surpassed the LMIC average. However, among the UMICs, Albania, Gabon and the Dominican Republic actually score below the UMIC average.

Stronger state capacity may also enable more innovation – though public spending on research and development varies significantly among cluster B countries – and more effective integration of economic, social and environmental policies. For example, in Costa Rica, since 1995 the environment and energy portfolios

have been housed in the same ministry.²⁰

In the Dominican Republic, meanwhile, the Ministry of Economy, Planning and Development brings together economic planning and social development.²¹

Our results also suggest that moderate ISET progress can be achieved under different combinations of power concentration and social foundation size – two key characteristics of a country's political settlement, the 'rules of the political and economic game' (tacitly) agreed among those holding power.²² In other words, a country's political settlement does not inherently determine whether it can achieve ISET outcomes, though it may affect other important factors, such as state capacity and risk.

The ability of citizens to influence development, including through the democratic process, can also support stronger ISET outcomes. However, on the WGI's voice and accountability metric,²³ the African countries in cluster B, except for Tunisia, scored below their income group averages. In contrast, Costa Rica and Jamaica scored significantly above average, and the Dominican Republic and Albania, slightly above average. The Philippines performed well until recently and remains above average.

Together, these results provide some indication that state capacity may be the most crucial enabling condition for ISET outcomes in poorer countries, while calls for citizen voice and government accountability may grow in importance as countries develop.

3 Lessons from Bangladesh, Indonesia and Kenya

In order to better understand how governments balance economic, social and environmental objectives in practice, we examined three case studies outside the ‘constant cluster B’ group: water sector management in Bangladesh,²⁴ the energy transition in Indonesia,²⁵ and national- and county-level development policies in Kenya.²⁶ We focused on three main questions:

- To what extent are economic transformation, social inclusion and sustainability embedded in national policies, and to what extent are these policies actually implemented?
- What are the key bottlenecks and opportunities?
- What can be done to foster joined-up policy-making and implementation?²⁷

All three countries were LMICs over the periods studied, and their economies have expanded rapidly, with annual GDP growth of 5–7% in 2010–2019.²⁸ Growth has slowed in recent years due to the Covid-19 pandemic and Russia’s war on Ukraine. Bangladesh and Indonesia have sharply reduced their extreme poverty rates, while Kenya made more modest reductions and saw a rebound due to the pandemic.²⁹ Informal employment still predominates, exceeding 80% in all three economies.³⁰ GHG emissions, meanwhile, have risen in all three countries,³¹ though both Bangladesh and Kenya remain relatively low emitters. Altogether, it

is clear that there is room for more transformative, inclusive and sustainable economic growth.

3.1 Enablers of joined-up policies and implementation

Bangladesh, Indonesia and Kenya have all prioritised economic growth and rising incomes. For many years, environmental considerations were treated as lower priorities, but that has changed in more recent medium- and long-term visions. In Bangladesh, the Mujib Climate Prosperity Plan 2022–2041 lays out strategies to foster investment in robust, inclusive, climate-resilient and low-carbon growth.³² Golden Indonesia 2045, launched in 2023, incorporates multiple aspects of sustainability, including a path towards net zero GHG emissions.³³ Kenya’s Bottom-up Economic Transformation Agenda (BETA), launched in 2022 and anchored in Kenya Vision 2030, recognises action on climate change and the environment³⁴ as an enabler of economic transformation and social inclusion. Still, in sectoral policies and implementation, economic transformation can sometimes eclipse social and environmental objectives.

Bangladesh and Kenya have both benefited from including a participatory framework within the policy design process. The development of BETA in Kenya involved a rigorous consultation process. Moreover, under Kenya’s 2010 Constitution, which

decentralised power and resources, aiming to bring government closer to the people, County Integrated Development Plans (CIDPs) must be drafted through a participatory process. There is evidence that devolution has also enabled counties to maintain and even expand basic services.³⁵ However, interviews for this project indicated that sometimes the National Treasury has only allocated funds to CIDP elements that were aligned with national policies and plans, disregarding local stakeholders' preferences.

An example from Bangladesh is the process used to formulate the National Adaptation Plan 2023–2050, led by the Ministry of Environment, Forest and Climate Change.³⁶ The NAP is aligned with 52 climate adaptation projects in the BDP 2100. The policy design involved sectoral and cross-sectoral assessments; the mainstreaming of the NAP into existing development policies and plans; and engagement with various government agencies, CSOs, academia, the private sector and affected communities. The NAP's goal to enhance climate resilience through effective measures that 'support natural resources management, strong economic growth, resilient ecosystems and sustainable livelihoods' reflects an ISET approach, though it is too early to tell how it will be implemented.

SDG-focused capacity-building, coordination and implementation have also reinforced joined-up policy-making. In Kenya, CSO initiatives on SDG monitoring are contributing to awareness of a multidimensional approach to development. The CSO-led Kenya SDG

Forum gathers data and produces an annual report on the progress of SDG implementation at the county level and shares it with the Ministry of Devolution and Planning (MDP).³⁷ The MDP coordinates SDG implementation across the ministries and counties through an Inter-Agency Technical Working Group and a dedicated SDG desk. The MDP also uses the annual report as an input for its county-level monitoring and evaluation of SDG implementation.

A third key enabler is support from bilateral and multilateral development partners. For example, the Just Energy Transition Partnership (JETP) Indonesia is mobilising US\$20 billion in international finance to help decarbonise the country's power sector. Indonesia's own energy transition policies have focused mainly on economic transformation and environmental sustainability, not on social inclusion – such as mitigating impacts on coal-dependent workers and communities. This gap is acknowledged in the JETP Comprehensive Investment and Policy Plan (CIPP),³⁸ but while the CIPP lays out a range of investments, it still lacks a clear strategy for addressing job losses. Recent analysis has linked the JETP's shortcomings to insufficient stakeholder engagement.³⁹

The potential to mobilise international finance can also encourage governments to adopt ISET policies, especially on climate. For example, Kenya launched pilot county climate change funds (CCCFs) in five counties (Isiolo, Garissa, Kitui, Makueni and Wajir) more than a decade ago to help identify and prioritise investments

to meet local needs. That, in turn, helped attract international climate finance. A 2019 evaluation found several benefits from CCCF investments, such as better access to water; improved livelihoods, incomes and food security, and new economic opportunities.⁴⁰ The success of these pilots generated demand from other counties, and the National Treasury has since launched a programme to finance locally led climate action nationwide, with World Bank support.

In the private sector, meanwhile, pressures from international buyers (or global headquarters) have led some firms to exceed national standards and thus advance ISET, particularly with regard to environmental sustainability. In Bangladesh, for example, pressure from international buyers to improve conditions in factories increased after the collapse of the Rana Plaza facility in 2013.⁴¹ As of December 2023, 204 ready-made garment (RMG) firms had achieved Leadership in Energy and Environmental Design (LEED) certification, and nine of the top 10 highest-rated LEED factories were in Bangladesh.⁴² To achieve LEED certification, factories have to meet standards on GHG emissions, energy and water use, waste, worker health and indoor environment quality, among others.

One additional enabler of ISET policy-making worth mentioning is climate and environmental sustainability initiatives, often driven by international commitments (such as the Paris Agreement). The case studies show that governments have sought to promote cross-sector collaboration and deliberately integrated

economic and social considerations into their efforts. For example, Kenya's Inter-Governmental Water Sector Coordination Framework has fostered dialogue and engagement among the Ministry of Water, the Council of Governors, county governments and key stakeholders to deliver 'water for all'. Another example is Bangladesh's Mujib Climate Prosperity Plan 2022–2041, which aims to support economic growth and transformation by maximising environmental resilience and strengthening employment in the green economy in an inclusive and gender-responsive way.

Nevertheless, there are limitations and trade-offs: in Indonesia, for example, energy transition policies have taken into account affordability to consumers, but paid less attention to impacts on workers or on how to ensure gender equality, as noted above. In Kenya, efforts to improve public transport and make it more sustainable have failed to address the needs of the drivers whose livelihoods depend on the existing system. Moreover, financial instruments to support green manufacturing practices are often extended to large businesses but not to MSMEs. In Bangladesh, the enforcement of environmental laws has sometimes spared politically influential groups while failing to take into account impacts on vulnerable workers.

3.2 Barriers to ISET policy-making and implementation

In many countries, the Covid-19 pandemic led governments to focus narrowly on mitigating economic impacts,

protecting vulnerable communities, and then stimulating economic growth. Environmental sustainability came up in efforts to ‘build back better’, but it received less attention. In Kenya, for example, the first Covid-19 rescue package focused heavily on social protection and tax relief for businesses and individuals. A second, smaller package then focused on economic recovery, with a broad range of investments, some of which would have environmental benefits.⁴³

One of the biggest barriers to ISET in all three countries is a more long-standing problem: inconsistent and even conflicting policies and objectives. In Indonesia, for example, the government has set out to increase the share of renewable energy, but also to add more value in coal production (e.g. coal liquification and gasification).

Such inconsistencies are often due to a lack of cross-agency coordination. In Indonesia, the target share of renewable energy by 2030 was set at 19.5% at the ministerial level, but 23% at the national level, for instance. Further confusion arises with the JETP CIPP, which sets a renewable share target of 44% by 2030. Despite the establishment of a National Energy Transition Task Force, the CIPP lacks a feasible roadmap to achieve this higher target.

Problematic incentives and subsidies can also hinder the achievement of ISET. In Bangladesh, for example, the institutions responsible for water infrastructure are largely rewarded for capital expenditure on new construction,

but less for maintenance and effective management.⁴⁴ This may compromise social inclusion objectives related to delivering functional and sustainable water access for all. In Indonesia, meanwhile, the Ministry of Energy and Mineral Resources (Kementerian ESDM) simultaneously aims to reduce GHG emissions and create jobs in coal mines. Moreover, the state-owned power company, PLN, can purchase domestic coal at below-market rates, effectively a subsidy on coal power.

There is also a lack of capacity for joined-up policy-making. In Kenya, for example, the concept of an ISET approach is rather new, and policy development capacity-building activities for civil servants still have a sectoral focus, rather than taking a multisectoral or interdisciplinary approach. Similarly, Indonesia’s greater focus on economic aspects of the energy transition may be due to a lack of capacity to involve, integrate or quantify social and environmental aspects in national policies. This results in less priority being given to joined-up thinking on ISET objectives for decision-making, planning, implementation and evaluation of transition strategies.

Even when ISET policies are adopted, implementation can be challenging, as different institutions may be responsible for different elements. For example, in Bangladesh, the Bangladesh Water Development Board, city corporations and city development authorities are all involved in urban flood management, but by law, only local governments may introduce water management interventions. The case studies also found multiple examples of special

interest groups hindering ISET policy implementation. Moreover, often there is little or no accountability or monitoring to ensure that policies were well implemented.

Inadequate resources can be a significant obstacle as well. For instance, in Kenya, some national policies have been approved without securing the resources needed to implement them, leaving agencies without the funds needed for capital or operational expenses. One example is the 2016 Climate-Smart Agriculture Policy, which remained unfunded through at least 2023. Disbursement of funds to counties also fell short of the allocations mandated by law in fiscal years 2017–2022. Along with more funding, local governments may need significant capacity-building to be able to contribute to achieving ISET goals.

Governments also need to be mindful of unintended consequences. For example, in Bangladesh, efforts to reduce the

environmental impacts of tanneries in urban areas by relocating them did not fully consider impacts on workers and on local communities in the new locations. Arable land was then converted to build housing, without approval from the Department of Environment. In Indonesia, a new renewable energy project reduced fishing areas for local communities. The project developer provided small-business skills training for affected people, but concerns remained about impacts on incomes, particularly in the near term.

In summary, the case studies point to key conditions with the potential to ‘lock in’ policies and actions that support ISET, especially overarching laws and longer-term development plans that promote joined-up approaches, and external financing opportunities. Conversely, one of the most powerful factors that ‘lock in’ siloed policy-making and harmful trade-offs is sustained support and investment in the status quo, such as through fossil fuel subsidies.

4 Sectoral perspectives

A key insight from sections 2 and 3 is that integrated national policies can only go so far in achieving ISET outcomes: Sectoral policies and investments can greatly hinder progress, or advance it. It is also clear that conditions vary across sectors. In any given country, it makes sense to prioritise the sectors with the greatest impacts on key indicators (such as economic growth, jobs, GHG emissions, productivity). For this project, we focused on three sectors that are particularly important for economic transformation: manufacturing (looking specifically at textiles and clothing, which is highly labour-intensive), smallholder agriculture and energy (specifically the power sector). In addition, we looked at ISET considerations in informal economies, which support a large share of the poor.

The full report includes deep-dives into all four; here we focus on manufacturing (drawing on insights from Bangladesh, Kenya and Vietnam entering the industry at different times) and informal economies, with only brief summaries of the insights on smallholder agriculture and the power sector.

4.1 Textiles and clothes manufacturing

The textiles and clothing (T&C) sector has served as a stepping stone for many lower-income countries to develop ‘modern’, export-oriented manufacturing sectors. At first, the priority tends to be to maximise output at competitive

prices to grow market share. Over time, social concerns may be addressed, while environmental impacts typically come last. However, export-oriented producers may also face scrutiny and pressure from international buyers to raise both social and environmental standards.

The T&C sector is governed by a patchwork of multilateral, bilateral, national and sector-specific agreements that are applied to varying degrees. A relatively small number of firms dominate key parts of global T&C value chains – high-value-added activities such as design – while manual labour such as stitching is outsourced to lower-paid smaller players, including an array of subcontractors, intermediaries, homeworkers and non-factory workshops. The greatest environmental impacts are associated with textile production (e.g. use of water and chemicals, production and consumption of crude oil for synthetic fibres), while the impacts of clothing manufacture relate mainly to energy use and waste fabric.

Economic transformation in the T&C sector involves increasing either productivity (efficiency) or profitability (value-added) and can be achieved through improvements in products or processes, or through the diversification of firms into related but distinct higher-value activities (e.g. from simple assembly to include branding or sourcing of materials). This usually requires large capital investment (either foreign direct investment, such as that by Chinese firms

in Kenya, or via state-owned enterprises, as in Vietnam) and technology transfer. However, sometimes smaller, more diffuse, bottom-up investments have facilitated gains in productivity and job creation. In Bangladesh, MSMEs are credited with creating millions of T&C livelihoods and slowing rural-to-urban economic migration.⁴⁵

A broader enabling environment is crucial. Most export-led economic transformation occurs within or around free trade zones and is generally governed by terms of trade deals. National policy-makers can support transformation by encouraging domestic linkages – such as sourcing fabrics domestically – to enable their country to retain more of the value created. This is difficult to achieve in practice, however, as countries may lack the capacity to undertake those higher-value-added activities. Indeed, foreign investment has often played a central role in kickstarting countries' T&C sectors. Skills and knowledge transfer can also help accelerate this transformation.

Social inclusion in the sector entails improving working conditions and generally providing decent work, as laid out in the Decent Work Agenda of the International Labour Organization (ILO).⁴⁶ The T&C sector employs millions of people, often disproportionately women, in mainly low-skilled, low-wage roles.⁴⁷ In Bangladesh, where the sector employs over 4 million workers, a majority female, women routinely earn less than men and are far less likely to be managers.⁴⁸ Social inclusion priorities

might include a safe work environment, fair pay and job security, collective bargaining, and ending discrimination.

In practice, improvements in work conditions have generally resulted from a combination of international pressures and advocacy by labour groups and other social movements, despite many T&C workers having weak collective bargaining power. Governments have stepped up to some extent, setting minimum wages, restricting work hours and providing social protection, for example, but these efforts tend to lag well behind the sector's growth. Actions by major brands and consumers in wealthier countries, meanwhile, can sometimes lead to significant improvements. As noted in section 3, the Rana Plaza collapse in Bangladesh in 2013 drew global attention to unsafe work conditions and led to an accord between apparel companies, factories and workers to improve those conditions. The effort has since expanded internationally, with an accord now in place in Pakistan and ongoing efforts in other countries.⁴⁹ Still, much remains to be done to protect workers across this large and diverse sector.

Environmental sustainability in the T&C sector entails avoiding or limiting pollution, using natural resources more efficiently, and reducing waste, among others. Along with national policies, international pressure and standards set by importers – such as the EU's Strategy for Sustainable and Circular Textiles⁵⁰ – can push producers to adopt washing and dyeing technologies that reduce freshwater use, or try to minimise waste.

Factories in Bangladesh alone produce about 500,000 tonnes of textile offcuts, scraps and fluff per year;⁵¹ however, so more needs to be done to reduce the industry's impacts, particularly with the rise of 'fast fashion'.⁵²

However, a key barrier to ISET progress in the T&C sector is that low prices are central to competitiveness. Few buyers are willing to pay a 'green premium' and even when producers receive subsidies (e.g. a 2% tax rebate in Bangladesh), these are insufficient to cover investment needs or additional operational costs.

4.2 Smallholder agriculture

Agriculture is extremely important for livelihoods, employing 29% of the labour force, on average, in MICs and 59% in LICs as of 2022.⁵³ The vast majority of farmers worldwide are smallholders, who grow about 36% of all food on just about 12% of total farmland.⁵⁴ Economic transformation in the sector has entailed boosting yields through the use of irrigation, fertilisers, improved seeds and various technologies. In many countries, it has also involved a shift towards large-scale commercial operations.⁵⁵

As climate change has put more stress on the sector, governments and their development partners have also promoted various adaptation measures, some of which can also make agriculture more environmentally sustainable. One widely embraced approach is climate-smart agriculture (CSA), a range of practices aimed at increasing climate resilience while enhancing productivity, and often

also reducing GHG emissions. Many measures can be climate-smart, and what is appropriate varies significantly by context. Governments, international donors and private companies have long promised more support for CSA, but implementation has been limited, particularly due to a lack of tailoring to local contexts – or even knowledge about what farmers are already doing or what is needed.

Delivering support to smallholders to facilitate the adoption of CSA and other productivity-enhancing practices and technologies has been a long-running challenge. Often international support has failed to reach individual farmers, due to difficulties in assessing creditworthiness, lack of knowledge of the sector, and other shortcomings.⁵⁶ The evidence on microfinance and financial inclusion in general is mixed, with some recognition that the transformative effects have been exaggerated, but also evidence that financial service 'ladders' can indeed enable people to rise out of poverty.

Helping farmers achieve sustainability accreditation, meanwhile, can advance ISET objectives by ensuring that agricultural value chains meet minimum social inclusion and environmental standards, with a price premium on consumers flowing back to producers. However, the evidence on actual economic benefits from such schemes is mixed, with better outcomes in some value chains than in others. Accreditation alone is not a panacea, and more research is needed to understand the factors that enable farmers to achieve real gains, including when adopting CSA.

4.3 The power sector

Ensuring that all households have reliable access to electricity is a core element of development. The power sector also plays a central role in ISET because electricity is essential to manufacturing and many other economic activities, including smallholder agriculture and processing. A key challenge for LICs and LMICs is how to expand the power supply to meet growing demands while limiting environmental impacts, including GHG emissions.

In many LICs and MICs, the national government wields a great deal of control over the power sector, through state-owned power companies as well as through energy policies, subsidies and more. Reform can strongly promote ISET goals, but is time-consuming and requires balancing competing interests. For example, interviews with experts in the Dominican Republic revealed that economic and business rationales predominated throughout the near-decade of discussions of the *pacto eléctrico* reform, despite the inclusion of a diverse group of expert stakeholders.⁵⁷

Social inclusion in this sector is usually discussed in terms of promoting universal electricity access (and/or alleviating energy poverty), as codified in SDG 7.1. This is unquestionably a priority, but it is not the only aspect of social inclusion that warrants attention. The energy sector (both of today and of tomorrow) is itself also a major employer. This is why a priority of ‘just transition’ efforts has been to help workers and communities who

depend on fossil fuel industries to shift to alternative livelihoods. At the same time, it is important to remember that expanding renewable energy in the power sector will itself create millions of jobs. Globally, direct employment in renewables was already around 14 million as of 2023.⁵⁸

The most pressing environmental sustainability aspect of ISET in the power sector is the need to phase out the use of fossil fuels – the single largest source of global GHG emissions.⁵⁹ This, in turn, will also sharply reduce other environmental impacts from the power sector, such as air pollution. Electricity production has other environmental impacts that also need to be addressed, however, such as through water use, radioactive waste, and mining for materials used to make solar panels and wind turbines.

While many LICs and MICs have added renewable energy capacity, continued growth in electricity demand has meant that, for the most part, fossil fuel capacity has not been retired at the same time. Accelerating the energy transition will require more finance, but also extensive politically demanding efforts to make visible and negotiate the trade-offs between ISET dimensions.

4.4 Informal economies

Nearly three in five workers worldwide are employed informally.⁶⁰ Institutions promote formalisation as a way to ensure workers are protected by labour laws, occupational health and safety regulations, and social protection programmes, yet this can come at a cost.

Informality tends to decline with development, but only slowly: In 1991–1999, an estimated 43% of lower-income countries' GDP came from informal activities; by 2000–2009, the share had dropped to 41%, and by 2010–2017, to 36%.⁶¹ Even in emerging economies, an estimated 28% of GDP came from the informal sector in 2010–2017. Focusing entirely on formalisation is thus likely to leave millions of people behind, particularly the poorest and most vulnerable.

Policy-makers face real challenges in engaging with informal economies. They are diverse and context-specific, and a lack of data makes it difficult to apply economic analytical tools. Planners may see informal activities as obstacles to the development of prime real estate. Yet informal enterprises provide valued services, from food sales, to domestic work, to waste-picking and recycling. Moreover, the formal–informal binary is artificial to a great extent: many informal enterprises pay taxes and fees, apply for credit and submit to regulation (including environmental), and many formal value chains employ large numbers of workers and subcontractors informally.

Social inclusion for informal workers could entail moving into formal employment – though in practice, this does not happen much⁶² – or increasing micro-enterprises' productivity. The latter is also rare, with successes mainly among the top 1–3%, typically male entrepreneurs and own-account workers, who may receive policy support. Most others are not touched by policy initiatives, except, sometimes,

adversely, such as when their interests conflict with planning priorities.

Certain groups, such as migrants, refugees, people with disabilities, poor women and children out of school, are especially vulnerable to exploitation.

Promoting environmental sustainability in the context of informal economies is also tricky. The literature suggests that current effects on GHG emissions, natural resource use and other matters vary, but the general tone is negative and lacking in nuance. Informal enterprises are often seen not as 'plucky entrepreneurs', but as 'shady firms.' There are clearly powerful actors that exploit informality in ways that frustrate ISET (e.g. by avoiding progressive taxation, and social and environmental standards), but this is far from universal. Efforts to green urban informal economies pose substantial risks but also potentially interesting opportunities for vulnerable communities engaged in these economies.

A key first step in making progress is to close the very large knowledge gaps that hinder more effective policy-making and lead to misconceptions such as that informal enterprises do not pay taxes. To fill data gaps, a good starting point is the ILO-curated detailed data on informal employment and self-employment for 120 countries. In addition, policy-makers need to build a solid understanding of the challenges faced by different types of informal businesses and workers. Such efforts should be made locally (or at least sectorally), targeted and participatory, and exercise the do-no-harm principle.

Overall, the focus should be on getting rules and regulations right, which may require iteration and an openness to understanding why well-intentioned measures may fail in practice. Informal workers also need

to be engaged in local planning and policy processes. Governments could allow informal providers to participate in procurement processes, and broaden the use of social and technological innovation.

5 The role of climate and development finance

A key insight from the preceding chapters is that development partners can significantly contribute to advancing ISET, by providing finance and other forms of support to LICs and MICs. Climate finance holds particular promise, as it is intended to integrate development and environmental objectives. To gauge how much of an impact climate finance is making in terms of ISET, we looked at the projects supported by two key sets of institutions: the multilateral climate funds (MCFs) and the multilateral development banks (MDBs).

The two MCFs analysed (the Green Climate Fund and the Climate Investment Funds) have developed conceptual frameworks to help them understand how to achieve sustainable and inclusive development benefits through the finance they provide. They have also evaluated the impacts of different parts of their portfolios to draw out lessons. Such efforts are crucial to designing effective interventions that advance ISET. Diverse partnerships, engagement across scales, and targeted support for the private sector in LICs and LMICs, such as smallholder farmers, are also key. We also found that more could be done to unlock private finance to support climate action and ISET more broadly.

6 Key takeaways

This project has shown how low- and middle-income countries have achieved at least some degree of inclusive, sustainable economic transformation (ISET), as have initiatives in different sectors. Yet a great deal of work remains to be done. This section summarises key takeaways from our study and their implications for policy and action.

6.1 Translating ISET into concrete policies

ISET is a straightforward concept, with a fairly clear ‘landing zone’ and ways to measure outcomes. It builds on established ideas, such as the vision of the SDGs and concepts such as ‘green growth’ and climate-resilient development. Still, much remains to be done to translate these ideas into concrete policies in different contexts, and to move from understanding trade-offs to resolving them effectively. It is also crucial to recognise the implications of ISET at the global scale – both for consumption by wealthier people, and for finance.

Implications: Countries need enhanced capacities and dedicated policy spaces to develop joined-up policies that integrate their specific economic, social and environmental objectives. Ministries of finance and planning are critical arenas for doing this. Governments should develop or retool central planning/finance units with an ISET mandate and expertise. This will likely mean bringing social and environmental expertise into what has

been predominantly economists’ territory, and updating ways of working (e.g. for monitoring, auditing and goal-setting). This retooling could be replicated at subnational levels of government.

Development partners, meanwhile, need to increase both financial and technical assistance to help LICs and MICs to pursue ISET. This includes supporting innovation, experimentation, and efforts to replicate successful approaches in new contexts.

6.2 From policies to outcomes

We found many examples of countries adopting ISET-related policies or goals, but no evidence of a big push towards joined-up decision-making and investment in ISET – much less of actual achievement of balanced social, economic and environmental outcomes. Where progress has been made, several factors have contributed, including external pressures from global value chains, standards or trade agreements, internal pressures from social movements, and crises.

There is no single pathway to achieving ISET, but in general, effective governance, and facing fewer risks and/or managing them better, seemed to help. We found ISET progress had occurred in countries with several different political settlement types, but not in those with both narrow social foundations and dispersed political power – a common profile of fragile and conflict-affected states. Conversely,

countries with ISET outcomes and policies tended to have stronger voice and accountability scores.

Implications: The international community needs to support countries to achieve ISET goals in an ambitious, but realistic way, given their income level, starting point and stated policy goals. In countries with high levels of risk, efforts to reduce risk and vulnerability are a crucial starting point. In countries with less risk, but poor ISET outcomes, a focus on government capacity is key, as government effectiveness is a vital ingredient for cross-sector collaboration and coordination. Where government is decentralised or devolved, enhancing capacities at the local level is also important.

6.3 Political economy issues

We found that work on ISET neglects political economy dimensions that are essential to success. The power of different actors shapes both the goals set in ISET-related policies and the speed of travel towards them. The most obvious barriers arise from opposition from powerful vested interests, but key political actors and institutions may also exercise passive, but highly effective resistance.

Implications: Efforts to promote ISET must proactively recognise the potential for both institutional barriers and outright opposition from vested interests and develop tactics to address them. Insights from previous economic, social and environmental transformations can help. Options may include compensation, public–private partnerships to steer

investment towards ISET, and building systems that require compliance with regulations or accountability. Within governments, attention to institutional arrangements and incentives is key.

6.4 Tackling implementation challenges

The coordination and implementation challenges noted in Bangladesh, Indonesia and Kenya are typical of political settlements with broad social foundations and dispersed power configurations, also known as competitive clientelist states. Change comes when coalitions of stakeholders mobilise for reform. As noted above, countries performing well on ISET themes also tended to score well on voice and accountability. This suggests that it is important to promote the participation of diverse knowledge-holders, from subject or disciplinary ‘experts’ to social movements. There is also substantial potential for mandatory and voluntary trade agreements to support ISET, yet their impact thus far has been limited.

Implications: More work is required to understand the potential of trade agreements – at all levels – to facilitate ISET. Approaches that fail to meaningfully consider social and environmental factors should be rejected, as they may promote a ‘race to the bottom’. The private sector. Companies also need to assess social and environmental outcomes all along the value chain, including informal workers and subcontractors and suppliers, and proactively address deficiencies. Governments, advocates

and consumers should continue to push for transparency and accountability for meeting agreed-upon standards.

In contexts where social movements have already made headway in bringing ISET ideas forward, it may be particularly effective to seek to empower a broad range of stakeholders to engage in promoting change. In narrower political settlements, it may be better to seek out powerful coalitions of actors close to sources of power that are or could be aligned with ISET themes and attempt to support their efforts to promote change, while also supporting efforts for more inclusive decision-making more broadly.

6.5 More effective finance

There is significant potential in international climate finance to support ISET, and a degree of integration across objectives is already being achieved. However, the slow pace of implementation that is typical of development finance has also limited progress with climate finance, and the volume of finance remains inadequate. More efforts are also needed to unlock private climate finance.

Implications: Climate finance needs to be scaled up rapidly, and the MCFs and MDBs need to develop new mechanisms as necessary to facilitate a change in the way climate finance is delivered. It is especially important to reach beyond national governments to local authorities, small and micro businesses, people's organisations and households, and to provide resources that are less conditional, less complex, and planned and disbursed faster than they are now.

It would be helpful if climate and other ISET-related finance providers recognise that the provision of new resources does not automatically rearrange existing economic power relationships within countries, hence justifying more tailored efforts. In terms of specific sectors, agriculture and informal economies should be given significantly higher levels of attention and financing than they currently are.

6.6 More attention to informal economies

A final, but crucial takeaway from this project is that achieving ISET requires paying far more attention to informal economies – beyond promoting formalisation. Governments have mostly neglected the needs of those who remain in informality, or even treated them as undesirable. There are also large knowledge gaps, which make it difficult to understand the contributions of the informal sector or the needs of the many people whose livelihoods depend on it.

Implications: Closing knowledge gaps on informality is essential to support the achievement of the SDGs and better integrate informal economies in strategies to pursue ISET. In particular, we need to understand how ISET themes interact with informal economies in different contexts. Decision-makers, policy-makers and other practitioners also need to pay more attention to informal economies in the context of ISET strategies. Smallholder agriculture, rural nonfarm and informal urban economies should be targets for action.

Lastly, researchers and practitioners alike should invest time, effort and resources in exploring the data on informality that are already available or could come soon. For example, more could be done now to make

use of readily available ILO labour data. Looking ahead, informal economies need to be included in the metrics used to monitor and evaluate progress on ISET-related goals.

Endnotes

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each dimension of ISET; see **Diwakar et al.** (2023), for a rationale for and caveats to the indicator selection.

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24. Cluster D, moving from a 'broad-dispersed' to a 'narrow-dispersed', then 'narrow-concentrated' political settlement between 2000 and 2020.
25. Mainly in cluster B, sometimes in cluster A, with a 'broad-dispersed' political settlement between 2000 and 2020.
26. Cluster D, moving from a 'broad-dispersed' to 'broad-concentrated' political settlement between 2000 and 2020.
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