

# Aid, poverty, and the working poor

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## KEY FINDINGS

- There are over 900 million working people who earn less than US\$2 a day, while 200 million people are unemployed.
- Unemployment is a bigger problem in high-income countries, in low-income countries unemployment is rarer as work is essential for survival for the poor.

One of the most pressing goals of development aid is the alleviation of poverty. One key way in which poverty reduction can be achieved is by helping the working poor to earn more in the labour market. This method of poverty reduction is underemphasized and there are a number of policy options that should be considered by those wishing to adopt it.

### Poverty and the labour market

It is an oft-repeated truism that the only asset of poor people is their capacity to labour. They have as much of this capacity as anyone else, but are poor because they are compensated very little for their labour, or because they are unemployed and earn nothing. Clearly then it is important to focus on helping the poor earn the money necessary to move up and out of poverty.

The International Labour Organization's estimate that there are around 200 million unemployed people in the world, but over 900

million working people are earning too little to achieve a standard of living of US\$2 a day. This, alongside the fact that unemployed people are found disproportionately in high-income countries, leads to the conclusion that while promoting employment is important, the greater development challenge is to generate higher earnings for those who are already working.

### Policy options

Having established the importance of helping the poor earn more in the labour market, it is important to look at the mechanisms through which this can be achieved. Five mechanisms are worth highlighting:



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1. **Economic growth:** stimulating growth is a common aim of development aid, and often leads to a reduction in poverty. However, this is not always the case and a development policy focussed on reducing poverty needs to recognise this and put in place mechanisms to ensure that all growth helps the poor.
2. **International trade:** a growth in exports has long been associated with an increase in wage levels. However, development policies that push for freer trade also tend to lead to an increase in imports which can lead to job losses in the domestic labour market. Countries considering whether to open their economies to trade need to explicitly consider the effect this will have on the poor. Those adversely affected by freer trade should be compensated in some manner.
3. **The private sector:** some aid is aimed at stimulating private sector development. While private sector growth may lead to more jobs, the motivation behind private companies is profit and as such wages will often be set at as low a rate as possible. However there is room for private sector development which benefits both employers and employees as it can enable companies to earn higher profits at the same time as benefiting workers through increased employment and higher wages. Governments and development institutions should therefore look for ways to harness the energies of private companies towards mutually advantageous ends.
4. **Generating more paid employment:** there are a number of steps policy makers should take when intervening in the labour market with the intention of creating more paid jobs:
  - Avoid prematurely high labour costs. Demand for labour is elastic, if the price of labour goes up, the amount of labour demanded will go down.
  - Remove undue barriers to employment. Restrictions on the dismissal of workers will increase security for those in work, but may make employers reluctant to take on new staff.
  - Increase employees' skills to the extent that skill deficiencies are causing vacancies to go unfilled. Unemployment due to a lack of skills is certainly a problem. However, if people are trained for jobs that do not exist then unemployment may increase as skilled workers wait for suitable jobs.

- Create jobs for the poor. Workfare programmes which place the poor into employment have had great success in Argentina, Bangladesh, and India.
  - Address the right problem. If the problem is a lack of jobs then policies aimed at improving information systems which make a limited number of jobs easier for some people to find will however not increase the total number of jobs available.
5. **Increasing self-employment earnings:** a large number of workers in developing countries are self-employed. Clearly increasing self-employment earnings will help to alleviate the problem of the working poor. There are a number of ways in which this could be achieved.
- Design products to help raise the productivity of the self-employed. Various organizations are already doing this and a wide variety of highly affordable products—from bikes designed, to transport cargo, to water filtration systems—have been developed. Access to these technologies helps would-be entrepreneurs with limited budgets develop their businesses.
  - Adopt a positive policy stance towards the self-employed. A large number of self-employed people operate in the informal sector as street traders or vendors. Policies which seek to restrict such activity by, for example, limiting the number of permits available work against poverty reduction by reducing the amount of available self-employment opportunities.
  - Provide the poor in agriculture with more to work with. Investment in agricultural research and technology can greatly increase the revenue of farmers in developing countries.
  - Facilitate supplemental employment and self-employment. Having a secondary job or business helps increase the earnings of the self-employed.
  - Make capital available to the poor at affordable rates. The poor have limited access to the capital required to make profitable investments that lift them up out of poverty.
  - Build skills and business know-how. A lack of knowledge is a clear barrier to starting a successful business.
  - Stimulate microfranchising. Franchising allows entrepreneurs to expand their businesses, and allows those seeking self-employment activities to adopt a model that has already proven successful.



choose between them. Three questions should be asked about any proposed policy. First, will the policy actually help poor workers? Second, how cost effective is the policy? Third, is the policy not only good but better than any alternative policy? The last question is one that is often missed by governments and development practitioners. All too often a policy is undertaken because of its predicted benefits, without considering whether the benefits of another policy would be greater or what the costs of alternative policies are.

Answering these three questions will not always be easy, but this is no reason to ignore them. When evaluating a policy proposal researchers and policy makers alike should be clear on which objectives the policy is trying to achieve: what economic criteria can be used to judge success; what model of the labour market the policy assumes; and what is the empirical evidence that favours that view of labour market functioning over any other.

There are a number of areas into which more research needs to be done. In particular there is a need for greater understanding about how exactly growth affects the labour market. Does economic growth provide more and better job opportunities to poor workers? Or does it primarily benefit those who already hold political and economic

power? Research is also needed to ascertain how exactly labour markets work in developing countries. As already noted, for successful policies to be formulated good models of the labour market are required.

Despite the uncertainty about the best method of improving labour markets for the poor, doing so should clearly be a priority for governments and development organizations interested in alleviating poverty. There are a number of ways that this can be achieved, from promoting growth, trade, and the private sector, to intervening to create more paid jobs and increasing the returns to the self-employed. A focus on theoretically sound models, appropriate empirical observations, and the exact goals of a policy should help governments and development partners to formulate specific policies aimed at achieving the same goal.

## Evaluating policy interventions

Having looked at a number of policies that could help raise the labour market earnings of the poor it is important to consider how governments and aid organizations should

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## IMPLICATIONS

- Those seeking to reduce poverty should focus on helping the working poor earn to earn more.
- Economic growth, international trade, the private sector, generating jobs, and promoting self-employment could all play a role in increasing the earnings of the working poor.
- It is important to consider the opportunity costs of projects. The question is not only will a project help poor workers, but will it help more than any alternative project.