

Issues in Employment and Poverty

Discussion Paper

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EMPLOYMENT POLICIES FOR POVERTY REDUCTION

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Preface

If one were to cite one problem which poses a challenge for world leaders, development practitioners (at the global as well as national level), and policy makers alike, it is the stubborn persistence of poverty in many parts of the world. While there has been a slight reduction in the incidence of poverty during the last decade, it needs to be noted that the pace of improvement since 1990 has been too slow to meet international development goals for the year 2015, which call for a reduction in the proportion of people in extreme poverty by half.

It is by now widely accepted that a high rate of economic growth is a necessary (though not sufficient) condition for achieving a sustained reduction in poverty. However, it is also recognized that productive employment is one of the best routes out of poverty. Indeed, countries which attained high rates of employment growth alongside high rates of economic growth are also the ones who succeeded in reducing poverty significantly. It is, therefore, important to understand the mechanisms through which the linkage between economic growth, employment and poverty reduction, works. The purpose of the present paper is to contribute to an understanding of these mechanisms, and to identify policies that could be employed to achieve a faster reduction in poverty through the employment route. The paper does it by undertaking a comparative analysis of the experiences of different regions of the world.

The paper starts by analysing the nexus between growth, employment and poverty and points out situations where high economic growth may fail to bring about a commensurate rate of poverty reduction, unless growth is accompanied by a rapid growth of productive and remunerative employment. It then goes on to enumerate eight employment-related interventions for achieving poverty reduction. This general discussion is followed by an empirical analysis of employment policies for poverty reduction based on the experience of different regions. That analysis provides valuable insights into the types of policies that could be conducive to high rates of economic growth and the creation of poverty-reducing jobs.

Regarding mechanisms through which output growth translates into employment growth and poverty reduction, a few points emerging from the paper may be worth highlighting.

(i) In countries of East and South-East Asia which succeeded in achieving a very significant reduction in poverty, the incentive structure in the market, and institutions did not have many distortions to encourage the use of inappropriate technologies in production, to discourage investment in sectors which are employment-intensive, or to lead to other employment-averse behaviour on the part of employers. That enabled output to be appropriately employment-intensive.

(ii) The countries mentioned above, by and large, adopted policies to endow their labour force with human capital. This enabled the poor to acquire skills needed in rapidly changing labour markets.

(iii) In some countries (e.g., Republic of Korea) conditions were created (through land reforms and other support services) to enable small farmers and landless labourers to convert themselves into productive entrepreneurs. In countries of South-East Asia also, the poor were enabled, in various ways, to convert themselves into micro entrepreneurs.

(iv) Increased labour productivity led to increased demand for wage labour which in turn led to increased employment and/or higher wages. Thus, the poor who depend on wage labour could benefit from the results of high economic growth.

The paper concludes that while growth is a precondition for sustained expansion of productive employment, the two together have always been associated with rapid poverty reduction. It also points out

that in most developing countries the utilization of the poor's capacity to work is also an effective way to raise the rate of economic growth. Thus, appropriate policies in that area can create the virtuous cycle of employment, growth and poverty reduction.

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EMPLOYMENT POLICIES FOR POVERTY REDUCTION

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I Introduction

Poverty is defined in many different ways and using many different standards. The essence of the concept relates to deprivation. Most simply it is measured unidimensionally as shortfall from some minimum acceptable standard of consumption or income. Increasingly, it is being measured multidimensionally as shortfall from minimum acceptable standards of not merely consumption and income, but also of such elements of human capability as health, education, security and empowerment. The reason that the poor are deprived of these minimum indicators of well-being is that they lack resources. World Bank's recent report on attacking poverty² identifies these resources as: (a) *human assets* (e.g., capacity for basic labour, good health and skills); (b) *natural assets* (e.g., land); (c) *physical assets* (e.g., physical capital and access to infrastructure); (d) *financial assets* (e.g., savings and access to credit); and (e) *social assets* (e.g., informal or formal social security and political power).

With the exception of the last element, which can typically protect only a small proportion of population from poverty on a long-term basis and possibly a larger proportion of population for very short periods, all the other elements help avoid poverty by increasing employment and its productivity. Access of the poor to land, physical assets and financial assets helps them overcome poverty not by providing them with entitlement to rent or annuity but by creating for them the opportunity for more intensive and productive employment and for a higher value of the product of their labour.³ Access of the landless to land enables them to employ themselves more intensively and remuneratively. Access of the poor to physical capital and financial capital helps them make productive use of their otherwise underutilized labour resources. Access to infrastructure helps increase the productivity of labour and obtain higher values for the produce of labour. Access to these resources make little sustained contribution to the welfare of the poor except by increasing the intensity and the terms of utilization of their capacity to work.

Informal or formal social insurance is necessary to alleviate poverty on the part of those who have inadequate endowment of labour. These institutions are also necessary to protect population from the worst consequences of short-term emergencies that afflict also those who have adequate endowment of labour. But the proportion of households that suffers from an inadequate endowment of labour is typically small.⁴ In most societies, especially the poor ones, the informal and formal institutions for social security do not have the capacity to protect a high proportion of population from poverty without finding a way of utilizing and enhancing their capacity to work.

It is in this sense that employment is the basic route for escape from poverty. The linkage between employment expansion and poverty reduction, however, has many facets. The poor are helped out of poverty when there is: (a) an increase in wage employment; (b) an increase in real wages due to a rise in demand for labour and/or a rise in the productivity of labour; (c) an increase in the opportunity of the poor to employ themselves; (d) an increase in the productivity of the poor in self employment; and (e) an increase in the terms of exchange of the output of poor's self employment. Employment policy for poverty reduction needs to concern itself with all these different aspects of the linkage between employment and poverty.

II Growth, Employment and Poverty

The linkage between employment and poverty is envisioned as a process in a market economy in which economic growth induces an increase in productive and remunerative employment which leads to a reduction of poverty. The effectiveness of the process in reducing poverty depends on the strength of each link in the process. These links consist of: (i) the rate of growth of the economy; (ii) the output elasticity of demand for labour; and (iii) the ability of the poor members of the labour force to respond to increasing demand for labour, especially for more productive categories of employment. Simultaneous strength of each of these links promotes rapid reduction in poverty while the weakness of any of these links weakens the poverty-reduction effect of the process. In recent history the successful operation of these linkages is best illustrated by the growth of the East Asian countries like the Republic of Korea (hereafter Korea), the Taiwan Province of China (hereafter Taiwan) and city states of Hong Kong and Singapore. Since about the mid 1960s, these countries achieved historically unprecedented rates of growth in their outputs. Economic growth in these countries was accompanied by a high output elasticity of demand for labour. Labour force in these countries came to be endowed with steadily increasing levels of human capital in terms of better health and higher skills. As a result employment increased rapidly and real wages increased roughly at the same rate as per capita output. Rapid economic growth resulted in low and stable inequality in the distribution of income and a dramatic decline in the incidence of absolute poverty. A summary of the experience in these countries is presented in section IV below.

Rapid economic growth is necessary for a high rate of expansion of productive and remunerative employment. Growth in productive employment is limited by the rate of growth in output. Employment growth in excess of the growth rate of output is possible only at the cost of a decline in the productivity of employment which has an adverse effect on the welfare of the poor.⁵ Thus poverty reduction by employment expansion fails in the absence of high enough a rate of economic growth. As discussed in section IV, the persistence of poverty in Sub-Saharan Africa is probably best understood as the very slow rate of the region's growth severely constraining the expansion in productive employment in recent decades.

Can the employment-poverty linkage be made to work without an adequately high rate of growth? It is possible to expand employment without growth; but it is unlikely for such an expansion of employment to entitle those employed with means to overcome poverty. This entitlement is successfully created only if employment is productive, i.e., accompanied by economic growth. Contemporary development experience is full of examples of guaranteeing employment in excess of what is warranted by the growth of output and income. The most extreme example of this consists of the former socialist countries which opted for guaranteed employment as a method of social security, a system in which employment was not determined by the labour demand induced by economic growth in a market economy, but by the use of employment creation as an instrument for guaranteeing livelihood irrespective of the employees' contribution to output. This kind of employment growth had, at best, a weak effect and, at worst, an adverse effect on poverty reduction due to its unfavourable impact on economic efficiency and growth. Less extreme versions of this policy has been practiced by many non-socialist countries as well, especially those with large public employment. As shown below in section IV, a number of developing countries, especially in Latin America, have often expanded employment at a substantially faster rate than output with the ostensible purpose of protecting the workers. In the long run these policies are unsustainable. In pursuing the objective of poverty reduction, absence of economic growth can not be compensated by arbitrary employment expansion.

High economic growth may, however, fail to bring about a commensurate rate of poverty reduction if it is not accompanied by a rapid growth of productive and remunerative employment. Several distinct scenarios, producing this outcome, can be documented from contemporary experience:

1. *Low output elasticity of demand for labour.* Economic growth may have low employment

intensity due to inappropriate economic policies and institutions. Past policies in developing countries, in Latin America and South and South-East Asia among others, often leaned heavily in favour of import-substituting industrialization which created an unduly high incentive for capital-intensive technology due to the artificial cheapening of credit and imported capital equipments. Labour market interventions often aggravated the distortion by emphasizing the protection of the workers employed in the small formal sector at the cost of restricting the growth of formal employment. In countries with concentrated landownership, e.g., the Philippines and Brazil, the intensity of labour use in agriculture has been low due to the widely-observed phenomenon of the inverse relationship between farm size and labour use per hectare and the withholding by large landowners of tracts of land from cultivation for speculative purposes, resulting in the restriction of employment and output in agriculture.⁶ As a consequence of these distorted policies and institutions, employment and wages have grown too slowly to permit a reduction in poverty that is commensurate with the rate of economic growth under appropriate policies and institutions.

2. *Employment impact of high growth offset by the countervailing contraction of employment induced by economic reform under globalization, thereby resulting in a low observed output elasticity of employment.* This phenomenon is characteristic of countries which in the past resorted to artificial employment creation as an instrument of social security and have succeeded in achieving high growth in the age of globalization by gradually abandoning those policies. Rapidly-growing transition economies, like China and Vietnam, represent the most outstanding examples of this case of which numerous non-transition economies also serve as less extreme illustrations. While economic growth may lead to a rapid increase in labour use - as measured by an increase in employment at *constant intensity of work* - the increase in the *headcount* rate of employment may be very low, or even negative, because the process of growth entails reform that results in a reduction of concealed surplus labour employed in public enterprises. The phenomenon can encompass private enterprises as well if the incentive system in the past had discouraged efficiency in the hiring of labour in these enterprises. Once the process of eliminating surplus labour is complete, employment and wages should rise rapidly once again and the transition should ultimately be beneficial to all, including the poor, because of the increased efficiency that it will instill in the economy. But the process of transition is characterized by an increase in the *headcount* rate of unemployment. Since the unemployed face a far greater probability of being poor than the employed, the process has an adverse effect on poverty reduction. As the evidence from many developing countries shows, the process may take decades to complete.

3. *Economic growth could lead to a high rate of growth in employment of a kind for which the poor do not possess necessary skills.* While this phenomenon may have been widely prevalent among developing countries, a clear example of it is the United States in the 1990s. Since the early 1990s the US economy has achieved a high rate of growth which has been highly employment intensive by the standards of the advanced industrial economies. The unemployment rate declined dramatically. The growth in employment, however, was directed much more to highly-skilled workers than to unskilled workers who were dominant among the poor. As a result, real wages increased much faster for the skilled workers than for the unskilled workers. Indeed, median real wage rate in the mid 1990s was lower than what it was two decades before.⁷ The result was a much slower decline in the incidence of poverty than would have been feasible if the poor workers had access to necessary skills. It appears that the same phenomenon has occurred in a number of developing countries where real wages have risen despite the persistence of high unemployment or a rise in the rate of unemployment. The rise in real wages in such cases often appears to reflect a growing inequality in the distribution of wages.⁸

4. Growth might also fail to reduce poverty if the distribution of scarce productive resources - land and physical capital - is highly concentrated. The scarcity of productive assets in this case dictates a very high and increasing share of income for them. Thus a very high, and continuously increasing, share of income would have a highly, and increasingly, unequal distribution. In this case growth would be associated with *immiserizing* employment, the creation and the perpetuation of the *working poor*. Employment would not

lead to an escape from poverty because of its low return. Growth would be associated with increasing inequality and a weak or adverse impact on poverty reduction. Indeed the preceding case may be regarded as a subcategory of this phenomenon, showing the consequences of a skewed distribution of skills. It is likely that the weak and declining impact of growth on poverty reduction in cases like Bangladesh since the mid 1980s was largely due to this phenomenon.⁹

What role does the distribution of income have in the growth-employment-poverty nexus? While there are relatively few instruments for improving the welfare of the poor except by improving the intensity and terms of utilization of their labour resources, there are many policy instruments to change the distribution of income including numerous methods of redistribution of income from one group of non-poor to another. Thus changes in the distribution of income need not be associated with equivalent changes in the welfare of the poor in the same direction. Strongly employment-intensive growth, leading to a high rate of absorption of the poor into productive employment with rapidly rising real wage, should be associated with undiminished or improving equality in the distribution of income, as indeed was the case, discussed later, in several East Asian countries. It is, however, unnecessary for poverty-reducing growth in employment to be associated with undiminished equality in the distribution of income. While economic growth may absolutely benefit the poor by expanding their productive employment, owners of other factors of production - viz., skilled labour, land and capital - may make proportionately greater gains. The result is a reduction of poverty with rising inequality as was the case in countries like Chile and Thailand, discussed later. The increase in inequality must in this case be viewed as a "leakage" that diverts resources from poverty reduction to non-poor beneficiaries. If this leakage is very large, i.e., if inequality increases sharply, it is possible for economic growth to fail to reduce poverty at all. As discussed later, this might have been the case in urban China in the period of its integration with the global economy. This kind of extreme increase in inequality is typically associated with an extreme employment hostility of growth as, shown below, the case of urban China may be interpreted. As long as productive and remunerative employment for the poor continues to rise as a proportion of population it is unlikely for the forces of inequality elsewhere in the economy to make it impossible for absolute poverty to decline. On the other hand, for growth to reduce poverty rapidly, it is essential for much of its benefit to be passed on to the poor in the form of rapidly rising remunerative employment and other methods, resulting in no more than a modest rise in inequality of income distribution.

III Employment Policies for Poverty Reduction

The growth-employment-poverty nexus described above provides a framework for the analysis of employment policies for poverty reduction. Employment-related interventions for the reduction of poverty could be classified under the following sets of policies.

1. *Rapid labour-absorbing growth providing the poor with productive and remunerative employment*. The present paper can at best discuss the rudiments of the policies and circumstances that lead to this outcome. First, the economy must succeed in ensuring a high rate of growth. This calls for comprehensive policies encompassing incentives for domestic capital accumulation and attraction of capital from abroad; policies for effective deployment of investment resources in socially productive activities and industries; and institutions conducive to the pursuit of efficiency. This is the subject matter of the literature on economic growth and development which, though not entirely agreeing about the ingredients of a strategy, have a broad consensus about what works and what does not. It is neither necessary nor feasible for this paper to summarize the consensus.

Growth must also be appropriately employment intensive in the given context of resource endowment. For developing countries this means a high output elasticity of demand for labor. The basic requirement for this is the reflection of resource endowment in the system of incentives guiding economic decisions. Artificial cheapening of capital - characteristic, for example, of the development policy based on

import-substituting industrialization - and the artificial increase in the cost of using labour - due, for example, to inappropriate interventions in the labour market - are some of the major factors that inhibited this process in developing countries. Labour use is also inhibited by inappropriate institutions. As discussed in the preceding section, this is often the case in agrarian systems characterized by highly unequal distribution of land. Different resource endowments of the large and small landowners lead them to use very different amounts of labour per unit of land. Speculation and the wielding of monopsonistic control on the workers can exacerbate the situation by inducing large landowners to keep land uncultivated while the landless and the small landowners are unable to fully employ themselves due to the shortage of land to work on. Industries under the influence of the demonstration effect of multinationals can advance along undesirably capital-intensive expansion paths unless economic incentives act as deterrents. Economic institutions and incentives need to be adjusted to eliminate or reduce these tendencies to make growth appropriately labour intensive.

Macroeconomic policies affect employment of the poor through the influence they exert on the growth performance of the economy. They can also have more *direct* influence on the employment and welfare of the poor members of the labour force. Thus macroeconomic stabilization, retrenching public expenditure, often causes curtailment in direct employment generation through public works programmes; and affects the employability of the poor by reducing public expenditure on basic education and skill development for them. Macroeconomic policies, guiding public revenue and expenditure policies, can affect the productivity of the poor and the terms of trade for the products of the poor's labour. For example, in an agrarian economy characterized by peasant farming and limited inequality in the distribution of land, a rise in the prices of inputs and/or a fall in the prices of outputs, brought about by changes in fiscal policy, can reduce the welfare of the self-employed poor. While imperatives behind macroeconomic policies are complex, their effect on the employment and welfare of the poor should receive due weight in the selection of the combination of such policies.

Appropriate institutions and incentives, complemented by well-developed infrastructure supported by public investment and an enabling system of governance, should normally be enough for the promotion of an adequately high rate of employment-intensive growth. This may, however, need to be supplemented by more direct public intervention for the promotion of employment-intensive growth. Examples of circumstances making this necessary are: periods of adjustment when private enterprise fails to absorb labour in necessary numbers (see 6 below); and the stimulation of growth in regions, with a disproportionately high concentration of the poor, which fail to attract large enough investment under market incentives even when the latter have been subjected to "market-friendly" methods of public intervention. In such cases public investment, e.g., public works programmes for the development of infrastructure in poor regions, can directly contribute to an acceleration of employment-intensive growth. Numerous developing countries have used this instrument to provide employment to the poor. To what extent these programmes have combined the objective of poverty reduction with efficient production of infrastructural capital is a matter of empirical analysis.¹⁰

2. *Conversion of the poor into productive entrepreneurs engaged in self employment.* Growth-induced employment generation, as outlined above, is often perceived as a strategy exogenous to the process of poverty reduction. In contrast, the promotion of self employment among the poor, by converting them into micro entrepreneurs, could be an efficient growth strategy *endogenous* to the process of poverty reduction. Its importance derives from the possibility that growth-induced employment generation may often be an inadequate strategy for poverty reduction even though the output elasticity of employment is reasonably high. This would be the case, discussed above in section II, if productive assets are scarce and distributed very unequally. In this case a small, and decreasing, proportion of output is shared among workers, conceivably leading to a decline in real earnings of the poor workers.

In the rural and subsistence sectors of most low-income developing countries the incidence of

poverty is far higher among smallholders and self-employed categories.¹¹ For these households employment expansion is often a matter of enabling them to attain a more intensive and productive utilization of household labour by improving their access to productive assets. Redistribution of land and/or an improved access of the poor to the use of land under favourable rental/tenancy arrangements is a powerful method of improving the income and welfare of the poor. Other methods are the provision of credit, infrastructure and public services for nonfarm micro enterprise and granting access to education and training that would make the poor more productive as entrepreneurs (see below). Targeted public action is essential for the promotion of the access of the poor to these resources.

Land is the most important of the resources to which the poor's access has a decisive effect on their welfare. Successful implementation of comprehensive land reform was a remarkably effective instrument of combining growth and poverty reduction in then-predominantly-rural Korea and Taiwan and in China during the early years of its reform. Such land reforms have proved impossible to replicate. The realization of their effectiveness in alleviating poverty and the difficulty of their replication has led institutions like the World Bank to seek "market-friendly" methods of redistributing land by inducing large landowners to sell land to the poor whose ability to purchase is augmented by the provision of credit. So far there is scant evidence of success of such policies in providing access to land to large numbers of the poor. The poor rarely possess the market power to gain access to such valuable a resource as land; the targeting of the poor to receive large volumes of credit that are necessary for such transactions is likely to face overwhelming problems of leakage in the direction of the non-poor.

A second instrument of targeted support to enable the poor to productively employ themselves is the provision of credit for micro enterprise. In recent years its appeal has greatly widened, partly due to the frustration arising out of the difficulty of redistributing land and partly due to the apparent success of programmes like the *Grameen Bank* in Bangladesh. The success of this instrument depends on the prevention of its leakage to the non-poor and the combination of credit with complementary resources like technology, skill and market access.

The attraction of activating the labour resources of the poor by the promotion of self-employing micro enterprise also derives from the fact that this is an effective way of pushing outwards the production possibilities of the economy. To the extent that these resources would otherwise have remained unused, poverty reduction in this case acts as what might be considered a *vent for surplus*, i.e., a source of growth in output that does not require resources in a conventional sense but can be achieved by activating productive energies and resources that are latent due to the absence of necessary incentives and institutions.¹²

3. *Increasing the productivity of the poor workers both in wage employment and in self employment.* Increased productivity leads to an increased demand for wage labour which is translated into increased employment or wages or both. Increased productivity of the self employed workers directly raises their income. Increased productivity therefore enhances the prospect of the labor-dependent households to escape poverty. The principal policy to enhance the productivity of the poor is to endow them with greater human capital: skill, education and health. This is another important area of targeted public support to enhance the productivity of employment of the poor. Skill, education and health are of course scarce resources with high productivity. Successful targeting of these resources to the poor, without large-scale leakage to the non-poor, is faced with all the problems that any programmes of redistribution faces in a society with undeveloped institutions of governance.

4. *Improvement and adjustment in the skill composition of the poor members of the society so that they can compete for employment in a labour market in which the skill composition of demand for labour changes rapidly.* This is closely related to, yet distinct from, the preceding policy. Endowing the poor with skills is not an once-for-all process. Their skills must adjust to the changes that skill

composition of demand for labour periodically undergoes. Failure to do so may easily prevent the poor from benefitting from growth-induced increase in demand for labour.

5. *Appropriate terms of exchange for the produce of the poor.* Given the employment productivity of the poor, the higher the terms of trade of their output the easier it is for them to escape from poverty. Ensuring appropriate terms of trade for the products of the micro entrepreneurs and the small farmers is an effective way of alleviating their poverty. For an agriculture *dominated by small peasant farmers*, an improvement in terms of trade is likely to favourably affect the poor because of the greater preponderance of net sellers, than net buyers, of food among the poor. The effect is likely to be the opposite for an agriculture dominated by large farmers, where the latter account for most of the marketed output while the wage-earning agricultural labourers account for most of the net buyers of food. Similarly, poor micro entrepreneurs in non-farm activities are favourably affected by an improvement in the relative price of their outputs to that of their inputs. Improved access of the poor to infrastructure and public services helps them achieve better terms of exchange for their produce.

6. Orderly dismantling of the past systems of inefficient excess employment, especially in state-owned enterprises. For many developing countries, especially the transitional economies, this may be the most important single measure to prevent a declining impact of growth on poverty reduction. Opening up to the global economy forces these countries to abandon their past system of social protection. This leads to large-scale increase in the *headcount rate* of open unemployment even though the aggregate labour use in the economy, measured in units of employment at constant intensity of work, may be rising. In severe cases, as in state and collective enterprises in China, the rate of shedding surplus labour has far outpaced the growth of aggregate labour use so that the number of unemployed, those without an entitlement to income, has increased sharply. To protect the newly-unemployed from poverty either some transparent system of social security (e.g., unemployment insurance) must replace the past concealed system of social security or large-scale public works programmes in productive capital construction be introduced. As already noted above, these are immensely difficult tasks in a period of budgetary retrenchment that reform programmes almost always impose on these countries.

7. *Specially designed employment opportunities for the labour-disadvantaged households.* Not all poor households have the ability to benefit from employment opportunities that economic growth offers in a market economy. Labour resources available in a female-headed and female-labour-intensive household would often be at a disadvantage if labour-intensive economic growth of the usual kind is the principal instrument for poverty reduction. For the benefit of increased labour demand to filter down to these poor families, special opportunities - e.g., subcontracting arrangements linking enterprises in the formal sector with micro and cottage enterprises that facilitate work for these disadvantaged households *in or near their homes* - should be created by appropriate incentives. Similar measures are needed to spread the benefit of increased overall demand for labour to remote and isolated communities.

8. *Caution in the design of labour market interventions in protecting vulnerable workers by ensuring security of employment at living wage.* Concerned policy makers have often felt that in a market economy the workers are at a serious disadvantage relative to the employers in the bargain concerning employment and earning. Those who are subject to these vulnerabilities have often been identified as groups in, or at risk of, poverty. The wish to protect them from these vulnerabilities has often led governments to adopt policies for employment security at regulated wage. Legislation of minimum wages, regulation of conditions of work and rules for termination of employment are examples of such policies. Caution needs to be exercised in the adoption of these measures. Implementing sensible standards of safety in work place and protection for vulnerable workers facing monopsonistic employers in a labour market characterized by gross inequality of power can be effective as instruments for the enhancement of the welfare of the poor. But it is counterproductive and detrimental to the welfare of the poor to allow these interventions to artificially raise the cost of employment to the point of restricting a healthy elasticity of labour

demand with respect to output growth.

Needless to say that comprehensive strategies for poverty reduction include policies in addition to the above. These additional policies are of two categories. The first of the two categories includes the subsidiary policies to facilitate the implementation of the above policies (e.g., providing the poor with an access to efficient public services which helps them succeed as micro entrepreneurs; and quickening the pace of demographic transition which reduces the imbalance between supply of and demand for labour, improves the prospect for increased wages and makes it easier to provide the members of the labour force with human capital¹³). They should be subsumed under the employment policies for poverty reduction. The second category consists of policies that are independent of employment-related interventions for poverty reduction. The most important intervention of this kind is direct income subsidies to the poor including relief in cash and kind (e.g., vulnerable group feeding). This is necessary and effective in improving the welfare of those poor households who do not have an adequate labour endowment. Governments also resort to income redistribution through the regulation of prices, public distribution and subsidies as an instrument to address the problem of poverty. Policy makers have made widespread use of public distribution, pricing policy and subsidies as methods of protecting vulnerable groups of population from poverty. Thus "essential goods" have often been distributed through the public rationing system at low cost. Goods and services used by the poor for consumption and production have been kept cheap through direct and indirect subsidies. While it has been argued that these policies make the real incomes of the poor higher than they would otherwise be, there is wide recognition that targeting these interventions to the poor is extremely difficult; that their benefits are substantially appropriated by the non-poor; and that they distort production incentives to the detriment of economic growth. The consensus seems to be that these interventions do not have an advantage over direct income subsidies to the poor. Even direct income subsidies are subject to limitations as an instrument for poverty reduction: they require budgetary resources that are difficult to find. Their targeting presupposes a degree of administrative capability and honesty which is rare among developing countries. The point of this brief discussion of poverty reduction policies unrelated to employment is to reinforce our argument that there are few effective instruments of poverty reduction that are not concerned with utilizing and improving the poor's capacity to work.

IV An Empirical Analysis of Employment Policies for Poverty Reduction

This section is concerned with an empirical analysis of the arguments made in the preceding sections. It tries to relate the performance in poverty reduction to performance in generating productive employment with reference to actual experience in developing countries with a view to seeking evidence for the arguments made above. It addresses the following questions: Can a clear relationship be established between employment expansion and poverty reduction? How can observed differences in the strength of the relationship between growth and employment expansion on the one hand and poverty reduction on the other be explained? What can one conclude about the effectiveness of different kinds of employment-related interventions for poverty reduction from an analysis of the experience of different developing regions and countries?

For the purpose of this analysis, we require indicators of performance in poverty reduction, growth and employment intensity of growth. Numerical estimates of long-term trends in the incidence of poverty with reference to common yardsticks are available for only a limited number of countries. Even when such estimates are available, they are often subject to controversies. At times it is hard to choose from competing estimates claiming very different outcomes. This paper tries to avoid unnecessary controversy by settling for consensus views on trends even when disagreements prevail about actual changes. Detailed data are

presented in annex tables for regions for which they are less readily available. Trends in poverty are discerned both from estimates based on national poverty thresholds and on World Bank's "internationally comparable" purchasing power parity dollar (PPP\$) poverty threshold. Comparisons of the incidence of poverty between countries are generally based on the latter for which changes in the incidence of poverty are available, for the main developing regions and a limited number of countries, only between the years 1987 and 1998.¹⁴ Measurement of economic growth presents fewer problems and can be represented by the rate of growth in (per capita) GDP or GNP. Employment intensity of growth should be measured by the GDP elasticity of employment: the proportionate change in employment divided by the proportionate change in GDP. It is, however, very difficult to obtain reliable estimates of aggregate employment for the developing countries where, for the large traditional and informal sectors, it is virtually impossible to get reliable estimates of employment at *constant intensity of work*. This section often uses the output elasticity of employment in manufacturing industries, for which these measurements are more accurate and easier to interpret, as the proxy for the employment intensity of growth. Attention is mostly focused on the *change* in the elasticity, which should make this procedure more acceptable than it would otherwise be. One would tend to regard a *fall (rise)* in the output elasticity of employment in manufacturing as a good indicator of a *deterioration (improvement)* in the overall labour intensity of growth. The critical importance of this elasticity, despite the often-small size of manufacturing in total employment, derives from the fact that manufacturing is typically the largest *incremental* source of employment in the earlier phases of transformation of the developing countries. Wherever possible supplementary evidence is provided for the labour intensity of the rest of the economy. Trends in unemployment are also used at times as supplementary evidence on employment performance.

This may also be the place to consider what is the right order of magnitude for the output elasticity of employment. This obviously depends on the level of development and the relative factor endowment of the country concerned. It is expected that the output elasticity of employment would gradually fall as a country becomes more developed and relatively less labour abundant (more labour scarce). Thus the elasticity in Korea is understandably lower for the 1980s than for the 1970s. The desirable level of the elasticity can also be judged by what the countries, with best-practice policies and institutions, achieved at the time of comparable levels of development and relative resource endowment. Thus, one might argue, that Korea's elasticity of 0.7 during the 1970s represents the level that most developing countries should aim at achieving until they attain something like an upper-middle-income status. With an output growth of at least 5 per cent, an elasticity of this order for the economy as a whole should enable a country to achieve an employment growth of at least 3.5 per cent which, with few exceptions, should allow an employment growth in excess of the growth in the labour force. This should complete the so-called "Lewis transition" reasonably quickly once demographic transition proceeds simultaneously.¹⁵ This also permits a healthy growth in labour productivity which, if properly harnessed and distributed in favour of the poor workers, can further help the process of poverty reduction. There is obviously a conflict between a high output elasticity of employment and a rapid growth in labour productivity. The right balance between the two depends on the specific circumstances of a country. In general, a country with a high incidence of poverty and a relative abundance of labour resources, will help its poor more by focusing on a higher elasticity of employment than on a higher growth in labour productivity.

Another way to view this matter is to consider that in an economy with a lot of poverty unemployment and underemployment are widespread and the elasticity of labour supply is very high. The effect of an upward shift in labour productivity in such an economy, bringing about a rise in demand for labour, principally results in an increase in employment rather than an increase in real wages. Initially poverty reduction takes place due mainly to an increase in employment per household, i.e., a reduction in dependency ratio and to a lesser extent due to a rise in real wages per worker. As the process succeeds in reducing unemployment and underemployment, the rise in real wages begins to accelerate. An attempt to artificially accelerate the process of increasing real wages by direct interventions in the labour market can at best succeed in a limited segment of the market, typically the relatively-small modern sector. This kind

of segmentation of the market adversely affects the distribution of earnings among the workers and aggravates the problem of poverty reduction among the workers employed outside the modern sector.

Should the output elasticity of employment be allowed to exceed the numerical value of one, indicating a lower productivity of employment at the margin than on the average? Normally a country should avoid this outcome. But this does not mean that an elasticity greater than one is necessarily a bad thing. A country, initially characterized by an undesirably highly capital-intensive technology with restricted employment, may benefit from a very different composition of incremental output representing a higher rate of growth in employment than in output, signifying a lower, and socially more desirable, capital-intensity at the margin. One, however, needs to be certain that the higher-than-unit elasticity of employment is consistent with efficient labour use.

Finally, the urgency of the drive for a high output elasticity of employment depends on the rate of output growth itself. A country with a high rate of growth can perhaps do with a comparatively lower output elasticity of employment than a country unable to achieve high enough a rate of growth. Below a critical minimum rate of growth of output, the pursuit of a higher output elasticity of employment as an instrument for poverty reduction is futile; attention must be focused on an acceleration of the growth rate itself by policies that make growth *endogenous* to the process of poverty-alleviating employment expansion, i.e., generating a higher output growth by utilizing otherwise redundant labour.

East and South-East Asia (ESEA)

ESEA has been the most rapidly growing region of the world in the second half of the twentieth century averaging an annual growth in GDP of 8 per cent over the last two decades. It is the largest of the regions into which the developing countries are usually classified.¹⁶ It accounts for 31 per cent of world population and 36 per cent of the population in the developing world. This region, however, accounts for only 23 per cent of the poor of the developing world; it is also the region which achieved the highest rate of decline in the incidence of poverty during the last decade according to the World Bank's PPP\$ poverty line. Indeed the number of people in absolute poverty thus measured in this region declined by a third between 1987 and 1998 while the number of poor in the rest of the developing world during the same period increased by a fifth. ESEA is thus the region that has achieved the fastest rate of growth and the most rapid reduction in the incidence of poverty in recent times. An understanding of the factors contributing to a successful poverty reduction must necessarily focus on the experience of this region.¹⁷

The experience in poverty reduction in the region has, however, not been uniform. Four distinct types of experience characterize the countries included in the case studies: (a) Korea, representing the four original "East Asian pioneers" (the other three being Taiwan, Hong Kong and Singapore); (b) China; (c) Indonesia, Malaysia and Thailand, the three later imitators of the original East Asian pioneers; and (d) the Philippines, a case of poor performance in poverty reduction by East Asian standards.¹⁸

Korea

In many ways the Korean case represents the broad features of the general experience of the four East Asian pioneers.¹⁹ During the last three decades of the twentieth century the country achieved an annual average growth in GDP of more than 8 per cent. A quick and early demographic transition enabled the country to convert much of this gain into increase in per capita income. Economic growth was highly labour intensive, as illustrated by the high output elasticity of employment in manufacturing, which was 0.69 during the 1970s and declined only to 0.49 during the 1980s when the country was left with little "surplus" labour. (The output elasticity of employment fell further to 0.28 since 1992 when Korea had become a labour scarce economy.) The result of high growth and high employment elasticity in the early phase of

development was not only a rapid rate of employment growth and a structural change in the composition of employment away from agriculture in favour of industries and services, but also an unprecedented rate of increase in real earnings of labour (as illustrated by the growth rate in manufacturing earnings which was faster than the growth rate in per capita income). Rapid growth in employment and wages brought about a sharp reduction in the incidence of absolute poverty. According to World Bank estimates, less than 2 per cent of population of Korea fell into the category of poor in 1998. Rapid growth over more than three decades was associated with undiminished and high equality in the distribution of income.²⁰

The case resembles the classic vision of a high rate of growth-induced expansion in employment, combined with a high growth in the productivity and earnings of workers, acting as the principal instrument for poverty reduction. There being few distortions in incentives and institutions favouring inappropriate techniques of production and employment-averse behaviour on the part of the employers, high economic growth was translated into a high rate of employment expansion at rapidly growing real wage. Early demographic transition helped accelerate the process.

It was, however, much more than a case of poverty reduction due to growth-induced employment expansion in a market operating under conditions of *laissez faire*. There were numerous employment-related policy interventions for poverty reduction in addition to the overall strategy of promoting a high rate of employment-intensive growth. Early in the growth process a thorough redistribution of land enabled the small farmers and the previously landless workers to convert themselves into productive agricultural entrepreneurs, a process that received a further positive impetus from the policy of ensuring a favourable terms of trade for them and granting them access to the benefits of publicly funded research in improved technology, public provision of infrastructure and public services.

Table 1: Average Annual Percent Growth Rates in Output, Employment, Earnings, Productivity and Output Elasticity of Employment in Manufacturing in Selected ESEA Countries

Country	Real Value Added			Employment			Real Earnings		
	71-80	81-92	92-97	71-80	81-92	92-97	71-80	81-92	92-97
Korea	16.71	11.93	8.11	11.61	5.80	2.30	10.56	8.05	5.44
Indonesia	14.56	12.09	10.35	6.49	11.19	2.55	4.30	4.72	7.87
Malaysia	11.48	10.62	12.81	10.28	4.22	3.05	2.61	2.11	4.35
Thailand	10.28	10.22	8.18	6.87	5.42	1.80	0.16	6.19	3.01
Philippines	5.93	0.90	4.47	11.13	-0.45	2.81	-3.34	5.88	-0.86
Country	Labour Productivity		Output Elasticity of Employment						
	71-80	81-92	71-80		81-92	92-97			
Korea	5.10	6.13	0.69		0.49	0.28			

Indonesia	8.07	0.90	0.45	0.93	0.25
Malaysia	1.20	6.40	0.90	0.40	0.24
Thailand	3.41	4.79	0.67	0.53	0.22
Philippines	-5.19	1.34	1.88	-0.50	0.63

Notes: Output elasticity of employment is the ratio of employment growth to growth in value added. Estimates are based on UNIDO data. For 71-80 and 81-92 the data are from Table 6.11 in A. R. Khan and M. Muqtada (eds), *Employment Expansion and Macroeconomic Stability Under Increasing Globalization*, ILO Studies Series, Macmillan, London, 1997. This paper has updated these estimates for the period 92-97 by adopting the same method as in the above source to the extent it could be ascertained. The estimates are growth rates between end points and the data are from the following sources: employment: UNIDO; value added: UNIDO current price value added deflated by the implicit deflator for manufacturing value added in World Bank, *WDI 2000*; real earnings: ILO, *Key Indicators of the Labour Market 1999*. For real earnings for the last period terminal year is 1996 for Indonesia, and 1995 for Malaysia and the Philippines.

Redistributive policies to promote productive entrepreneurship among the poor featured prominently in other East Asian pioneers as well. Taiwan implemented a highly egalitarian land reform. Singapore and Hong Kong, being city states, avoided the need for land reforms. These countries, however, went for an egalitarian distribution of housing, perhaps the most important asset in these societies, through public housing programs. While South Korean industrialization was by and large promoted by large-scale enterprises, subcontracting with small and cottage producers was practiced widely especially in later years. Elsewhere in the region, notably in Taiwan, industrialization itself was largely accounted for by the growth of small-scale enterprises. Another important employment-related policy that helped poverty reduction was large public investment in improving the human capital endowment of workers. Very early implementation of universal primary education was quickly followed by widespread access to secondary education and the removal of gender disparity in access to basic education. Easy access to skill acquisition has been instrumental in bringing about massive shifts in the occupational structure, which facilitated the change in the pattern of production and trade that was frequently warranted by rapid growth, without impairing the welfare of the poor.

It thus appears that the remarkable success of Korea, and the other three East Asian pioneers, was due to a strategy that incorporated the first five of the eight employment-related policies identified in the preceding section. These countries do not appear to have needed the remaining three policies: they did not face a significant problem of initial inefficiency in the form of excess employment in public enterprises. In these countries the share of the public sector in total employment has generally been small and employment and wages in the public sector has not been far divorced from market rules. They all appear to have avoided using labour market interventions in the form of minimum wages and the regulation of conditions of employment during the early phase of their development. Indeed there was little need for these instruments in the context of rapidly growing employment and real wage.²¹ Indeed Korea's labour laws inherited a provision which made it virtually impossible for enterprises to terminate employment. There is, however, little evidence that this law prevented drastic restructuring of employment that was periodically required by the process of structural transformation. The extraordinarily high rates of growth in employment and wages made voluntary restructuring possible.

Indonesia, Malaysia and Thailand

These countries gradually adopted the development strategy of the four East Asian pioneers during the late 1970s and the early 1980s. Like the East Asian pioneers they succeeded in achieving high rates of

growth with an emphasis on the efficiency of resource use. The incentive structure on the whole favoured rapid labour absorption. These countries generally supported small-scale enterprises by avoiding the disincentive that these enterprises are subjected to, relative to the large-scale enterprises, in much of the developing world. Their performance in endowing the members of the labour force with human capital was also good. They have generally exercised caution in the use of labour market interventions. Public employment, as a proportion of total employment, has been limited. There has been little attempt to regulate the conditions of employment and its termination in the private sector. Minimum wage legislations have either been non-existent or set wages at a sufficiently low level so that their effect was to protect the very vulnerable groups of workers rather than to affect the overall level and structure of wages. They all achieved rapid demographic transition which made it easier to absorb the growth in labour supply into productive employment.

However, these countries differed from the East Asian pioneers in so far as their development policy has not been characterized by major redistributive programmes. Malaysia resorted to some redistribution of assets although the emphasis was on the disadvantaged *ethnic* group. Indonesia's agriculture was characterized by peasant landownership with limited inequality. Although land reform was avoided, public policy in Indonesia strongly emphasized investment targeted to benefit the smallholders and favourable terms of trade for agriculture. Thailand avoided land reform and, until the recent past, imposed an unfavourable terms of trade on agriculture by discriminatory trade policy. Urban/rural inequality in Thailand has remained very large and Thailand's record with respect to the *change in inequality* in the distribution of income is the worst among the countries in the group.

By and large, these countries were able to achieve an appropriate linkage among growth, employment generation and poverty reduction although, as shown in Table 1, the linkage was not always as powerful as that in the case of the East Asian pioneers. Nevertheless the demand for labor increased rapidly in these countries until the early 1990s, resulting in the steady growth in employment and real wages. All the three countries experienced rapid reduction in the incidence of poverty in the decades preceding the crisis of 1997.

In the early 1990s the output elasticity of employment in these countries declined sharply. It is hard to argue that during this period these countries experienced a significant tightening of the labour market. Indeed both Indonesia and Thailand still bore the marks of comparative labour abundance. And yet industries in these countries became less labour absorbing than industries in Korea which became a relatively labour-scarce country in this period.

The financial crisis of 1997 appears to have reversed the trend of poverty reduction rather seriously in Indonesia, significantly in Thailand and modestly in Malaysia. The crisis has also raised issues about the resilience of the growth process itself in these countries, especially in Indonesia and Thailand.

China

Available estimates about levels and trends in poverty in China are often in conflict with one another. There, however, seems to be a broad agreement among various sources about the following two propositions: (a) China achieved a remarkably rapid reduction in poverty in the years after it embarked on economic reforms; (b) since about the mid 1980s the rate of poverty reduction drastically slowed down. A detailed World Bank study estimated that the proportion of rural population in poverty in China declined

by two-thirds between 1978 and 1984 and showed no further decline for the decade of the 1980s thereafter. It also found a similar break in trend in the incidence of urban poverty in the year 1984. A study based on carefully designed household surveys for 1988 and 1995 shows that the rate of reduction in rural poverty between the two years was far slower than the rate at which rural poverty is generally estimated to have declined before the mid 1980s. The study finds that between the two years urban poverty did not decrease at all and, arguably, went up. It also estimates that inequality in the distribution of income increased very sharply over the period. China's economy achieved a historically unprecedented growth during the entire post-reform period with a slight acceleration in the rate of growth since the mid 1980s. The evidence on the break in trend in China's performance in poverty reduction suggests a major shift in China's development policy around that date.²²

China's remarkable growth in the immediate post reform period was led by growth in agriculture. This was based on an egalitarian access of the rural households to land; a sharp and steady improvement in agriculture's terms of trade; and the liberalization of the rural economy including encouragement for entrepreneurship in nonfarm activities. This led to a sharp increase in the productivity and earning of rural population who accounted for an overwhelming proportion of China's poor. The urban economy benefitted from the backward linkage of rural growth. The *observed* output elasticity of employment in urban areas was reasonably, though not remarkably, high. During this period, China's state and collective enterprises continued the policy of supporting excess employment as a concealed method of social protection. China had a decent record of human capital endowment of the labour force. Thus there was a combination of the first five of the policies listed in the preceding section while the need for the sixth policy - viz., an *orderly* dismantling of the past systems of inefficient excess employment - had not yet arisen. The result was a remarkable increase in income of the poor, especially those in the rural economy, based on the productive use of their labour.

Table 2: Annual Percent Growth in Value-Added, Employment, Real Wages in Manufacturing and Output Elasticity of Employment in Manufacturing in China

Time Period	Value Added	Employment	Real Wages	Output Elasticity Of Employment
1978-80	10.6	5.2	8.0	0.49
1980-85	9.9	4.7	4.5	0.47
1985-90	9.2	3.1	2.8	0.34
1990-95	17.7	2.6	7.8	0.15
1995-99	10.3	-4.6	8.3	-0.45

Source: National Bureau of Statistics, *China Statistical Yearbook 2000*, China Statistical Press, Beijing, 2000.

Note: Growth rates are annual compound rates between end points. Real wages have been estimated by deflating nominal wages by the urban consumer price index. Output elasticity of employment is the ratio of growth rate in employment to growth rate in value added.

Since the middle of the 1980s the focus of China's development policy changed from rural development to industrialization, led by exports, within the overall strategy of a rapid integration with the global economy. Public resources for agriculture declined. The improvement in agriculture's terms of trade was halted and, for a period, reversed. As a result, the rate of improvement in the welfare of the rural poor sharply slowed down. But the most serious failure of the growth-employment-poverty linkage took place

in the urban economy. As China opened up to private and foreign investment, its vast state and collective enterprises were forced to begin reducing the concealed surplus labour that they had carried in the past in order to regain a semblance of competitiveness. The result was a sharp fall in the *observed* output elasticity of employment in industries: it fell to 0.34 after 1985 and to a dismal 0.15 after 1990. Since 1995 employment in manufacturing has contracted rapidly, resulting in a highly negative output elasticity of employment. The contrast with Korea, with an elasticity of employment of nearly 0.7 during the comparable phase of development, is obvious.

How might one explain the paradox that industrialization based on the expansion of labour-intensive exports during the era of globalization resulted in such a slow - and negative since 1995 - growth in employment? It is particularly intriguing that this happened in spite of the fact that empirical studies show that the growth of China's manufactured exports was concentrated in labour-intensive products.²³ The explanation of the paradox lies in the initial conditions of manufacturing industries. The system of incentives prevailing in the period before accelerated globalization permitted an absorption of labour far in excess of requirement in the overwhelmingly dominant state and collective sector. Economic reform for integration with the globalizing world economy made it increasingly difficult to continue with this system of concealed social protection. Thus a process of shedding the concealed surplus labour began. The observed low output elasticity of employment hides the fact that it represents the sum of two effects: (a) a fairly high output elasticity of employment measured at constant intensity of employment per worker; and (b) a rise in the intensity of employment per worker due to a reduction of concealed unemployment in industries. It is possible to argue that reforms leading to globalization should not be blamed for the slow growth of employment in industries. Industrial employment, measured at constant intensity of employment per worker, has increased quite rapidly but this has been outweighed by the contraction in employment brought about by the reduction in concealed surplus labour in public sector industries. Once the process of shedding surplus labour is completed, industries will become more efficient. Indeed a continuation of concealed unemployment in industries is an inefficient method of protecting workers. A proper method of protecting surplus industrial workers is to institute either a formal system of unemployment insurance or sufficiently large public works programmes during the transition period. China found it very hard to pursue either of these alternatives in an environment of macroeconomic policies emphasizing fiscal retrenchment. The problem is that poverty reduction depends on the growth of the headcount rate of employment which, in these cases, was very slow and, since 1995, negative.

Inappropriate labour market interventions, e.g., the strict rationing of urban employment and the exclusion of the floating migrants from the urban labour market, further exacerbated the inequity in the labour market. No doubt the poor performance of China in poverty reduction since the mid 1980s was aggravated by many other factors: the regional concentration of development in the rich provinces in the age of globalization, the strongly disequalizing change in the distribution of public subsidies and the weakening of public services for the poor. But much of the explanation of the phenomenon lies in the failure of the employment link in the process of converting growth into benefit for the poor. In terms of the policy interventions listed in the preceding section, China failed to implement policies 5 and 6 and allowed inappropriate interventions in policy area 8.

It is useful to note that real wages in manufacturing continued to rise in the period of rapidly-growing unemployment. It is difficult to judge how this came about. Conceivably this could have been due to the replacement of the large number of previously underemployed workers by fewer workers with greater skill and higher productivity. But it is more likely that this was due to a regulated market for employment in state and collective enterprises from which the floating migrants were excluded. The result was a greater inequality between the employed urban workers and the rest. Be that as it may, the phenomenon demonstrates that rising real wages is a favourable factor for poverty reduction only when it is a part of a process of increasing labour demand in a well-functioning labour market. It is not a good indicator of the welfare of the poor when it is artificially buttressed by arbitrary regulations in a situation of falling demand.

for labour.

It may be useful to note that the failure of the employment linkage during reform in the age of globalization can be observed in the other major transition economy in the region. In Vietnam the annual growth in employment in industries (including construction) during 1991-95 was 1.6 per cent while output in those sectors increased at an annual rate of 13.8 per cent, yielding a dismally low output elasticity of employment of 0.12.²⁴

The Philippines

The Philippines stands out as an exception to the other major ESEA countries in that it failed to achieve a high rate of growth, thereby failing to fulfill the basic condition of poverty reduction through growth-induced employment generation. As Table 1 shows, Philippines' employment performance was erratic and enigmatic: during the 1970s it expanded employment far in excess of output growth and during the 1980s it experienced a negative output elasticity of employment. Since 1992 the output elasticity of employment has been quite reasonably high except that the *growth in employment* itself remained quite low. While a distorted system of incentives and the dominance of oligopolies in industries prevented the growth of output and employment, in agriculture a highly unequal distribution of land encouraged speculative non-use of land and restriction of employment. The poverty reduction process was further hampered by a slow rate of demographic transition which created a large imbalance between the supply of and the demand for labour and made the task of imparting human capital to the labour force difficult. The performance on poverty reduction was highly unsatisfactory.²⁵

South Asia

South Asia - overwhelmingly dominated by five major countries, viz., Bangladesh, India, Nepal, Pakistan and Sri Lanka - accounts for 22 per cent of world population and 26 per cent of the population of the developing world. They, however, account for a staggering 45 per cent of the developing world's poor in 1998 according to the World Bank's PPP\$ poverty line. Between 1987 and 1998 this region experienced the largest *absolute* increase in the number of poor of all developing regions. The *percentage* increase in the poor was, however, lower than that in all the other three regions (Latin America and the Caribbean; Sub-Saharan Africa; and Europe and Central Asia) in which poverty increased according to World Bank estimates. These estimates also show that the proportion of population in poverty actually decreased from 45 per cent in 1987 to 40 per cent in 1998.

South Asia has achieved relatively steady, if unspectacular, growth in recent decades. Since the 1970s the growth rate in GDP has steadily accelerated in all countries with the exception of Pakistan. India's growth rate has increased substantially and, if the current growth rate is sustained, India might soon be said to have made a qualitative transition to a higher growth trajectory than what it experienced in the past. The acceleration in growth in Bangladesh, Nepal and Sri Lanka has been modest. In all these four countries the steady decline in the rate of population growth has served as an independent element in the improvement of their living standard; the growth rate in *per capita* GDP in all these countries rose substantially faster than the growth rate in GDP. Pakistan is the only country in the region which has experienced a reduction in the rate of per capita GDP growth: since the late 1980s its per capita GDP growth rate has been less than half of what it was in the decade before. Belatedly, the demographic transition has started to reduce the rate of increase in the labour force.

The accelerated growth in per capita GDP should have enabled Bangladesh, India, Nepal and Sri Lanka to achieve a faster rate of poverty reduction in the late 1980s and the 1990s than before. Even Pakistan should have achieved a reduction in the incidence of poverty if only at a slower rate than before.

Available evidence, though sometimes controversial, does not suggest that this has happened. In Bangladesh the rate of poverty reduction dramatically declined since the mid 1980s, particularly in rural areas where most people live.²⁶ In India there is an intense controversy on the question of whether poverty reduction has just slowed down or been reversed in recent years. There, however, appears to be little disagreement that it has at best slowed down substantially. Careful recent studies suggest that the rate of reduction in poverty since the early 1980s has been rather slow with virtually no change in the proportion of population in poverty between the late 1980s and the mid 1990s.²⁷ In Pakistan the incidence of poverty is estimated to have increased since the late 1980s.²⁸ There are many reasons for this perverse outcome resulting in the failure of higher growth to be transmitted to an equivalently higher rate of poverty reduction. One factor that needs to be noted is the extreme employment hostility of growth in these countries since the 1980s.

Table 3: Growth and Employment Elasticity in South Asia

	GDP Growth Rate (% per year)			Output Elasticity of Manufacturing Employment		
	1965-80	1980-90	1990-98	1971-80	1981-90	1991-98
Bangladesh	4.2 (75-80)	4.3	4.7	0.165*	0.637*	0.390*
India	3.8	5.8	6.1	0.463*	0.272*	0.234
Nepal	2.3	4.6	5.0	0.004*	0.213*	0.266
Pakistan	5.2	6.3	4.2	0.516*	0.399*	0.615*
Sri Lanka	4.0	4.6	5.0	0.796*	0.369*	0.268

Note: Growth rates are based on the data shown in World Bank, *WDI* and *WDR* (various issues) except for Bangladesh for which national data have been used. The estimation of the output elasticity of employment has been explained in the Annex. Asterisks follow the estimates that are significant at least at 95 per cent level. This is more fully explained in the Annex.

Evidence on output elasticity of employment in manufacturing is shown for each of the last three decades. Two important points emerge:

(a) With only minor exceptions, these countries failed to achieve a high degree of labour intensity in manufacturing throughout the period under review. All these countries are vastly more labour abundant than Korea was during the 1970s. And yet none of them ever approached the elasticity that Korean industries achieved at that time. The elasticities for Sri Lanka for the 1970s, for Bangladesh for the 1980s and for Pakistan for the 1990s are the only exceptions. Sri Lanka's high elasticity only highlights the opportunity that the country and the region has failed to take advantage of during the last two decades. The

Bangladesh estimate for the 1980s perhaps reflects the well-known phenomenon of concealed unemployment in public sector enterprises that the country has since been struggling to get rid of. The relatively high estimate for Pakistan during the 1990s almost certainly represents the lag in the response in the adjustment in employment during a period of sharply falling growth in output.

(b) In all these countries, except Pakistan, the elasticity has been dismally low during the 1990s, a period of widespread reform in the system of incentives and rapid integration with the global economy. For India, Bangladesh and Sri Lanka the elasticity declined during the 1990s from the already low levels of the 1980s. For Nepal the estimate was extremely low by any absolute standard. Even for Pakistan the relatively high value of the elasticity during the 1990s needs to be seen in the context of low growth in employment due to the drastically lower rate of growth. The average value of the elasticity during the 1990s reflects an employment-hostile pattern of growth for the region.

The decline in the labour intensity of industries in the post-globalization period can not be explained with reference to distorted incentives affecting the choice of techniques alone because these incentives generally improved in this period. It appears that these countries were also faced with the kind of phenomenon that afflicted China in the form of excess employment in manufacturing. Economic reforms and privatization to ensure competitiveness in the process of increasing integration with the global economy must have led these countries to reduce the concealed unemployment in industries, thereby making the *observed* output elasticity of employment so very low.²⁹

Low employment intensity of industrial growth meant declining real wages in those countries in the region for which information is available. Real manufacturing wages declined between 1990 and 1995 in both India and Pakistan by 25 per cent.³⁰

In Bangladesh the poor performance in poverty reduction was largely a rural phenomenon. It was due to a period of agricultural stagnation which reduced the growth of productive employment in the rural economy. As noted earlier, real wages in agriculture fell by more than 16 per cent between fiscal year 1985/86 and the second half of calendar year 1998. This demonstrates how the working poor can face increasing immiserization in case the concentration of ownership of land and other assets leads to a rising share of incremental output being distributed among non-labour factors of production. The relatively better urban poverty performance in Bangladesh was at least partly due to the expansion of employment in export-based garment industry although traditional industries, mostly in the public sector until recently, faced the same problem of adjustment for excess employment that other countries faced.

The failure of the growth-employment-poverty linkage in the region must have been due to a broader failure of policies for the promotion of productive and remunerative employment as outlined in the preceding section. The region's performance in the redistribution of land and the widening of the access to productive resources for the promotion of self-employment and microenterprise has been very poor.³¹ The region's record in endowing the poor with human capital has also not been particularly good (Sri Lanka being an exception). Furthermore, it has been alleged that the region's inappropriate interventions in the labour market exacerbated the problem of employment expansion. Regulations of conditions of employment, termination of employment and the level and structure of wages were effective only in the modern sector of the economy. These measures at best succeeded in creating small islands of protected high-cost employment and generally contributed to the low elasticity of labor demand.

Sub-Saharan Africa

Sub-Saharan Africa has 13 per cent of the population of the developing world and, according to the World Bank's PPP\$ poverty line, 24 per cent of the poor of the developing world. The number of poor

in SSA, thus measured, increased by a third between 1987 and 1998. It is the developing region with the highest proportion (46 per cent) of population in poverty.

In terms of our framework, the overwhelming reason for SSA's failure to prevent a rise in poverty was its failure to achieve growth.³² This is demonstrated by the contrast between those few countries which achieved reasonable growth and those failed to do so.

Ethiopia, Ghana and Uganda are three countries which achieved reasonable growth in the 1990s. They all succeeded in reducing the incidence of absolute poverty quite substantially. Cote d'Ivoire also achieved similar, though less convincing, an outcome. They were helped in this by high labour intensity of growth especially in agriculture. This is particularly well documented for Ethiopia and Uganda. An important fact about their poverty-reducing growth was that it was based on a wide access to productive work. In each of these countries nearly 90 per cent of the workers are principally employed in agriculture.³³ The key to livelihood for these workers was access to the critical complementary factor of production, land. In Ethiopia the distribution of land is quite equitable by the standard of the LDCs.³⁴ The land reform of the 1970s finally brought its benefits to the poor peasant households as the oppressive and coercive villagization, collectivization and unfavourable compulsory procurement, resorted to by the Derg regime, were finally abolished in the early 1990s. In Uganda the formal distribution of land is less equal; but approximately 97 per cent of the rural households have access to land use; and land rent, under the existing system of tenancy, is very low.³⁵ Thus the distribution of income in the rural economy was relatively equitable. While the equality of the distribution of farm income was assured by widespread and equitable access to land, the equality of the distribution of this primary source of income led to the equity of the distribution of non-farm income growth that it induced. Restoration of peace and comparative security by itself was a major boost to rural incentives. This was supplemented by the abolition of compulsory procurement at unfavourable prices, as in Ethiopia, and other discriminatory practices prevalent in the past. Ghana and Cote d'Ivoire also had very rapid growth of agriculture during the 1990s.

Table 4: Economic Growth, Employment Growth in Manufacturing and the Output Elasticities of Employment in selected African countries, 1980-99

	GDP Growth Rate (%)		Output Elasticity of Employment in Manufacturing	
	1980-90	1990-99	1980-90	1991-98
Countries in which Poverty Declined in the 1990s				
Ethiopia	1.1	4.8	-0.001	0.108*
Ghana	3.0	4.3	0.368*	0.433*
Uganda	2.9	7.2	0.211*	0.236
Cote d'Ivoire	0.7	3.7	0.466*	0.574*
Countries in which Poverty Increased or Remained Undiminished in the 1990s				
Burkina Faso	3.6	3.8	0.688*	0.421
Kenya	4.2	2.2	0.756*	1.401*
Mauritania	1.8	4.1	-0.486	-0.324

Nigeria	1.6	2.4	0.040	1.241*
South Africa	1.0	1.9	1.306*	0.850
Tanzania	-	3.1	-	2.670
Zambia	1.0	1.0	0.460	-0.115*
Zimbabwe	3.6	2.4	0.925	-0.546*

Sources: The growth rates are from World Bank, 2000.. Output elasticity of employment for Tanzania is taken from Rizwanul Islam and Jean Majeres, 2001. For the other estimates of the elasticity the method and data sources have been explained in the Annex. Asterisks follow the estimates that are significant at least at 95 per cent level (see the Annex for a fuller explanation).

Note: For Mauritania poverty increased according to the international poverty line and decreased according to domestic poverty lines. For Kenya, South Africa and Tanzania poverty estimates are not available. For Kenya and South Africa per capita income have declined in the 1990s and there are indirect evidences to support the hypothesis of increasing poverty. Poverty figures are shown in Annex Table 1.

Non-agricultural sectors, relatively small in absolute size, experienced very rapid growth. Not a great deal is documented about these sectors. The output elasticity of employment in manufacturing for Ethiopia remained dismally low during the 1990s although higher than during the 1980s. This probably indicates the adjustment for the past years of arbitrary growth of employment in industries which were almost entirely in the public sector. For Uganda the absolute rate of growth of manufacturing employment was high and the low elasticity of employment was a reflection of an extremely high rate of output growth which probably created an opportunity to productively absorb the excess employment created in the past. In Ghana and Cote d'Ivoire the elasticity increased during the 1990s and approached a healthy absolute level. It appears that the output elasticity of employment in manufacturing in these countries during the 1990s reflects the beginning of a process of adjustment for the arbitrary expansion of employment in state-owned enterprises in the past. These countries have also started directing resources to an improvement of human capital, especially by targeting a reduction of AIDS which affects members of the labour force in their prime. In contrast to these favourable examples stand the experiences of Kenya, Nigeria, South Africa, Zambia and Zimbabwe where the absence of robust growth was the principal cause of the increasing or non-diminishing incidence of poverty. These countries also had arbitrary employment growth in industries, unrelated to efficient labour demand dictated by growth in output. This is reflected in employment elasticities greater than one for Nigeria and Kenya and negative elasticities for Zambia and Zimbabwe during the 1990s. As discussed earlier, employment expansion without growth can not be a sustainable basis for poverty reduction. South Africa suffered from the same phenomenon during the 1980s.

Tanzania, Mauritania and Burkina Faso also achieved moderate growth during the 1990s. Mauritania's decent *overall* growth clearly failed to create the right linkage for employment growth; it's manufacturing industries rapidly expanded employment despite negative growth in output. Tanzania and Burkina Faso attained only modest overall growth. In Tanzania, fairly rapid growth in manufacturing employment was based on a very slow output growth. Burkina Faso experienced too slow a rate of growth in manufacturing employment.

The failure of the employment linkage in the SSA region was exacerbated by the unfavourable supply side conditions because of the absence of a demographic transition. The annual rate of population growth during the last two decades of the twentieth century was 2.8 per cent for the region as a whole as compared to an average of 1.9 per cent for all low-income countries.³⁶ The supply side problem was further aggravated by the high incidence of AIDS which had a disproportionately large impact on the most productive age group of the labour force and thereby contributed to a worsening of the dependency ratio.

Latin America and the Caribbean (LAC)

Latin America and the Caribbean has a PPP\$ per capita income which is almost twice as high as that of ESEA. And yet the proportion of population in absolute poverty, as measured by the World Bank's PPP\$ poverty line, is slightly higher in LAC than in ESEA due to the much greater inequality of the distribution of income in the region. According to World Bank's PPP\$ poverty threshold, LAC has just under 7 per cent of the developing world's poor as compared to 10 per cent of the developing world's population. Between 1987 and 1998 the number of people in poverty increased by 23 per cent. As a proportion of population, the poor in Latin America remained virtually unchanged, 15.3 per cent in 1987 and 15.6 per cent in 1998.

Table 5: Output Elasticity of Employment in Manufacturing Industries in Major Latin American Countries

	1971-80	1981-90	1991-98
Argentina	0.441	-0.168	0.503*
Brazil	0.394*	0.739*	0.498
Mexico	0.635*	0.898	0.580

Note: See the Annex for method and data source for the estimates. Asterisks indicate that the coefficients are significant at 95 per cent level (see the Annex for further explanation).

Estimates of poverty made by CEPAL, based on national poverty lines related to basic consumption bundles, show that the incidence of poverty - the weighted average proportion of population in poverty for eight major countries: Brazil, Chile, Colombia, Costa Rica, Honduras, Mexico, Peru and Venezuela - (i) declined in the period before 1980; (ii) increased during the 1980s; and (iii) declined during the 1990s. If Brazil is excluded, CEPAL estimates show no decline in the proportion of population in poverty in the aggregate of the remaining seven countries between 1990 and 1997.³⁷

In the decades before 1980 Latin America had a very high rate of growth in per capita income: 4.6 per cent in the eight years before the first oil shock and 2.4 per cent between the first oil shock and 1980. CEPAL estimates show that the incidence of poverty declined relatively modestly during this period, from 43 per cent of population in 1970 to 38 per cent in 1980 for the eight countries (see Annex Table 2). The rapid growth that the region experienced before 1980 might have led to a faster rate of poverty reduction if growth was more employment friendly. As Table 5 shows, the output elasticities of employment in Brazil and Argentina were very low in this period. The incentive system underlying the strategy of import substitution, adopted by all the countries except Peru, was not conducive to a high demand for labour. Inequality in the distribution of land, and the consequent obstacles to the development of small-peasant farming, reduced the rate of labour absorption in agriculture. The relatively low and slowly-growing access to human capital, and the resulting low and slowly-rising productivity of labour, contributed to both a low demand for wage labour and a slow growth of productive self employment. Despite these adverse factors, considerable productive employment was generated to make it possible for a steadily increasing proportion of the labour force to be pulled into employment in the relatively highly paying modern sector. Employment growth served as the main link between output growth and poverty reduction.³⁸

This linkage was broken during the 1980s when per capita income in the region *fell* by one per cent per year. Among the major countries, per capita income fell in Argentina, Brazil, Mexico and Peru making it impossible for the growth-employment-poverty reduction linkage to function. Argentina expanded employment in industries despite falling output, thereby attaining a negative elasticity of employment. Real wages fell in Argentina and Brazil while in Mexico it fell for most of the period while recovering since 1988, a phenomenon that was almost certainly a reflection of rising wage inequality due to a rise in the wages of skilled workers. In Peru, employment in manufacturing remained unchanged over the decade while real wages in manufacturing showed a steady rise which would be considered a perverse and unsustainable phenomenon but for the possibility that this was due to a break in the composition of data.³⁹ Among the major countries of the region only Colombia and Chile experienced significant growth in per capita income during this lost decade. But in Colombia employment failed to rise, as is indicated by a level of manufacturing employment in 1990 that was lower than that in 1980. Chile was the only country with a healthy growth of industrial output inducing a rapid growth in employment. Indeed, the growth in employment in manufacturing was a bit faster than the growth in output, perhaps signifying that growth of industrial output was concentrated in sectors and products with more than average labour intensity. Real wages fell initially - an evidence that is consistent with high labour intensity at the margin - and increased later to record a rise over the decade as a whole. For Latin America as a whole, the rise in poverty during the decade largely reflects the failure of employment to rise due to the stagnation of the economy. CEPAL evidence for Chile, where the growth-employment linkage operated satisfactorily, is available only for the period after 1987 when poverty shows a decline.⁴⁰

The 1990s witnessed a restoration of economic growth in most Latin American countries. Per capita income growth in the major countries has increased over what it was during the 1980s (Colombia being the exception) although not to the high levels prevailing before 1980, especially before the first oil shock. Has the resumption of growth in Latin America been accompanied by a healthy linkage, operating through high employment elasticity and rising productivity and real wages, to exert a substantial impact by way of reducing poverty? The evidence is summarized in Tables 5 and 6. Estimates of output elasticity of employment are shown only for the three largest countries in Table 5. For all three countries the estimates suggest at best a modest degree of employment friendliness of growth.

Table 6 shows trends in unemployment for Chile and trends in urban unemployment for the other countries. Since more than 75 per cent of employment in Latin America is in urban areas, where nearly 80 per cent of the people reside, variations in urban unemployment can be a good indicator of the overall employment performance of the economy. The Table also shows trends in real wage rates.

As noted earlier and shown in Annex Table 2, the record of poverty reduction in the 1990s has been rather poor for the seven major LAC countries, i.e., the group of eight excluding Brazil. For these countries taken together, the decline in the proportion of population in poverty between 1990 and 1994 was offset by the rise in the proportion of population in poverty by 1997. Can this unfavourable performance in poverty reduction be related to the employment performance in the period of restored growth in these countries?

Argentina succeeded in reversing its long stagnation during the 1990s by attaining a high rate of growth by its past standards. But it failed to achieve the desired impact on employment. The unemployment rate in Argentina has been high and has increased. The output elasticity of employment in manufacturing has not been high. Real wages have fallen. CEPAL data on poverty do not include estimates for Argentina; but the evidence on unemployment and real wages do not indicate the likelihood of a favourable poverty outcome.

Colombia had an all-round poor performance: growth rate fell sharply; and unemployment has been

high and increasing. Average real wages have, however, increased steadily, albeit at a modest rate. Since the rise in average real wages is backed neither by growth nor by a rising demand for labour, it is almost certainly due to either a rise in inequality in the distribution of wages or to unsustainable labour market interventions by the government. Neither can be the basis for a healthy reduction of poverty.

Table 6: Growth, Unemployment and Real Wages in Latin America

	Per Capita Income Growth (% p.a.) 1981-90	Growth (% p.a.) 1991-99	Trend Rate of Change (% p.a.) 1991-99 in	
			Unemployment	Real Wages
Latin America	-1.0	1.4	4.9	-
Argentina	-2.1	3.3	21.5 until 97 12.6 since 97	-0.3
Brazil	-0.7	1.0	Insignificant until 97 3.1 since then	4.0 until 97 3.1 thereafter
Chile	1.3	4.4	-2.3 (ignoring higher rates at end points)	3.6
Colombia	1.6	0.5	11.7 (ignoring high initial rates in 91 & 92)	1.5
Mexico	-0.3	1.3	Insignificant; humped during 95, 96	5.7 till 94 0.2 thereafter
Peru	-3.3	2.9	0	-0.8 (ignoring rise in 94)

Memo Item:

Average unemployment rates, 1991-99 (per cent) & type of unemployment data:

Latin America (Mostly Urban)	7.0	Colombia Urban	11.3
Argentina Urban	11.7	Mexico Urban	3.6
Brazil Urban	5.7	Peru Capital City	8.5
Chile National	7.2		

Source: Growth rates and data on unemployment and real wage rates are from CEPAL, *Preliminary overview of the economies of LAC*, Santiago, Chile, 1999.

Note: Trends are based on semilog regressions. Unless stated to be insignificant, all coefficients are significant at 1% or 5% level, the only exception being the growth rate in real wage in Peru which is significant at 10%. Where trends have a break, the estimates are based on equations like: $\log X = a + bT$

+ cZT where X is the dependent variable, T is time (=1 for 1991, 2 for 1992 etc.) And Z is a dummy set at 0 for years up to the break and at 1 for years after the break. Trend growth rate is b up to the break and (b+c) thereafter. Humps and initial and terminal high levels have similarly been taken care of by inserting dummies.

Mexico's recovery of economic growth was interrupted by the crisis of 1994 and the average rate of growth for the 1990s has been modest. The measured unemployment rate in Mexico is low on the average and, excepting the rise in the years following the crises of 1994, there is no trend change in it. Real wages rose until 1994 and has been almost stagnant thereafter. The output elasticity of employment is not particularly high. On-going research, however, shows a high and rising inequality in the structure of wages. The picture is one of lacklustre economic growth resulting in a sluggish rate of increase in overall labour demand. It is not surprising that CEPAL estimates show that the proportion of population in poverty was higher in 1998 than in 1994.

There was a strong revival of growth in Peru in the 1990s. While unemployment rate is relatively high, it shows no trend during the decade. Real wages have not increased; they may be said to have declined a little. The substantial reduction in the incidence of poverty that CEPAL data show must be attributed to a sharp rise in the rate of growth of per capita GDP, from -3.3 per cent during the 1980s to 2.9 per cent during the 1990s, and an avoidance of increased unemployment.

Chile continued to be the country with the most dynamic growth-employment-poverty reduction linkage: there was a robust increase in the rate of growth accompanied by a steady reduction in the rate of unemployment and a steady rise in real wages. CEPAL estimates show a dramatic decline in the proportion of population in poverty between 1990 and 1998.

According to CEPAL data, Brazil achieved substantial reduction in poverty between 1990 and 1996. It should be noted that in the four years leading up to 1996 Brazil's per capita income growth was quite high, approximately 3 per cent per year. During this period the unemployment rate was relatively low and stable and real wages rose rapidly. The highly favourable poverty outcome for the period up to 1996 is a reflection of this positive growth-employment-poverty reduction linkage. For the entire decade of the 1990s, Brazil's performance has been far less favourable: per capita income grew at a meagre one per cent per year for the decade and at a negative rate after 1997. Unemployment rose since 1997. The rate of increase in real wages fell somewhat.⁴¹ The impact of these unfavourable performances in growth and employment on poverty is yet to be measured.

Latin America faces a long agenda of improving its performance on the links in the growth-employment-poverty nexus. Foremost in the agenda is the stabilization of a decent rate of growth. It should then improve the employment intensity of growth by reforming the institutions and incentives that still serve as obstacles to high labour absorption. The extreme inequality in the distribution of land continues to be an obstacle to rural labour absorption, a serious obstacle to poverty reduction in a region in which the rural society still accounts for 30 per cent of all the poor. The Latin American countries generally have a poor record of redistribution and promotion of entrepreneurship among the poor through an expansion of their access to productive assets. Recently, attempts for land reform have been intensified in Brazil although the outcome so far is very modest. The record of Latin America in endowing the poor with human capital is also

mixed: it is rather poor for Brazil, the largest country in the region, but good to reasonable for Costa Rica, Uruguay, Chile, Argentina and Mexico. The “leakage” of the benefits of modestly-restored growth from the poor to the non-poor is illustrated by high and rising inequality in income distribution in the region. The mean of the Gini ratios for the Latin American countries increased from 0.481 in 1988 to 0.491 in 1993.⁴²

Other Regions

According to World Bank’s PPP\$ poverty threshold, the incidence of poverty in the other two developing regions - Middle East and North Africa (MENA) and (developing) Europe and Central Asia - is very low, respectively 1.9 per cent and 5.5 per cent of the population in 1998. Lack of growth was the central problem faced by these regions. The MENA region averaged an annual growth in GDP of 3 per cent during the 1990s, much of which was eaten up by the 2.5 per cent or higher rates of annual population growth that the countries in the region experienced. According to the World Bank estimates, the region nevertheless succeeded in further reducing the incidence of poverty in recent years. The (developing countries of) Europe and Central Asia averaged an annual *decline* in GDP of 2.9 per cent during the decade. This region also experienced widespread breakdown of the system of protection for the poor, however inefficient, in so far as the past system of guaranteed employment was abandoned without being replaced by an alternative. The catastrophic proportion of the crisis is captured by the combination of the large fall in per capita income with the sharp increase in inequality of income distribution: the mean of the Gini ratios for these countries increased from 0.217 in 1988 to 0.326 in 1993.⁴³

For the countries in these two regions a return to the right kind of growth-employment-poverty reduction linkage must begin with the restoration of growth to a decent level. Individual countries in these regions - e.g., Syria, Tunisia and Poland - appear to have achieved this transition. But most of the countries in these regions are stagnating or declining. The restoration of growth by itself will not establish the right kind of linkage among growth, employment and poverty reduction in these regions. The rest of the policy agenda, outlined in section III, will need careful implementation. The transition economies will have to create the right structure for their systems of incentives and institutions. They need to replace their past inefficient system of social protection, now abandoned, by an alternative system. The notion of entrepreneurship for self employment has been comparatively unknown in these countries. Compared to their levels of income per capita, the MENA countries have generally had very low levels of human capital, a fact that is illustrated by the lower ranks of these countries in terms of UNDP’s Human Development Index than in terms of per capita income.

V Conclusions

The most effective way to reduce poverty is to make growth-induced employment accessible to the poor. In other words, poverty is most effectively reduced by the greater utilization of labour, the resource that most poor households have more of than any other resource, in a way that it creates for them entitlement to income and welfare. An analysis of the experience of the developing countries shows that rapid expansion of productive and remunerative employment has always been associated with rapid poverty reduction.

Growth is a precondition of sustained expansion of productive and remunerative employment. For employment to alleviate poverty it must create an entitlement to income. Without economic growth, employment expansion, in the ultimate analysis, is an inefficient method of redistribution, a concealed system of unemployment insurance. Numerous cases in contemporary development experience demonstrates the futility of seeking a way out of poverty by employment expansion without the backing of adequate growth. The Philippines in the 1970s expanded employment ahead of effective demand for labour only to pay for it later in the form of extremely low output elasticity of employment. Bangladesh in the 1970s went through a similar binge of employment expansion in public enterprises, without an increase in effective demand for

labour, for which a full adjustment is yet to be made.

It is, however, not useful to think of growth as a process exogenous to poverty-reducing employment generation. Indeed, in most developing countries the utilization of the poor's capacity to work is an effective way to raise the rate of economic growth. For growth to be *endogenized* into the process of employment expansion for the poor, it is necessary to provide poor households with access to resources: land, other physical assets, credit and public services. It is in this sense that redistribution of land and assets can be an effective method of ensuring complementarity between high growth and rapid poverty reduction. The experience of countries which promoted wide access of the poor to land and other resources demonstrates the validity of this claim. It should be underlined that access of the poor to assets rarely brings about an improvement in their welfare independently of enabling them to utilize more effectively their capacity to work. It is also worth noting that this kind of redistribution is far superior a method of poverty reduction than redistribution of consumption which quickly runs into resource, administrative and political constraints. Redistribution may also be a *necessary* condition of poverty reduction in cases where assets are so scarce that a high and increasing proportion of income is appropriated by their owners, thereby reducing the poverty-alleviating effect of employment-intensive growth.

For employment expansion to be an effective instrument for poverty reduction, it is necessary for the poor workers to be endowed with adequate human capital. The human capital endowment of the poor needs to be continuously updated in order to ensure that they can adjust to the changing composition of demand for skills which characterizes contemporary economic development.

Proper functioning of the process of poverty reduction through employment promotion also critically depends on the terms of exchange that the produce of poor's labour faces in the market. Case studies show that adverse changes in the terms of trade for small peasants and self-employed poor have often deprived them of the opportunity to escape poverty.

Ensuring a high rate growth, within a framework of incentives and institutions that promote appropriately employment-intensive technology, may not generate high enough a head-count rate of employment creation. There may be countervailing and offsetting reduction in employment that is often unleashed by the reform for higher and more efficient growth. This is a particularly serious hazard in the age of globalization when existing systems of inefficient allocation of labour, resorted to in the past as an alternative to unemployment insurance, have to be dismantled as part of the reform for the promotion of efficiency and competitiveness. This puts a heavy additional burden of employment generation, or social protection, on the poverty-reduction strategy. Finding resources for this kind of additional employment generation, or an alternative form of social protection, poses an enormous challenge for expenditure-retrenching reform in the process of which these problems emerge. The experience of China and Vietnam, and to a lesser extent South Asia, is a graphic reminder of this danger.

There are groups of poor who are at a serious disadvantage to compete for employment in the market place. They need to be helped by special measures: e.g., endowment with special skills and opportunity for work at home for the female members of poor households.

Careful interventions in the functioning of the labour market, with a view to protecting the weak members of the labour force, especially in an environment of unequal bargaining power, can improve the welfare of the poor. It is, however, important to ensure that these interventions do not restrict the growth of demand for labour which is detrimental to the welfare of the poor.

While growth-induced employment expansion is the most effective method of poverty reduction, it is necessary for the policy makers to recognize its limits. For the households with inadequate labour

endowment, admittedly a small minority of the poor in most societies, there must be additional policy interventions, viz., income and/or consumption subsidy, to alleviate poverty.

Employment policies for poverty reduction must be continuously reviewed to ensure their evolution with changing circumstances. East Asia's success in eliminating much of poverty by growth-induced employment expansion, buttressed by redistribution of assets and egalitarian access to human capital, was a remarkable achievement. These countries should have reinforced this achievement by building a system of social protection for the workers, especially after they had reached high levels of income. Their failure to do so at the right time contributed to an unwarranted intensity of decline in the welfare of the workers, and a descent into poverty for many of them, in the wake of the crisis of 1997.

ANNEX

This Annex discusses the method of estimation of the output elasticities of employment and shows the data on trends in poverty for those regions for which these estimates are not readily available.

Output Elasticity of Employment in Manufacturing

Data on employment and value added in manufacturing are from the UNIDO. The value added data are at current prices. These are deflated by using the manufacturing value-added deflator from the World Bank, *WDI 2000*. For the ESEA region estimates of output elasticity of employment have been available and well known. All that has been done for the countries of this region is to update the estimates shown in Table 6.11 in Khan and Muqtada (eds.), 1997 by following the methodology believed to have been followed by the authors of those estimates (see Notes to Table 1 above). For all other cases the elasticities are estimated by fitting the following equation to the data described above:

$$\log EMP = C[1] + C[2][D1] + C[3][D2] + C[4][\log VA] + C[5][(D1)*(\log VA)] + C[6][(D2)*(\log VA)]$$

where: EMP = employment in manufacturing

VA = real value added in manufacturing

D1 = a dummy which is 0 for all years from 1971 to 1980 and 1 for all years thereafter

D2 = a dummy which is 0 for all years from 1971 to 1990 and 1 for all year thereafter

C[1] to C[6] are estimated coefficients.

The output elasticity of employment is C[4] for the period 1971-80; C[4] + C[5] for the period 1981-90; and C[4] + C[5] + C[6] for the period 1991-98. For the SSA countries only the elasticities for 1981-90 and 1991-98 can be estimated. An asterisk has been used to indicate that a coefficient is significant at least at 95 per cent level of confidence. If C[4] has high enough a t-value then the elasticity for 1971-80 is shown as significant. If the t-value is high enough for C[5], the elasticity for 1981-90 is shown as significant (even if C[4] for the country is not significant). If the t-value for C[6] is significant, the elasticity for 1991-98 is shown to be significant (even if C[4] and C[5] for the country are not significant). In a few cases the initial/terminal year is different from the limits indicated above.

In using the data set described above several inconsistencies with other known sources were detected for countries and/or periods for which estimates based on these data are not used in this paper. This nevertheless points to the need for caution in using these results. Since the real value added was somewhat indirectly derived, it is possible that occasionally the estimates do not quite conform to what direct estimates would have been.

Poverty Data for SSA and Latin America

In the text references have been made to estimates of trends in poverty in Sub-Saharan Africa and Latin America. These estimates may not be readily available and hence are reproduced in the following tables. Trends in poverty in Asia are well documented and widely available. In the text detailed analysis of alternative estimates and references to their sources have been given. No need was felt for the reproduction of these estimates. These are in any case far too numerous for convenient reporting, in this Annex.

Annex Table 1. Population in Poverty, Selected Countries of Africa, 1980-99

Country	Incidence of Poverty (%) ^{ab}		International Poverty Line(%) ^c	
	Year 1	Year 2	Year 1	Year 2
Burkina Faso	Rural 51.1	Rural 50.7	-	-
	Urban 10.4	Urban 15.8		
	National 44.5	National 45.3		
Cote d'Ivoire	-	-	17.7	12.3
Ethiopia	-	-	46	31.3
Ghana	Rural 45.8	Rural 36.2	-	-
	Urban 15.3	Urban 14.5		
	National 35.7	National 29.4		
Mauritania	Rural 72.1	Rural 58.9	31.4	37.9
	Urban 43.5	Urban 19.0		
	National 59.5	National 41.3		
Nigeria	Rural 45.1	Rural 67.8	-	-
	Urban 29.6	Urban 57.5		
	National 42.8	National 65.6		
Tanzania	-	-	-	-
Uganda	Rural 59.4	Rural 48.2	-	-
	Urban 29.4	Urban 16.3		
	National 55.6	National 44.0		
Zambia	Rural 79.6	Rural 74.9	-	-
	Urban 31.0	Urban 34.0		
	National 57.0	National 60.0		
Zimbabwe	Rural 51.5	Rural 62.8	-	-
	Urban 6.2	Urban 14.9		
	National 37.5	National 47.2		

a. The dates in this column correspond to several years. They are for Burkina Faso 1994,1998; Ghana 1991/92,1998/99; Mauritania 1987,1996; Nigeria 1992, 1996; Uganda 1992,1997; Tanzania; Zambia 1991,1996; Zimbabwe 1991,1996.

b. Nutrition-based poverty lines. c. International poverty line as defined by population below \$1 a day. The years in this column vary among countries. They are: Cote d'Ivoire 1988, 1995 and Ethiopia 1981-82, 1995.

Source: Rizwanul Islam and Jean Majeres, 2001.

Annex Table 2. Poverty in Major Latin American Countries (% of Population)

Brazil		Mexico		Latin America (7 Countries +Brazil)	
1970	52	1970	32	1970	43
1979	41	1984	34	1980	38
1990	43	1989	38	1990	41
1993	37	1994	34	1994	37
1996	29	1996	42	1997	35
		1998	35		
Chile		Peru			
1970	15	1970	45		
1987	39	1979	46		
1990	33	1986	51		
1994	23	1995	40		
1996	20	1997	35		
1998	18				
Colombia		Latin America (7 Countries: Chile, Colombia, Costa Rica, Honduras, Mexico, Peru, Venezuela)			
1970	45	1970	35		
1980	39	1980	36		
1994	45	1990	41		
1997	43	1994	38		
		1997	41		

Source: Data from CEPAL, *Social Panorama in Latin America*.

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NOTES

1. The author is Professor of Economics at University of California, Riverside. He wishes to express his gratitude to Rizwanul Islam for the opportunity to work on the subject and for helpful suggestions and comments at all stages of preparing the paper. The paper benefitted from comments received from the participants at an informal seminar at the ILO in March 2001. Ajit Ghose, Rolph van der Hoeven, Iftikhar Ahmed and M. Muqtada gave numerous useful comments. Savvina Chowdhury helped with computations.
2. World Bank, 2001. While this list conforms to the broad categories in the WDR, there are certain differences in the sub-categories.
3. A poor person could escape poverty without using her capacity to work if she received an endowment of assets large enough to provide an annuity that is greater than the poverty threshold. Few societies in the world can afford to provide such an endowment to a significant proportion of their poor.
4. The proportion may be high in post-war societies and after natural disasters. Also the proportion of households whose labour endowment is of such special kind that they can not benefit from an expansion of the usual types of employment - e.g., female labour that can not compete for employment in a market for wage employment because of the commitment to child care and household work - may be substantial in many societies. As discussed later, special measures are needed to enable them to convert their capacity to work into remunerative employment.
5. Note, however, that an exception to this is possible when the economy is initially characterized by an undesirably high degree of capital intensity. In such a case the shift towards a more appropriate technique of production would indicate a faster rate of increase in employment than in output. This kind of *correction* is, however, an once-for-all process and is unlikely to continue for long.
6. There is a large literature on the subject. A recent empirical study documenting the phenomenon for Brazil is William C. Thiesenhusen and Jolyne Melmed-Sanjak, 1990. The paper reports that employment per hectare was 9.78 person months for farms 1-10 hectares in size and only 0.7 person months for farms 50-200 hectares and 0.02 hectares for farms 10,000 hectares and above.
7. The phenomenon of widening wage inequality in US industries until the mid 1990s is documented in Galbraith, J. and V. G. Cantu, 1999. The paper also shows a declining wage inequality in US industries since the mid 1990s whence the very low rate of unemployment finally improved the supply demand balance for unskilled workers.
8. Examples of this, as a probable explanation of rising real wages with increasing unemployment in some Latin America countries, are given in section IV.
9. The inequality in the distribution of the extremely scarce land, and the consequent rise in its factor share, probably goes a long way to explain the decline in real wages in Bangladesh agriculture by more than 16 per cent between 1985/86 and the second half of calendar 1998, which in turn constitutes a major explanation of the poor performance in poverty reduction in rural Bangladesh during this period (see section IV below and A. R. Khan, 2000a). This phenomenon is distinct from the case, discussed above, of the unequal distribution of assets restricting employment growth but not necessarily bringing about an *increase* in the share of these assets in total output.

10. Notable contemporary examples of this are: Food-for-Work programmes in Bangladesh and China; the Maharashtra Employment Guarantee Scheme and the Jawahar Rozgar Yojana in India, and the Community Employment and Development Programme in the Philippines.

11. See World Bank, 1993 and World Bank, 1998 for evidence of this respectively for Uganda and Bangladesh.

12. The term vent for surplus, originally used by Adam Smith, was applied by Hla Myint to the utilization of otherwise unused land and labor resources of countries by their being opened to foreign trade (Hla Myint, 1959). We are using the term in a broader sense to include all activation of productive energy and resources that are latent and unused due to the absence of incentives and institutions required to facilitate their utilization.

13. Demographic transition can also help poverty reduction in important ways that are not directly related to employment expansion, viz., increasing per capita resources of poor households by reducing their dependancy ratio.

14. These measurements are based on the World Bank estimates of absolute poverty defined as population living on less than “\$1 a day” (to be exact \$1.08 a day at 1993 PPP\$ prices). The method underlying these estimates involves many crude approximations so that the results should be treated as no more than orders of magnitude. The source of these Estimates is World Bank, 2001.

15. “Lewis transition” is visualized in the context of W. Arthur Lewis’ model of economic growth and indicates the turning point at which the surplus labour in “disguised” unemployment in the traditional sector of the economy is exhausted.

16. In this section the regional classification is the one that the World Bank uses. ESEA is what is called “East Asia and the Pacific” in the World Bank classification.

17. Perhaps it is useful to note that the incidence in poverty in ESEA in 1998 reflects the worst consequences of the 1997 financial crisis but for which the outcome might have appeared more spectacular. Poverty also declined over the same period in one other developing region, viz., the Middle East and North Africa. This region, however, represents less than 5 per cent of the population of the developing world and had a low initial incidence of poverty. Thus the absolute decline in the number of the poor was minuscule. The number of people in poverty increased in all other developing regions.

18. These six countries account for 91 per cent of the population of the developing ESEA region.

19. There are many case studies of this experience. For an ILO study of the experience see Chapter 6 (by Deepak Majumder and Priya Basu) of A. R. Khan and M. Muqtada (eds.), 1997.

20. World Bank, 1997 shows no trend in Korea’s Gini ratio of income distribution between the early 1960s and the late 1980s.

21. It has been alleged that the undeveloped system of social protection in Korea was responsible for some of the adverse consequences of the financial crisis of 1997 on the poor. This does not invalidate the argument that the country successfully eliminated almost the entire problem of poverty without resort to these policies prior to the financial crisis. It, however, underlines the need for a transition in policies at the right time. These countries should have gradually instituted these systems of social protection once they had reached a high level of per capita income. The effect of the crisis and its aftermath need careful study. It is, however, noteworthy that the crisis resulted in negative growth of very modest proportions in Korea for

only one year after which growth was reinstated at a higher than pre-crisis rate. The other three East Asian pioneers were far less adversely affected by the financial crisis than was Korea.

22. For sources and documentation see A. R. Khan and Carl Riskin, 2001, chapter 4.

23. See Boltho, 1994.

24. These estimates are based on the official data quoted in IMF, 1996.

25. For an analysis of the growth-employment-poverty linkage in the Philippines see, A. R. Khan, 1997a.

26. See A. R. Khan, 2000a, for a summary of sources of the evidence.

27. See Gaurav Datt, 1997 and 1999.

28. See R. Amjad and A. R. Kemal, 1997 (pp. 39-68).

29. See A. R. Khan, 2000b for evidence for Nepal.

30. ILO, 1999. These rates of decline appear rather high. It has not been possible to ascertain the method underlying the estimates shown in this ILO report.

31. Bangladesh's much vaunted microcredit programme must have helped rural income growth. It's overall impact does not appear to have been sufficiently large. Also the targeting of the poor by the microcredit programme in Bangladesh became weaker after initial years. See, Rushidan Islam Rahman, 2000. Also see Rizwanul Islam, 2001 for an evaluation of these direct interventions.

32. For rural Sub-Saharan Africa, the problem is empirically documented in the ILO study: A. R. Khan, 1997b.

33. Note that this means that for nearly 90 per cent of the labour force agriculture is the *principal*, not the *sole*, occupation.

34. IFAD, 2001 shows that the Gini ratio of land distribution in Ethiopia is 0.47 as compared to a range between 0.6 (Mauritania) and 0.8 (Madagascar) in which it lies for most other countries of SSA.

35. See World Bank, 1993, pp. 94-96.

36. World Bank, 2000, Table 2.1.

37. CEPAL, 2000. The data are shown in Annex Table 2.

38. See chapter 4 (by Berry et al.) in Khan and Muqtada (eds.), 1997.

39. This possibility is indicated in World Bank, 1995, the data from which provides the basis for these statements.

40. Employments trends in Latin America during the 1980s are based on World Bank, 1995.

41. Real wages continued to rise, however. This was clearly unsustainable in the long run without a reversal of the growth performance.

42. Branco Milanovic, 1999. These are the Gini ratios based on pooled household data converted into internationally comparable PPP\$ values.

43. Branko Milanovic, 1999.

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