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Say's Law, Poverty Persistence, and Employment Neglect

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Forthcoming: JI. Of Human Development and
Capabilities

Despite championing the cause of poor people around the world, and dramatizing the 'human condition,' the UN's Millenium Development Goals make no mention of employment generation as a means to battle poverty; there is silence on using economic policies---employment, fiscal industrial, monetary and trade---to create more industries that could provide additional jobs above the starvation level. A World Bank history that starts in 1944 and covers over half a century mentions employment only 7 times in a total of 1,234 pages! (Kapur, Lewis et al. 1997). A popular book on poverty by Paul Collier, the Bottom Billion (2007), while highly praised by Larry Summers, George Soros and the Economist

[#] I benefitted from the comments of an anonymous reader and Helen Shapiro from Big Sur.

magazine, fails in its nine-page, small-print index to make *any* reference to employment, unemployment, self-employment, jobs, or work. Even China elicits silence, no matter how fast employment has grown. "What have been the effects of China's rapid industrialization and economic growth on employment in the country? No widely accepted answer to this question is available from the existing literature. Indeed, there are not many studies that even ask the question" (Ghose 2005) 42. These omissions exist despite the fierce global competition over jobs that will probably define the twenty-first century! Will Africa and other poor countries get a piece of the pie?

Breaking Into the Circle

A steady, well-paid job is regarded as a treasure in the developing world because unemployment and underemployment are typically rampant, and a job is a ticket out of misery and into the middle class. In a country like Mexico, it allows a worker to save, buy a house, and pay for schooling. In all of India's manufacturing industries

except one ("machine repair"), the "formal" sector, where paid employment predominates, is almost three-times more productive than the "informal" sector, where most anti-poverty money goes.¹ To be self-employed in informal services like auto-rickshaws, transport porters, and ready-food stalls, is to earn less in India than an agricultural worker (Banerjee 2005). While poverty alleviation programs tend to rely heavily on volunteers, paid employment acts as a stimulus to economic activity from greater expenditures, as Keynes argued---he called for more jobs, not poverty alleviation to combat the Great Depression. Yet despite all this, while the fight against poverty since 1980 has boomed, job growth in developing countries has stagnated, along

^{##1}More than five years after the Millennium Development Goals were adopted, World Leaders at the World Summit at the UN in September 2005, undertook the commitment to make the goals of "full and productive employment and decent work for all" a central objective of (their) relevant national and international policies . This was followed by a ministerial declaration at the ECOSOC High-level segment in July 2006 expressing the same and the inclusion of a new target, echoing the commitment of the 2005 World Summit, under Millennium Development Goal Number 1 (Eradicate Extreme Poverty and Hunger). See United Nations (2007).

¹ Studies that get other results typically compare micro-enterprises in both sectors, which misses the point---the formal sector has succeeded in building larger, professionally managed enterprises whose productivity may be higher than a micro-enterprise located in either sector. Gelb, A. and et. al. (2009). "To Formalize or Not to Formalize? Comparisons of Microenterprise Data from Southern and East Asia."

with explanations for why this is so.²

This paper looks at two startling facts and then gives a general answer to why there is dementia over jobs (as well as over population planning, which also lies in oblivion). The answer lies in the misapplication of "Say's Law" at the grass roots level, and State Department politics, both biased against employment expansion.

The first fact, based on World Bank statistics, is that between 1981 and 2005, when statist employment policies were being scuttled and the bottom up poverty movement was at its prime, poverty in most developing regions did **not** decline (see Graphs 1 and 2). The bottom-up approach that field-activists and foundations swear by cannot be said to be working effectively, and there's nothing to suggest the data are wrong, at least in terms of measuring how much the poorest people consume (health improvements and water sanitation may not be captured adequately in the numbers). Whether regional poverty is measured by the

² For an excellent overview of the relationship between jobs and poverty see Khan, A. R. (2007). "Growth, Employment and Poverty". Towards Full and Decent Employment. J. A. Ocampo and Jomo Sunderam, Orient Longman for the United Nations.

population share living on less than \$1.25 a day (measured in goods and services), or as a gap between acceptable and unacceptable living standards, regional poverty rates for over twenty-five years in Africa, Latin America and the Middle East *failed to fall*. The most shocking case is Africa, because attention has been focused there and absolute standards of welfare remain low. Ironically, poverty rates fell furthest in East Asia (especially China), the poorest region in the beginning of the period, but where the ratio of employment to population in 2003 was as high as 76.6, compared with only 62.5 in the rest of the world (International Labour Organization 2004-05).

While the stickiness of regional poverty rates may have other causes besides a bottom-up approach (such as HIV/AIDs and population growth), this approach gives short shrift to the use of demand side policies to create jobs, and thus is partly accountable for slow poverty reduction.

Grass root ideas about job creation became dysfunctional because activists--- international estimates of NGOs are roughly

40,000---behave as though "supply creates its own demand" (Jean Baptiste Say, a nineteenth century economist later discredited by Keynes, proposed a law, now called Say's Law, to the effect that under full employment, what an economy produces will be purchased). Like Say, grassroots activists hold as an article of faith that a supply of better clothed, housed, and fed workers automatically creates the demand to employ it at a living wage. Yet if unemployment already exists, then to invest more in workers' human capabilities, whether in the form of healthcare, housing, and schooling, or political freedom, democracy, and transparency (as the Nobel laureate Amartya Sen suggests), may create more perturbed unemployed jobseekers, rather than more plentiful jobs.³ To believe otherwise is a leap of faith. With slow-growing demand for new job seekers, further investments in skills may simply force people to "hire" themselves at starvation wages, as in many micro-enterprises. If more money is poured into tertiary education,

³ Sen, A. (2000). Development as Freedom. NY, Anchor Books.

graduates are likely to add to the educated unemployed or migrate abroad (educated unemployment in Indonesia is estimated to have exceeded 787,800 in 2007).⁴ If a child is inoculated against an infectious disease, but her landless parents have no livelihood and she's hungry, then the effects of the inoculation are blunted. Thus, jobs do not necessarily make an appearance simply because the supply of qualified job-seekers improves as a result of grassroots activism. The demand side must also be improved.

Job dementia, or focusing on the supply side of the job market and forgetting about the demand side, may produce the poverty data presented in Graphs 1 and 2.

The second fact pertaining to job dementia is that US foreign economic policy since the Pax Americana doesn't put 'jobs first'; to the contrary, it gives job formation low priority by leaving capital formation to create jobs *exclusively to private (foreign) investors*. This principle of "private-only" was formulated after World War Two by Dean Acheson, Secretary of State under President Harry Truman, and holds that

⁴ ILO LABORSTA (laborsta.ilo.org).

American aid shouldn't be given if it puts American jobs at risk, or competes for a project with American industry. If it does, it has low priority for Congressional funding (Acheson 1969). The World Bank, whose President is appointed by the US, also never lends to the private sector (except for loans from one small Bank subsidiary); the World Bank lends only to the governments of member states. Lending to the private sector in developing countries is left to private lenders, mostly in developed countries, which helps multinational companies expand abroad. In the 1960s and 1970s the World Bank lent heavily for infrastructure, which may have laid the foundations for steel mills, for example, which in turn created jobs. But the Bank, in the case of South Korea and India, refused to lend to the steel industry directly (even the government-owned segment). Washington opposed, in the belief that more steel mills would create global excess capacity, and thus more competition for steel mills in the US.⁵ What the World

⁵ See Amsden, A. H. (1989). Asia's Next Giant: South Korea and Late Industrialization. Oxford and New York, Oxford University Press.

Bank now favors are loans for privatizing government enterprises, to increase "for-profit" opportunities. In practice, then, American foreign policy is biased against Third World employment because neither foreign aid, nor World Bank loans, nor Third World industrial policies can be used to promote it in a flexible way.⁶

Job dementia that is due to conflicting aims on the part of foreign donors and lenders, therefore, may also influence the desultory results presented in Graphs 1 and 2.

If all governments in the developing world are corrupt, as the grass-roots generally believes, then governments may be hypothesized to become *less* corrupt with reverse brain drain of the highest talent. This talent faces the greatest personal opportunities for economic gain through *legitimate channels*---in business, finance and services---and doesn't need to be

, Kapur, D., J. P. Lewis, et al., Eds. (1997). The World Bank: Its First Half Century. Washington, DC, Brookings.

⁶ For the under ground industrial policies that have emerged as a result of restrictions on industrial policies by the World Trade Organization, see Amsden, A. H. and T. Hikino (2000). "The Bark is Worse than the Bite: New WTO Law and Late Industrialization." Annals.

corrupt, or doesn't care to be corrupt given its culture. The difficult task of attracting talent back home, and into the government, requires incentives. As reverse brain drain in fast-growing East Asia and Middle Eastern oil-producing countries suggest, governments tempt talented "brain gain" back home by offering it public-sector jobs with high pay and heavy responsibility, from starting a public venture-capital fund to running a national oil company (as many as 40 developing countries now produce at least one million barrels of oil a day). With this elite in place, joined by home-educated top talent, governments can strengthen their anti-poverty programs by introducing new technologies (for energy, Brazil's sugar ethanol), by accumulating expertise (for rural electrification, China's state power companies) or by forming small- and medium-size enterprises in poor regions for profit.⁷ With reverse brain drain gathering momentum, there are likely

⁷ Rural electrification, despite its centrality to fighting poverty, has made notable gains in China, although little is written about this possibly because China's approach was not bottom up. Stanford University Program on Energy and Sustainable Development (2006). Rural Electrification in China 1950-2004. Stanford, Ca, Stanford University.

to be enough qualified professionals around to strengthen the capabilities of private companies, using a top down approach that draws on government money and expertise (national and provincial). Taiwan is a role model for this because it has always had hundreds of private small factories operating in rural regions and towns, supported by government research centers.⁸ Its neighbor, China, is a paragon for collectively owned "town and village enterprises" (TVEs).

Countries like Taiwan and China, that excelled in developing after World War II, *all* started with prewar *manufacturing experience*, either from foreign émigrés or colonial firms (Amsden 2001). A focus on poverty alleviation of professionally managed small- and medium-size firms--- more professional and more likely to survive than the typical micro-enterprise---might provide a way for the poorest countries to break into this circle.

⁸ For the machine tool industry, see Amsden, A. H. (1977). "The Division of Labor is Limited by the "Type" of Market: The Taiwanese Machine Tool Industry." World Development(5): 217-34.

No Substitute for A Good Job

To increase low incomes, a society can either invest directly in factories that provide employment, or invest in a public good like transportation that supports the rise of factories. The two are complementary, but not perfect substitutes. A rise in paid employment has a greater absolute advantage than a rise in poverty alleviation in advancing the *institutions* of economic development. Falling *population growth rates*---a plus for development---tend to respond more to changes in paid employment than to changes in poverty alleviation.

Population and Wage Labor

The "mortality revolution," as the economic historian Richard Easterlin calls it, involves radical changes in mortality rates, birth rates and population growth rates. As this process is theorized, it begins with an increase in productivity, due to the division of labor, which then leads to an increase in labor demand in urban areas, where *specialization in production and distribution goes furthest*. There is a

turning point in mortality as paid employment spreads. "A decrease in the demand for children is caused primarily by several processes linked to modern economic growth---education, urbanization, and the introduction of new goods." Universal schooling takes children away from work, so they are worth less as breadwinners, driving down birth rates. Paid women workers, with more education, prefer fewer children than foregone earnings, driving birth rates down further. Material aspirations rise and culture changes in favor of a pattern of consumption that is less family-centric and more oriented towards 'buying' rather than 'making' goods and services (Easterlin 1998).

This epochal demographic shift tends to be slower under a regime of poverty alleviation. Because people tend to remain where poverty alleviation is administered, in the rural regions, culture changes relatively slowly. As it remains in tact, especially in the absence of land reforms or technological change in agriculture, population growth rates don't fall fast. Unemployment worsens and out-migration

overburdens cities, reinventing the poverty cycle. Thus, the impact of poverty alleviation on radical institutional change is less positive than the impact of job formation.

Dementia over jobs and population growth rates have gone hand in hand; little external finance has flowed to either recently, and wages have sagged under population strains. In the 1970s, "the World Bank's population advocacy had done much to legitimize the developmental significance of family planning," but this stopped after negative fall-out from Indira Gandhi's forced sterilization program (and China's one-child family). Both programs are now associated with gender bias in births, but they should also be associated with fast economic growth and large falls in birth and death rates, especially in China (China's poverty fell much faster than India's, as shown in Graphs 1 and 2). Yet uncourageously, the World Bank took a more "roundabout" approach to population, one in which "family planning was integrated with and partly disguised by health and nutrition projects" (Kapur, Lewis et al. 1997) 344-45.

Thus, as poverty alleviation spread, the two headlights guiding the way towards economic development were dimmed, job formation and the mortality revolution.

Investing in the 'Heart of Darkness'

While the bottom up approach to poverty alleviation takes Say's Law for granted (employment---including self-employment at a living wage---is seen as the automatic reward of greater grassroots effort), the top down approach also requires an assumption: that there are, in fact, profitable investment opportunities in poor regions (rural or urban) that a private entrepreneur would consider investing in if government incentives were right (such as free land, good roads, cheap credit and hard-driving, docile workers). Together, these incentives might make an otherwise unprofitable investment in the short run profitable in the long run, as investments in learning bore fruit. The evidence from investment feasibility studies, or what the World Bank calls "investment climate

reports," is almost always positive.⁹ There are opportunities in impoverished lands for small factories, or agri-businesses, or service outlets, including some of Africa's poorest countries. A CEO from one of Korea's conglomerates (now defunct), that exported textiles in the 1970s to Indonesia and Africa, said "I can see money everywhere...It is in America and in Africa, but you have to work hard to see it and to get it. If you try hard enough, you will see more money than you could possibly collect in your lifetime" (Harvard Business School 1985).

Beyond Micro-Enterprises

Paid factory employment will only prosper in low-income regions if it can overcome the primary problem that has vexed entrepreneurs stuck in tiny, family firms: forming sustainable business enterprises that have some modicum of professional

⁹ A number of World Bank investment reports are mentioned in a popular seller, the Bottom Billion, which argues that the poorest countries are poor due to war but can be saved from free trade. Unfortunately, most world trade is now conducted within the confines of regional trade agreements, and many poor countries are not a part of any viable agreement. Collier, P. (2007). The Bottom Billion: Why the Poorest Countries are Failing and What Can be Done About It. NY, OUP.

management. This is the primary challenge today to entrepreneurship in poor countries. Clifford Geertz, in his classic interpretive study of Javanese traders in 1963, Peddlers and Princes, emphasized this organizational weakness of Third World businesses: "What the entrepreneurial group of Islamic small businessmen most lacks is not capital. . .or drive...or a sufficient market. . .It lacks the capacity to form efficient economic institutions; it is a group of entrepreneurs without enterprises" (Geertz 1963). What can activists do to help?

Scientists and engineers can raise living standards by inventing something the developing world can "make," not only "use." They can put less (relative) weight on transferring technological innovations to poor countries that are designed to be consumed by the poor, like air-friendly charcoal briquettes for indoor cooking, and provide more products around which a business can start, like finding new markets for briquettes, and improving the production process for cooking stoves. The \$100 laptop, designed by the MIT Media Center, raises literacy, but just because millions

of youth gain computer skills doesn't mean they can find gainful jobs. The first place to look for paid work, though, may be found in manufacturing computer parts.

Conclusion

To slay the dragon of poverty, deliberate and determined investments in jobs above starvation wages must play a central role, whether for self-employment or paid-employment. The grass roots approach to solving poverty doesn't go far enough, because it aims only at improving the supply side of the labor market, making job seekers more capable, and not the demand side, making new jobs available for them.¹⁰ It acts as though new ways of earning a living emerge (at a positive wage) simply because the supply of job seekers is better clothed, housed, and fed, or enjoys more human rights---which is the same fallacious reasoning behind Say's Law, to the effect that the supply of whatever an economy produces creates the demand to buy it (at a positive price). One ignores unemployment; the other ignores under-consumption. By not

¹⁰ Some grass roots groups, of course, like OXFAM, do worry about the demand side.

strengthening the demand side, twenty-five years of supply-side poverty alleviation has left poverty rates for the poorest people unchanged (assuming World Bank data are correct), including Africa's poor, the target of the attack on poverty (see Graphs 1 and 2).

Employment generation is different from poverty alleviation because it has a concept behind it, "capital." This means that the labor market is influenced by, and influences, all flows through the savings-investment nexus, including accumulation, distribution and innovation. It is at the heart of political conflict. Multi-faceted policies, therefore, are required to promote employment growth, from fiscal and monetary, to industrial and trade. Poverty alleviation has its policy rages, too, but they're more confined, outside the capital accumulation process. Still, the coordination of policies to create employment in the Third World's most impoverished regions is not impossible even if it is multifaceted. Excellent work in the 1970s was produced on

the subject, only to be shelved in the 1980s for political reasons.¹¹

Besides Keynesian and industrial policies to raise investment and employment, and to reverse brain drain (which can alter a country's comparative advantage overnight), three changes in embedded practice might go a long way towards "bringing employment back in."

The first is to cease a heavy reliance at the grass roots on volunteer, unpaid labor---it is necessary to form NVOs (non-voluntary organizations) along with NGOs (non-governmental organizations). The greater the number of unpaid volunteers, as in healthcare workers, the greater the difficulty of creating paid professionals, as in nurses.

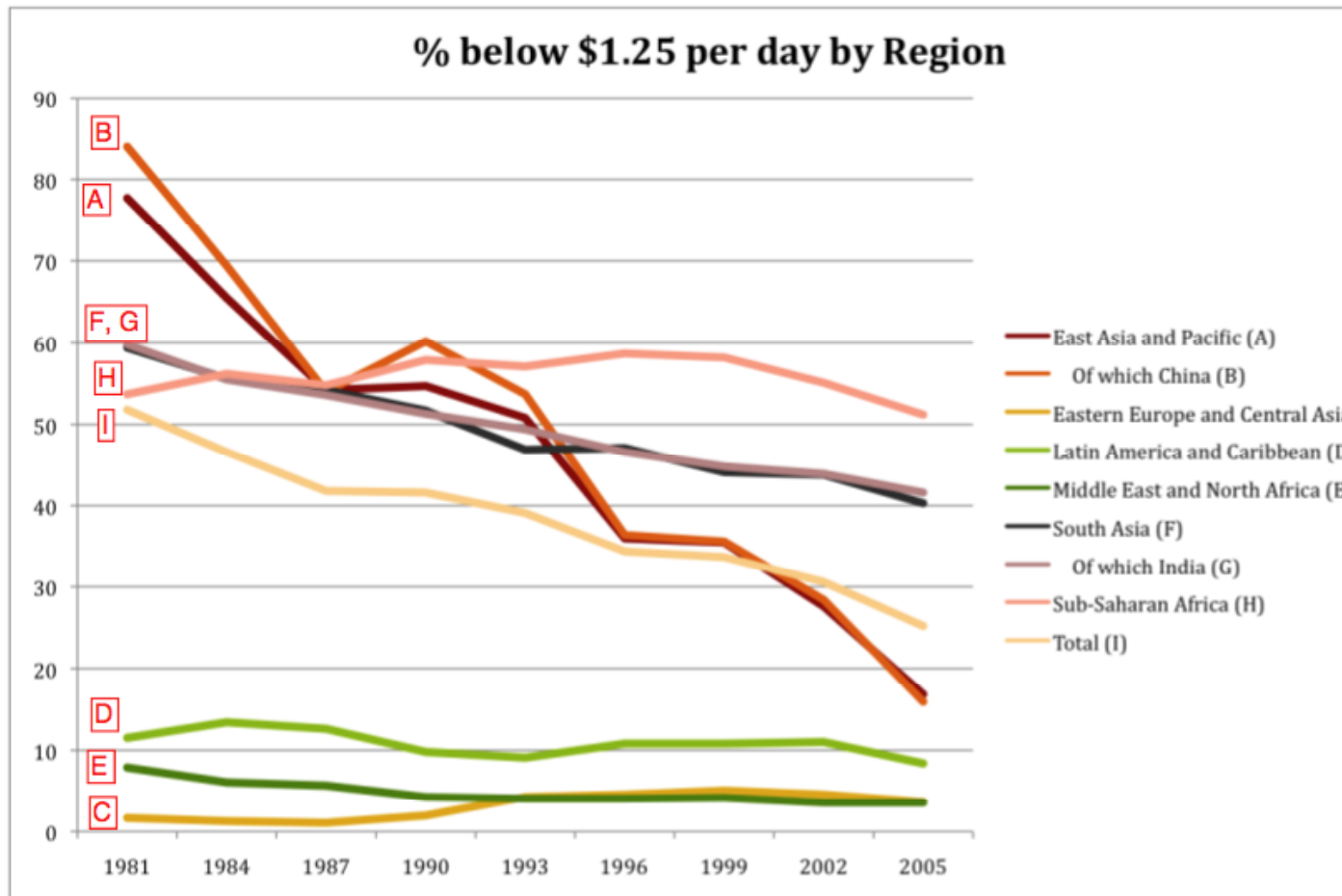
The second is to strengthen the alliance between grassroots activists who are not hostile to government intervention and government bureaucrats who are involved

¹¹ One of the best studies, that combined poverty alleviation and job promotion, was done by the ILO in Kenya: International Labour Office (1974). Employment, Incomes and Equality: A Strategy fo Increasing Productive Employment in Kenya. Geneva, ILO. It was experimental and tried to open the doors to new ideas. One was that if income is re-distributed to the poor, employment will increase faster because the poor consume a bundle of goods made with more labor-intensive technologies than the rich.

in poverty reduction. Not just working together, but also working on a model for future collaboration, would lay the groundwork for a new generation to follow.

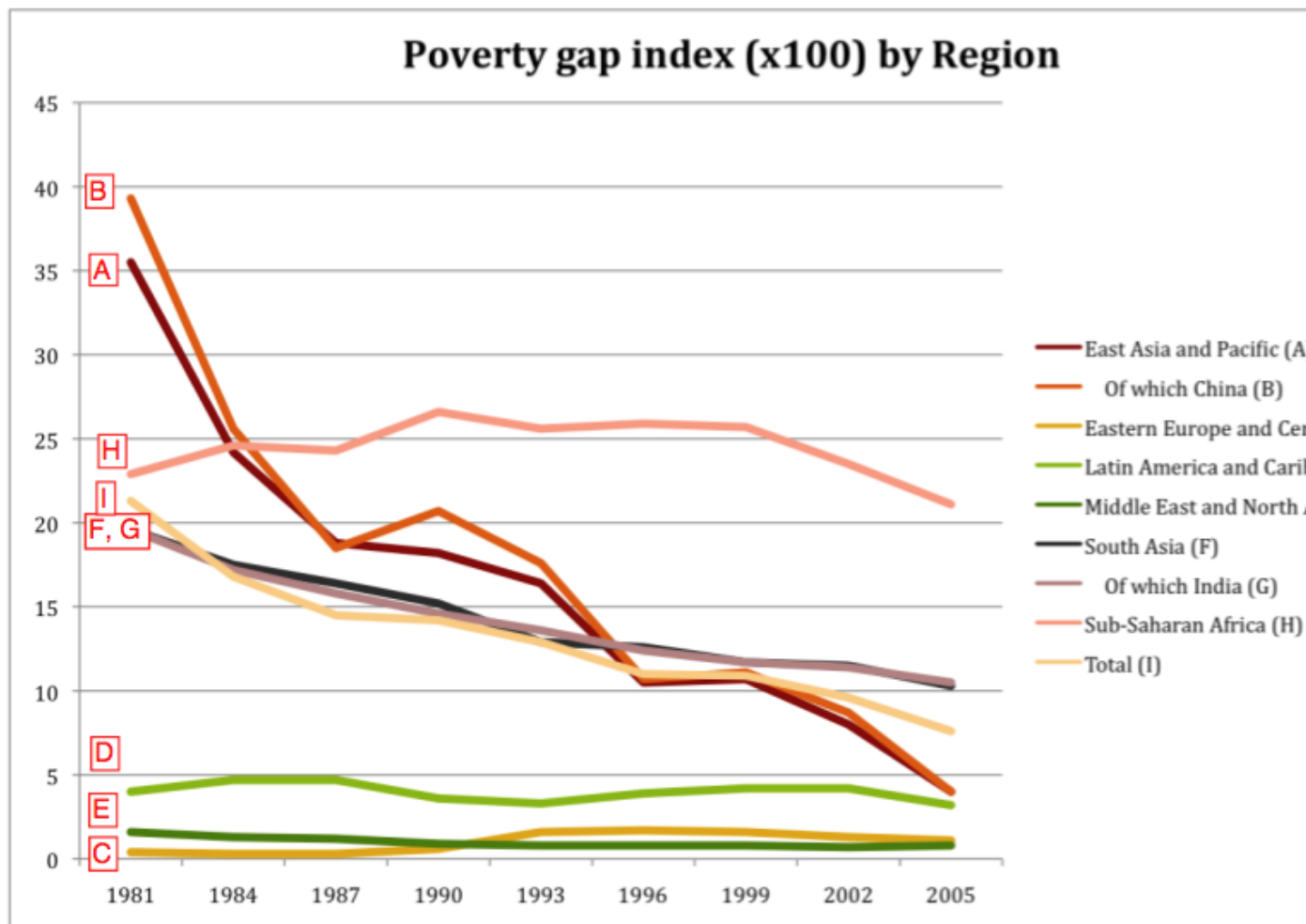
The third is to revolutionize foreign aid by tying it to jobs. For every dollar spent on poverty alleviation, a dollar should be spent in the poorest regions on employment creation, following the lead in rural employment generation established by China and Taiwan. Some aid donors could concentrate on the investment part of the project and other donors, with hands on experience in business, could provide technical assistance on what is likely to work. Instead of buying a \$100 laptop computer, developing countries could start competing by producing a \$95 dollar one!

Graph 1



All data are adapted and taken from: Chen, Shaohua and Martin Ravallion. Aug 2008. "Policy Research Working Paper 4703: The Developing World Is Poorer Than We Thought, But No Less Successful in the Fight against Poverty." The World Bank Development Research Group.
http://econ.worldbank.org/external/default/main?pagePK=64165259&piPK=64165421&theSitePK=469372&menuPK=64166093&entityID=000158349_20080826113239

Graph 2



All data are taken from: Chen, Shaohua and Martin Ravallion. Aug 2008. "Policy Research Working Paper 4703: The Developing World Is Poorer Than We Thought, But No Less Successful in the Fight against Poverty." The World Bank Development Research Group.

<http://econ.worldbank.org/external/default/main?pagePK=64165259&piPK=64165421&theSitePK=469372&menuPK=64166093&entityID=000158349_20080826113239>

Poverty Gap index = the mean distance below the poverty line as a proportion of the line where the mean is taken over the whole population, counting the non-poor as having zero poverty gaps.

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