

EARNING THEIR WAY OUT OF POVERTY: A BRIEF OVERVIEW

Gary S. FIELDS*

The Magnitude of World Poverty and the Importance of Work

As I write this paper in October 2009, the Turkish economy is starting to recover from the last year's global financial crisis. National income is up about 2% this quarter from last, but it is still below its 2007 level. Unemployment has now leveled off at the unacceptably high level of 14%. Despite the progress that is now being made, economic problems abound.

The problem I focus on in this lecture is poverty. Turkey is a middle-income country. Its national income per capita is US\$8,609, which places it at a similar level to Mexico, Argentina, Brazil, South Africa, and Russia. By international standards, Turkey has a poverty problem, but its problem is nothing like the ones in India and China. By those same international standards, there is essentially no poverty at all in the United States or the European Union.

Let us take a look at some of these people. Tuğçe, a young woman in her twenties, lives in Istanbul. A university student during the day, she works four hours each evening at a large supermarket serving customers in the deli and stocking shelves. Tuğçe earns slightly more than the Turkish minimum wage – that is, about two U.S. dollars per hour.

Where does Tuğçe's earnings level put her in the world's earnings distribution? Janie, an administrative assistant at a global computer company operating in China, earns about one U.S. dollar (US\$) per hour, half of what Tuğçe earns. Janie does well compared to Wang, a Chinese farmer, who earns maybe half of what Janie does. In India, Kalavati, who works eleven hours each day to hand-roll one thousand cigarettes, has to work for two days to earn what Tuğçe earns in an hour. On the other hand, the minimum wage workers at the supermarkets in the town I live in in New York State earn nearly four times per hour what Tuğçe does.

The most careful study of poverty in the world has been carried out by Shoa-hua Chen and Martin Ravallion at the World Bank. Expressed in terms of Purchasing Power Parity dollars in 2005 prices (PPP\$) – that is, adjusting official exchange rates for what money will actually buy in different countries – Chen and Ravallion calculate that 1.4 billion people in the world live on less than PPP\$1.25 and another 1.7 billion live on between PPP\$1.25 and PPP\$2.50.¹ Compared to the European Union's 500 million people and the United States' 300 million people, global poverty is massive. Nearly half of the world's 6.5 billion people are absolutely poor by the World Bank's standard.

In the balance of this lecture, I will tell you how the world's poor work, describe what policy interventions have helped the poor earn their way out of poverty, and set forth a criterion for deciding how to allocate scarce resources to combat poverty.

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¹ . . . **Chen and Ravallion** . . . See Chen and Ravallion (2008).

How the World's Poor Work

In the United States, where I come from, much of the discussion of poverty is about non-work. Poverty is often analyzed in terms of single mothers who stay at home to care for their children, cultures of poverty, breaking the cycle of poverty by limiting the duration of welfare benefits, and the like.

However, in the low- and middle-income countries of the world, the discussion of poverty is in very different terms. In those countries, poverty is very much an issue of low earnings for those who work, not an issue of non-work. Here are the major dimensions of developing countries' employment problems:

Unemployment rates are lower in the developing countries than in the richer countries. The unemployment rates in developing countries are four percent in China and India and five percent in Mexico – much lower than in Europe (eight percent), the United States (ten percent), or Turkey (fourteen percent). The explanation is straightforward: few people in the developing world can afford to spend an entire week doing no work at all, which is what it takes to be counted as unemployed by standard international definitions. The fact that unemployment is higher in the richer countries than in the poorer countries is why I regard the unemployment rate to be a dubious measure of labor market distress.

Not only do the great majority of the poor work, but they work long hours. The percentage of working people who work more than forty-eight hours per week is greater than fifty percent in Peru and between forty and fifty percent in Ethiopia, Pakistan, Thailand, and Korea. In addition, it can take hours a day for the poor to gather firewood, fetch water, and meet other basic requirements which we in the richer countries take for granted. The problem the poor face is that despite working long hours, they earn so little per hour that their total weekly or monthly earnings are not enough to raise them above their countries' poverty lines.

The poor want to work. As the President of Argentina, Cristina Fernández de Kirchner, puts it: “When you listen to people saying that fifty million jobs have been lost this year, it is not enough just to agree how dreadful it is. It is not just the figure that is important: it is the losses and destruction that have been caused to individuals and to families. It means fifty million people who are living on their wits and nothing else. These are the people we have to think about when we hear people talking pure economics or statistics.”² As for the poor themselves, here are their voices. A poor elderly man in Jamaica says, “Work makes all the difference in the world. . . My wife, at 78, is still working. My dream is a little work to make ends meet.” In Egypt another man says, “Lack of work worries me. My children are hungry and I tell them the rice is cooking, until they fall asleep from hunger.” A South African man tells me, “My wife and I are unemployed. We want to be employed. You are employed when you go to the same workplace every day and get paid every Friday.”

The composition of employment is very different in developing countries from that in developed countries. As compared with the developed countries, the developing countries have: a smaller percentage of people who work in offices and factories; a greater percentage of people working in agriculture; greater importance of self-employment, own-account work, and unpaid family work and lesser importance of paid employment; and widespread absence of job-related social protection. In India, just seven percent of working people are wage or salaried employees in enterprises that are registered with the government – what in India is called the “organized sector” and in most other countries the “formal sector.”³ Thus, the great bulk of working Indians - ninety-three percent - are “unorganized” or “informal.”

² . . . **Fernández de Kirchner.** . . . Quoted in ILO (2009(b)).

³ . . . **what in India . . .** See National Council on Enterprises on the Unorganised Sector (2009).

Typically, the better jobs are in wage employment, not self-employment. It is because of this that nearly “everybody” in developing countries wants to work in a wage job. In the absence of sufficient wage employment for all who would like such jobs and are capable of performing them, people often decide to set up their own, often very small, businesses. But not all microenterprise operators and family workers are doing such work involuntarily. Some could be working as wage employees but choose not to.

What the developing countries have is an employment problem – that is, poverty among those who work - rather than an unemployment problem. Using figures provided by the International Labour Organisation, the agency of the United Nations specializing in workplace issues around the globe, I calculate that there are six-and-a-half times as many working poor in the world as there are unemployed.⁴ Thus, the principal policy challenge is how to create more good job opportunities.

Let us turn now to five components of a policy package toward this end.

Helping The Poor Earn Their Way Out of Poverty: Lessons from the International Literature

To meet the challenge of creating more good job opportunities, the international literature suggests a five-part policy package:

Basic workplace protections. In 1948, the United Nations proclaimed a Universal Declaration of Human Rights, Article 23, Item 1 of which stated: “Everyone has the right to work, to free choice of employment, to just and favorable conditions of work, and to protection against unemployment.” These solemn words notwithstanding, these rights are a distant dream for billions of working people around the world.

In 1999, the ILO issued a Declaration on Fundamental Principles and Rights in the Workplace in which it is proclaimed that workers in all ILO member countries are provided with four rights: freedom of association and the effective recognition of the right to collective bargaining; the elimination of all forms of forced or compulsory labor; the effective abolition of child labor; and the elimination of discrimination in respect of employment and occupation. The ILO has also set a “Decent Work Agenda,” which seeks four strategic objectives: creating jobs, guaranteeing rights at work, extending social protection, and promoting dialogue and conflict resolution. The Declaration and the Decent Work Agenda are good starting points for labor rights and standards throughout the world.

Harnessing the energies of the private sector. For the most part, those employed in developing countries work in the private sector, not the public sector. In Latin America, just 10% of the labor force is employed in the public sector; the private sector (including both paid employment and self-employment) engages ninety percent of the labor force. In Africa, Kenya’s private sector comprises eighty-four percent of registered employment and presumably all unregistered employment, and ninety-four percent of total employment in Ghana is in the private sector. Thus, the private sector is where most of the progress in improving earning opportunities for the poor is likely to be made. Governments need to try to create a favorable business environment and investment climate so that private enterprises will want to employ more of their countries’ workers.

The crucial importance of economic growth. From studies around the world, we have learned two fundamental lessons about the relationship between economic growth and poverty.⁵ First,

⁴ **Using figures . . .** See ILO (2009(a)).

⁵ **. . . Two fundamental lessons . . .** See Fields (2001).

in the great majority of country cases, when economic growth has taken place, poverty has fallen. And second, when poverty has not fallen, typically it is because economic growth has not taken place. From this evidence, I conclude that economic growth is vitally important for poverty reduction and refer you to the thoughtful work of the Commission on Growth and Development for lessons on how to achieve economic growth and what to avoid.

Labor market policies for generating more paid employment. In addition to the policies just discussed, the international literature suggests four lessons about employment generation. First, be careful about pushing wages up prematurely as some countries such as South Africa have done; it may well be better to be patient and strive to pull up wages through increased labor demand relative to supply. Second, consider which laws impede employment and consider removing them; it is widely thought that India's legislation prohibiting worker dismissals discourages firms from hiring workers in the first place. Third, invest wisely in the development of skills and productive abilities; Mexico has a particularly effective job training scheme in place. And fourth, create job opportunities for the poor; India's National Rural Employment Guarantee Act is an ambitious effort in this direction, but corruption on the ground is diminishing the delivery of benefits to the target population.

Raising self-employment earnings. Among the actions that have proven effective in this regard are adopting a positive policy stance and avoiding hassles, providing the poor in agriculture with more to work with, facilitating off-farm employment and self-employment, making capital available for the poor, and improving skills for self-employment.

Criteria for Policy Choices

From ample research, we know how poor people work. We know which policy actions have helped the poor earn their way out of poverty. And we know too that the resources available for the fight against global poverty are small relative to the needs the poor face.

The scarcity of resources for combating poverty makes it all the more important that the limited resources available be deployed to maximum effect. There is no one single thing to do everywhere in the world. There is, though, a broadly applicable way of deciding what to do.

I would suggest two basic steps. The first is to ask whether the policy judgment is to be made on the basis of process or of outcome. Some production processes are themselves abhorrent: slavery; child prostitution; those that do permanent mental or physical harm to working people. The question to ask regarding objectionable production processes is, would I rather that people not work at all than work under such objectionable conditions? In those cases where the answer is "not work at all," then a process-based policy judgment may be in order.

Otherwise, policy decisions should be made on the basis of the outcomes that they would be expected to produce. In my view, the most successful outcome-based policy judgments have three ingredients.

First, they are based on one or a small number of ultimate objectives that are made explicit – what I call "bottom-line objectives." I have worked with different bottom-line objectives at different times, but the one I keep coming back to is to do all that can be done to minimize poverty. In this framework, employment and earnings are key intervening variables, but neither one alone is the sole bottom-line objective.

Second, good policy judgments are ones that formulate theoretical models of how each major labor market segment works and how the various segments interact with each other. As a young man, I was profoundly impressed by an analysis conducted in Kenya which produced two revolutionary results: that a policy of urban job creation would *worsen* urban

unemployment, and that the solution to urban unemployment was *rural* development. Formal theoretical modeling is needed to produce new insights such as these.

And third, besides the statistical and econometric modeling that we do at the level of individuals and firms, we need more analysis at the level of markets. Speaking on the occasion of winning the Nobel Prize in Economics, James Heckman (2001) said:

Important challenges to the field include the development of a microeconomic data-based general equilibrium theory for testing theory and evaluating the impacts of large-scale policies. They also include the development of empirically credible econometric cost benefit schemes for the valuation of micro policies that link the program evaluation literature more closely to economics.

What would help achieve the three ingredients just identified - explicit bottom-line objectives, careful theoretical modeling, and statistical analysis at the right level – is social cost-benefit analysis. Social cost-benefit analysis has three essential features.

It deals equally with benefits and costs, not either one alone. It is not enough to show that a given use of resources produces benefits. It must also be shown that the benefits outweigh the costs, both the direct costs and the opportunity costs.

It deals with marginal benefits and costs, not average ones. We all learned in our first economics course to make decisions in terms of marginals, not averages. Just because it is easier to calculate averages does not make that the right thing to do.

It deals with social benefits and costs, not private ones. Nowhere is the failure to distinguish social benefits and costs from private ones more egregious than in the area of educational policy. It is not enough to know that everywhere in the world, people with more education earn more than those with less. We need to know too how much more productive the economy as a whole is likely to be if more people are educated, but that question is seldom asked and even more rarely answered.

In Conclusion

A seventeen year old Kenyan sex worker named Alice has said, “I try to use condoms every time, but sometimes they refuse or offer much more money if we don’t. If I am offered 200 [shillings] for sex with a condom or 1,000 [shillings] for sex without, then I don’t use condoms. I have to feed my baby.”⁶

In his speech earlier this morning, the Mayor of Yalova told us, “We all need our dreams.” Here is mine. I dream that in my lifetime, or if not in mine, in my children’s, all men and women will have had the opportunity to earn their way out of poverty so that stories like Alice’s will become a thing of the past.

⁶ **I try to use condoms every time . . .** See United Nations (2009).

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