

# Growth, Employment and Poverty Reduction

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**New Tools for More Employment  
Focused Development Strategies**

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# Outline

- The rationale and objective for the course
- Understanding the structure of labor markets in developing countries
- Why the quantity and quality of employment matters for inclusive growth
- The importance is reinforced if the labor market is segmented
- The need to rethink the role of employment in inclusive growth strategies
- Emerging findings
- Tools for conducting analysis in your country

# The rationale and objective for the course



# The rationale

- At **operational level** there is increasing demand for
  - analytical work and
  - technical assistanceto improve evidence-based policy making in the area of creation of productive employment, esp. for the poor.
- But **our capacity** (and that of our client countries) to deliver on these tasks in LICs/MICs is often **limited** by the lack of
  - reliable and comparable **data** and
  - well-established **indicators**; and
  - easy to implement **diagnostic techniques**.

# The need for more and more reliable data

- Lack of reliable, comparable and time consistent **data** means that:
  - labor market indicators for LICs are often not available or non-standard, preventing comparisons across countries,
  - misleading information and messages can be derived,
  - monitoring of trends over time prevented;.

# The need for better and easier diagnostics

- Standard labor market **indicators** badly reflect the complexity of labor exchange in developing countries;
- Lack of a **comprehensive diagnostic framework** for employment-focuses shared growth strategy prevents effective integration of job generation as a target in comprehensive development strategies.

# We have gone a long way but ..

- .. a number of areas could benefit from greater attention:
- Developing **indicators** that adequately reflect the complexity of labor exchange in LICs
    - ie, unemployment a luxury, employment predominantly self-employed in subsistence family enterprise, for the most in agriculture → Returns jointly produced and for the most jointly consumed → no wage.
  - The **links between employment, growth and poverty**.
  - The importance of also monitoring the **quality of jobs**.
  - The **impediments** to job creation, eg
    - the links between growth, output demand and job creation; and
    - the identification of any existing weak link in the transition channel;
    - the potential dilemma between strengthening growth via higher productivity and creating labor-intensive sources of employment.
  - **Barriers to accessing** the existing 'good' jobs (beyond skill levels).

# The main objective of the course ..

.... is to present a new toolbox that PRMPR is developing to

- **facilitate better understanding of**
  - the structure of labor markets in developing countries;
  - the impact of sectoral pattern of growth and its productivity/employment profile on growth poverty reduction;
  - the correlation between patterns of growth and labor regulation/structure;
- **provide guidance on how to best identify country-specific effective policies levers to**
  - Create more 'good',
  - Increase access to these jobs for excluded workers,
  - Make 'bad' jobs better;
- **increase effectiveness** of employment focused development strategies via **better targeting** of interventions to the factors that matter most.

# Understanding the structure of labor markets in developing countries



# The complexity of labor exchange (1)

In LICs the concepts of unemployment and LM activity are of little relevance:

- **Unemployment** is a luxury that only skilled, relatively well-off individuals in urban area can afford;
  - **LM participation** is a very fuzzy concept in the context of subsistence employment
- The concern is not with access to employment but with the type and quality of employment available.

# The complexity of labor exchange (2)

In LICs **employment** is predominantly self-employment in subsistence family enterprise, mostly in agriculture

- Labor exchange is a complex phenomenon going well **beyond** the buying and selling of labor for a **wage**;
- **Employment** is a complex concept that comprises of
  - wage employment,
  - self-employment, and
  - employment (paid and unpaid) in **household enterprises** (both agricultural and non-agricultural);
- **Earnings** include
  - wages,
  - profits from self-employment, and
  - **Individual contributions to jointly produced (and jointly consumed) returns to household enterprises.**

# The complexity of labor exchange (3)

- By **labor market (LM) structure**, we mean:
  - the quantity and quality of the **available workers**,
  - the quantity and quality of the **available jobs**, and
  - the **matching process** linking workers and jobs
    - Do workers get matched where they are best suited?
    - Are certain types of individuals excluded?
- The LM structure is influenced by **LM regulations and institutions** (and their impact on items above)
- It is possibly more influenced by **other factors** (eg. education system, financial markets, land markets, legal systems, communication systems, cultural norms, etc.)

# Some Results: Bangladesh, Ghana Madagascar, Nicaragua, etc. (1)

- **Unemployment is a luxury.** It is very low and highly concentrated amongst the highly educated and in urban areas. It is *positively correlated to growth.*
- **Participation rate is a fuzzy concept,**
  - especially for women
  - especially if it includes 15-24 year olds
- **Employment rates are very high →** concern with *quality* NOT quantity of jobs.

# The quantity and quality of job creation is important for inclusive growth but how?



# Because ...

- The creation of *more better jobs* is an important transmission channel between growth, income inequality and poverty
  - an essential element of the inclusive growth agenda;
- **Mismatches and frictions** in the labor market are
  - potential barriers to growth;
  - critical factors in determining the impact on growth and income distribution of macroeconomic shocks;
  - important determinant of impact of structural reforms — in trade, education, etc — on growth and inequality.

# Employment and inclusive growth

The structure of the LM affects inclusive growth through its impact on

- **growth** potentials;
- the **distribution** of the benefits of growth;
- the **extent** to which different groups in the population participate in the growth process.

→ i.e. the structure of the labor market impacts both **efficiency** and **equity**.

# Employment and growth

- **Transmission channels:** LM conditions—i.e., labor market regulations, quantity and quality of the labor supply, etc.—affect growth through their impact on employment decisions and K accumulation.
- **Barriers to growth:** The prospects for sustainable growth in per-capita GDP may be severely impaired by:
  - **Labor supply shortages** due to adverse demographic trends (ECA) or inefficiently-low participation rates (MENA),
  - **Skill shortages,**
  - **Inefficiencies in input allocation and price setting** due to labor market regulations that affect firms' capacity to choose the optimal combination of inputs.

# Access to productive employment matters also for poverty reduction

- The capacity to sell labor is the main potential source of income for the poor.
  - Labor market outcomes are important transmission channels between growth, income inequality and poverty.
  - The impact of growth on labor market outcomes is an important determinant of the extent to which growth is shared.
- The employment intensity of growth is widely conceived as an indicator of how much growth is 'shared'.
  - Focus on estimates of employment elasticity of growth
- However, in LICs, access to a job is not sufficient to guarantee adequate living standards (18% of the those employed are estimated to be *working poor*).
  - The impact of growth on wages is also important but much less studied.

# Its importance increases if the labor market is segmented



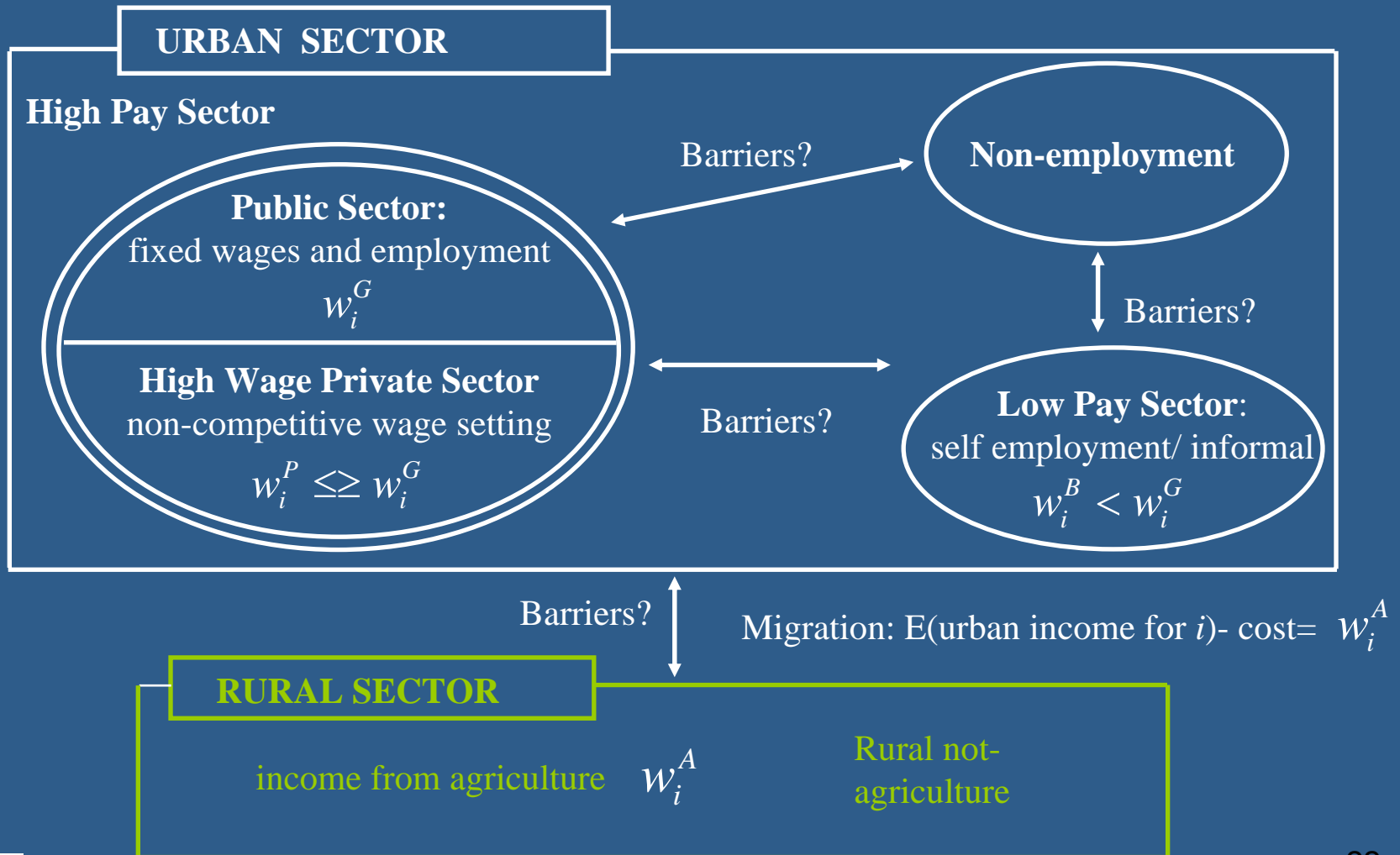
# Essential Features of Segmented LM

- The LM consists of various segments that offer qualitatively distinct types of employment for individuals with identical productivity endowments—i.e., ‘preferred segment’ and ‘least preferred segments’.
- There is limited access to ‘preferred segments’:
  - Not all who want a job there (and can reasonably aspire to get one) can get it.
- Three main issues to be addressed:
  - The wage/employment setting mechanisms within each sector,
  - The way the segments are connected
  - The role of frictions and barriers to mobility.

# Basic Implications of Segmentation

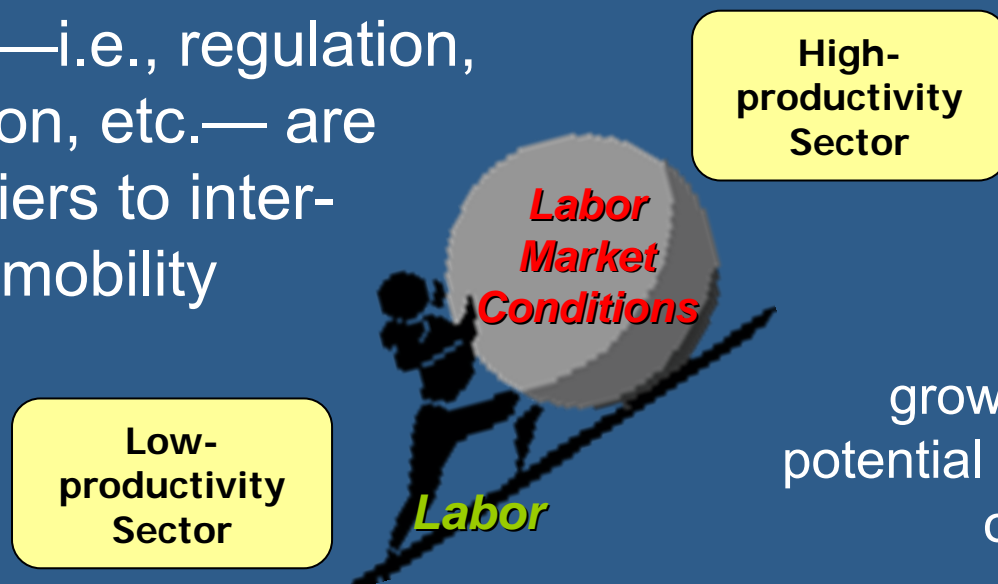
- Cross-segment differences in marginal products may persist over the long-run.
- Wages may differ from marginal product at least in some sectors (oligopsonistic/ bargaining/efficiency wage models/wage floors).
- Labor supply may be abundant in some sectors but restricted in others.
- Barriers to mobility prevent optimal reallocation of labor across segments (efficiency losses).
- Poverty would be reduced and welfare enhanced if the causes of segmentation were addressed and those working in the least-preferred segments could gain access to the preferred jobs

# Modeling a Segmented Labor Market



# Segmentation and Efficiency

LM conditions—i.e., regulation, skill composition, etc.— are important barriers to inter-sectoral labor mobility

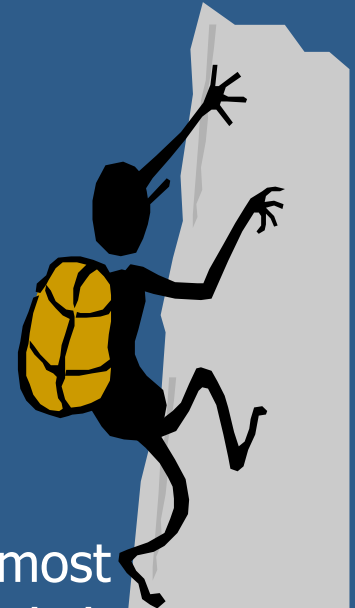


Link between labor market conditions and growth reinforced by potential negative impact on labor mobility

- Segmented structure of the labor market is a source of inefficiency as TFP losses may arise from the resulting factor misallocation.
- These losses may be substantial:
  - Reallocation of labor away from agriculture explains 20% of cross-country variations in TFP growth [Temple & Woessmanm, 2006].

# Segmentation and Equity

- **Segmentation** may threaten the **equitable distribution** of the benefits of growth.
- The **sectoral pattern** of growth may be as important as the overall level in determining the extent to which it is poverty-reducing.



- If the 'preferred' sector(s) is also the most dynamic, growth may reinforce pre-existing differentials in MVP and earnings.



Barriers to cross-segment labor reallocation may prevent workers in the 'least preferred' sector(s) from benefiting from increased employment opportunities in the 'preferred' sector.

# Policy Implications of Segmentation

- Education may not guarantee access to the preferred segments if employment in these segments is rationed.
  - ➔ Increased education is an effective policy option only if (i) it increases sectoral mobility of labor and/or (ii) it increases returns in the least-preferred, non-rationed segments
- It may be more effective to target the sectors in which the poor are not, so that growth in these sector can pull the poor out of the less productive sectors
- Identifying and addressing barriers to mobility and other sources of segmentation (ie, matching efficiency, inefficient regulation) is a priority objective of development policies.

# Some Results (1)

- **Substantial inter-segment differences in returns to labor** (controlling for individual characteristics), especially between:
  - Agriculture and other sectors,
  - Rural and urban labor markets,
  - Formal/informal and waged/other,
  - Lowest returns for family enterprise workers in agriculture
- **Differences in returns to education across segments**

## Some Results (2)

- There is **evidence of queuing** for good jobs and barriers to moving out of agriculture (Nicaragua).
- **No evidence of skill constraints and mismatch:**
  - Exception: Madagascar.
- Evidence of inter-segment differentials in returns to education and in some countries, **NO returns to schooling** in the 'least preferred' jobs segment.
- **LM regulation NOT** a major **constraint** in LICs but in MICs some regulations act as a barrier to job creation in the good segment (minimum wages, severance pay and payroll taxes).

# The need to revisit the role of employment in inclusive growth strategies



# Recapping key points (1) ....

- Focusing on **quantity of employment ONLY** is **not enough**.
- Focusing on aggregate **employment elasticity** of growth may give misleading perceptions.
- Focusing on **changes in average earnings** may also be misleading.

# Recapping key points (2) ....

- This calls for the need to focus on:
- Employment intensity of growth in high-earnings sector(s),
  - Impact of growth on upward inter-segment mobility,
  - Its impact on the returns to labor in the low-earnings sector(s).

# Emerging findings

## The links between Growth, Poverty, and the Labor Market



# Links between Growth, Poverty, and Labor Markets (1)

- Profiling per capita growth through **growth decompositions** into:
  - Demographic changes,
  - Sectoral structure,
  - Productivity/employment intensity,
  - Intersectional labor shifts.
- **Linking** the profile of **growth with poverty changes** using both cross-country sectoral data and country specific micro data.
- Identifying the **determinants of changes in labor income** at household level.

# Some Results: Cross Country and Country Case Studies

The findings **support the** implications of the **segmented LM** model:

- The aggregate **employment intensity** of growth is not a good indicator of the extent to which growth is inclusive.;
- But the **sectoral patterns of** employment/productivity **intensity** is. In particular:
  - Movement **out of agriculture and increases of agricultural productivity** are correlated with poverty reduction.
  - **Increases in secondary sector employment** are correlated with decreases in poverty but **increases in secondary sector productivity** are not.
  - The correlation of employment growth in the **tertiary sector** with poverty reduction is **unclear**.

# Finding 1: Aggregate employment intensity does NOT matter

- **Nicaragua (2001-2005):** Employment increased 4% per year (1% > labor force) but there was no change in poverty due to
  - Increased employment was primarily in low-paying sectors, ie agriculture,
  - new well-paid employment concentrated in *maquila* required complete secondary education
    - barrier to access for the poor.
- **Ghana (1991-2005):** poverty nearly halved while the employment rate decreased by 9%.
  - 88% of growth accounted for by increased productivity and the rest to an increase in active population.
- **Bangladesh (2000-2005):** poverty decreased by roughly 20% while the employment rate stayed unchanged.
  - Poverty reduction linked predominantly to increased productivity and wages within economic sectors, within job categories and within rural/urban areas.

# Finding 2: What MATTERS is the sectoral employment and productivity intensities

- **Cross-country:** poverty reduction  $\uparrow$  with
  - employment intensity of growth in the secondary and tertiary sectors and
  - productivity intensity in agriculture:
    - A 1% growth rate associated with an equal increase in
      - secondary sector employment shares  $\rightarrow$  poverty  $\downarrow$  5%
      - agricultural productivity  $\rightarrow$  poverty  $\downarrow$  7%
      - tertiary sector employment shares poverty  $\rightarrow$  poverty  $\downarrow$  3%,
    - Productivity intensive growth in secondary and tertiary sector is not robustly correlated with poverty,

# Finding 3: Skills as main factor behind the poverty impact of growth

- **Cross-country:** where **skills** are very **low** the role of **agricultural productivity** in overall growth is **limited**
  - poverty impact is also low.
- **ICA surveys:**
  - lack of skill is **NOT a constraint** to employment growth in manufacturing in **Nicaragua** but
  - it is a **'major' or 'most severe' obstacle** for nearly one third of the formal firms in **Madagascar**
- In all **our country studies**, at individual level, lack of education/training **is an important barrier** to
  - access to employment in secondary sector and to well-paid jobs in the tertiary sector and
  - ↑ productivity in the primary and tertiary sectors.

**What if I want to conduct  
this analysis in my country?**



# Required data

- **Cross-sectional data**

- Need data from two different periods

- with employment status and category
- with individual earnings (at least for wage workers)
- with poverty data

- Ex. Typical LSMS

- **Macro level data**

- GDP Value Added, by sector

# Tools

- **Toolkit available** to guide you every step of the way
  - Step-by-step guide explaining the methods for analyzing the data
  - ADEPT program to automatically compute many of the tables used in the above labor market analysis
    - will see later in course
  - ADEPT manual defines key labor market variables

## Coming soon....

- Guide on how to clean labor market data
- Excel programs for decompositions and other more complex analysis

# Website with tools

<http://www.worldbank.org/employment>

Click on Operational Resources link

