

Policy Brief

Growth, Poverty Reduction and Inequality in Ethiopia: The role of Labor Markets (between 1994 and 2004)

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THE ISSUES

In poverty literature, poverty reduction in a growing economy is analyzed in association with *inequality*. Economic growth could be accompanied with growing inequality, or with no change in inequality (distribution neutral growth), or with declining inequality (pro-poor growth). Poverty reducing impact of growth with increasing inequality is low while that of distribution neutral growth and pro-poor growth is higher. This means growth does not necessarily lead to poverty reduction.

Since poverty reduction is the leading millennium development goal and hard earned growth should not be wasted with little effect on the highly cherished goal, it is of paramount importance for policy making to understand the channels of transmissions of growth leading to poverty reductions

For a poverty reduction concern, the natural question arising is then "*what makes growth non inequality increasing?*" or "*what transmission channels render growth either pro-poor or distribution neutral nature?*"

Poverty reduction in the context of "growth with non increasing inequality" can materialize through diverse channels that enable the poor to have more income or consumption. **Redistribution of growth bonanza**, through government transfers and provision of basic services, is one channel. Generation and expansion of income through **labor market transmission mechanisms** is another channel. Enhancing **ownership of assets** that generate income flows for the poor may still be cited as another channel. This study attempts to shed light on the existence on the ground of labor market transmission mechanisms that render growth itself either distribution neutral or pro poor nature and hence poverty reducing. On the reverse, the study asks the extent to which poverty was reduced by labor market variables. In short the study investigated whether:

- labor market channels were open during the growth process,
- Consumption level and growth (and hence poverty reduction) were affected by labor market variables.

Labor market transmissions channels considered in a context of growing economy are: *creation of local productive employment rises in wages/earnings, and expansion of migration opportunities for gainful employment elsewhere.* The existence of these channels, in significantly wide extent, renders growth inequality non-increasing, which is poverty-reducing. The assessment of the existence of the channels in the growing economy attempts to answer the following question from the available data on the labor market. *What was the extent of employment creation? Were there rises in wages or earnings? Were there opportunities for the poor to migrate?* The other line of investigation goes in the direction of assessing *the significance of labor market variables in increasing consumption and reducing poverty.*

The datasets used are country level aggregate data obtained from labor force surveys ^{(1),(2)} conducted in the period under study by the Central Statistics Agency (CSA) of Ethiopia and household panel data of five rounds on urban samples and household panel data set of six rounds on rural samples collected by the Department of Economics, Addis Ababa University, in collaboration with Oxford University and IFPRI since 1994 up to 2004. The descriptive aggregate analysis largely relied on the country level labor force survey data of CSA. The econometric analysis used the household panel data. These household level panel data sets were preferred as they were apt to capture the dynamics at household level.

MAJOR FINDINGS

1. The opening of labor market channels

(a) Employment expansion and poverty reduction

In the period under study rural underemployment prevailed in the guise of employment.

Rural employment rate was 95% and 96.5% in 1999 and 2005 respectively. The high rural employment masked the underlying underemployment. Unpaid family employment dominated agricultural employment (55percent and 58percent in 1999and 2005 respectively). In comparison, self employment accounted for 42 percent and 39.8 percent employment in the respective years. Unpaid family employment is, in most cases, a last resort engagement taken up when other employment opportunities do not appear. Such engagement does not enable individuals to use the full potential of earning from own labor endowment. Those engaged in agricultural unpaid family labor are underemployed because of the fixed land supply for a growing agricultural population.

Rural open unemployment rate was relatively too low in the period to be responsible for much of rural poverty. The poor were largely underemployed in the guise of extended employment. Such employment is not likely to reduce headcount index, though it may reduce poverty gap or severity. Rural employment expansion as a labor market channel for poverty reduction was weak under the existing circumstances of growth. Or the growth process did not create gainful employment opportunities for the rural poor.

Urban employment was not expanding to match the growing output share of urban based activities.

There was no change in proportion of urban employed to country level employed in the period. The percentage of urban employed in total employed remained at 11% in both 1999 and 2005. Moreover, while agricultural share of output has declined by 8 percent and share of service has increased by 9 percent, the sectoral shift in output was not reflected in sectoral shift in employment. In the period under study agriculture still engages, even if partially, 80 percent of the work force, with no significant change in share of employment. The growth process was not expanding the share of urban employment.

(b) Labor earnings and poverty reduction

Changes in agricultural productivity were extremely low.

Change in agricultural productivity either arising from changes in land productivity or from changes in labor productivity or both were extremely low. In the period, yield per hectare remained between 11.7 and 13.5 quintals in grain production (CSA, Agri. Surveys ⁽³⁾). Low productivity change coupled with growing agricultural labor force suggests low real labor income.

Percentage of employed in sectors and occupations characterized by low payment remained high.

Urban informal employment was 50.5 and 39.4 percent in 1999 and 2005 respectively, and urban employment in elementary occupation was 28.7 percent 25 percent. The highest proportion (about 80 percent) of employed persons in the country was for those engaged in elementary and agricultural occupations. Such occupations are known for being at the lowest rung of payments or returns.

c) Migration and off farm activities

Increased demand for off farm services where the poor could be employed and migration in search of such activities were limited.

The rate of structural shift in output was not accompanied by comparable employment shift to enable gainful rural urban migration. The rate of structural transformation and the subsequent increases in opportunities for employments and remittance generation from internal migration do not seem large enough to reduce poverty.

Overall the contribution of the labor market in transmitting growth to poverty reduction outcome was limited.

The reason lies in the expanding underemployment in agriculture and the nature of demand for labor induced by the growth process was unable to shift labor to the growing sectors. The absence or low sectoral employment shift has obstructed migration opportunity and the benefit of reducing poverty thereof.

The official figure of poverty reduction in head count index in the ten years period (1995/6 to 2004/5) was 7%. Per capita GDP growth for the period 1994 to 2005 was 2.57 percent per annum, which amounted to 25.7 percent across. The change in poverty reduction per unit growth of output was 0.27 which means that 10 percent growth reduced poverty only by 2.7 percent. Rural poverty reduction was higher (13 percent) than the urban counterpart (2 percent). If the labor market channels were weak on aggregate level to transmit growth to poverty reduction what explains the observed rural outcome? The achievement in rural poverty reduction may possibly have been due primarily to non labor market channels such as the then ongoing pro-poor programs of "Food Security Program", and the "Productive Safety Net Program" (MOFED, 2005/6) ⁽⁴⁾ etc.

2. Impacts of labor market variables on household poverty

While the results from the labor force survey data tell a story that labor market channels were not wide open to impact on poverty, the panel data results tell a story that in occasions, where they were open to households they were giving the desired poverty reduction outcome.

a) The Effect of Employment on poverty

The household panel data unveils that urban employment and sector of employment mattered for consumption. Those employed were in higher consumption quintiles while the unemployed were in lower consumption quintiles.

Urban poverty was more responsive to labor employment than the rural poverty. Rural poverty did not respond to farm employment expansion on fixed land supply. Relative to working in the agricultural sector, working in industry, service and other sectors were associated with increased growth and level of consumption. The effect of number of working family members in the poverty status of the rural households was insignificant suggesting that employment on the agriculture alone could not reduce poverty under the given circumstances.

The richest rural households devote almost twice as many days of work as the poorest, signifying the availability of more opportunity to work as an important factor for increased consumption.

b) Urban earning effects on poverty

Income to households from female business activities was negligible in any of the survey years. Hence, for those households, with significant proportion of their income coming from female business activity, escaping poverty was extremely difficult. The returns from their labor market activities were very low.

c) Migration and off farm employment effects on poverty

In rural areas the number of days devoted for off-farm activities (i.e. the intensity of employment away from agriculture) mattered for better welfare. Households that devote more days for such activities were located in the higher quintiles. Such engagement reduces underemployment. The total

numbers of days spent by household members on off-farm activities are associated with higher level of consumption.

Policy implications

a) While employment is positively associated with consumption level and growth, employment in most occupations provided extremely meager income. Creating employment reduces the poverty gap. To reduce poverty in terms of head count index, improvement in real wage/earnings has precedence over expansion of employment in existing occupations. The growth process would have pronounced head count index reducing effect if it primarily changed the occupational composition, and the productivity of employment.

b) Expansion of employment was in actual fact more of underemployment in disguise. Under such circumstances removing underemployment becomes as relevant as removing open unemployment. This refers to the importance of reducing the percentage of employed poor, be it paid (casual, contractual permanent employees), unpaid, self employed or informal.

c) Growth that brings changes in employment type, converting unpaid family workers to paid workers, informal workers to formal workers, could be crucial to poverty reduction. Being unpaid family worker is a last resort employment when other opportunities do not materialize. The unsurprising conclusion that may be drawn is that growth having strong impact on poverty reduction seems to be one that shifts the flexible agricultural labor and informal urban labor to the modern sector with formal employment.

d) The two most important variables that increase growth as well as level of consumption are the total number of household members for households engaged in off farm employment and the remittance received by households. Providing off-farm employment opportunities is the direct and strong policy implication of this result.

e) The actual contribution of the labor market in transmitting growth to poverty reduction outcome was limited. This is confirmed by the low response of poverty to growth. On the other hand the household data analyzed with econometric methods tells that the labor market variables of

employment and occupational sectors have a good potential in transmitting growth to poverty reduction outcomes.

Recommendation

Overall the data suggest that although labor related variables play important role in determining the poverty status of households, the channels of transmission, i.e., employment expansion for the poor, productivity rises in employments that hire the poor, and migration opportunities to the poor, have not been opened wide by the growth process. The growth experience and the achievement in poverty reduction indicate the need to open the channels more for better results in poverty reduction. Growth that fails to expand employment, or that doesn't raise productivity and that expand migration of the poor is likely to be inequality increasing, in which case channels of transmission other than the labor market might be needed for poverty reduction. Poverty reduction policies using the labor market as a transmission mechanism to meet welfare improvement goals need to emphasize:

- Facilitation of the employment of urban poor (This requires Investment policies, land policies, credit policies have to be aligned to facilitate faster creation of jobs)
- Improving the productivity of urban poor, prioritizing the informal sector. Establishing linkages with formal sectors, training support, market support for input as well as product and credit access might improve those working under the informal sector.
- Creating more non-farm employment opportunities. This calls for encouragement of the establishment of activities using unskilled labor in non-farm sectors in rural areas or in neighboring towns. Such interventions can increase rate of transformations from agriculture to non-agriculture
- Facilitating migration and guiding the rural poor to better paying sectors through facilitating ease of mobility of labor so that labor migration to nearby towns and workstations to generate income on daily basis is enhanced. The facilitation leads to labor availability and that in turn induces entrepreneurs to creating labor using businesses.

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 2. Report on The 2005 National Labor force survey, May 2006, Statistical Bulletin 365, CSA
 3. Annual Agricultural Sample Surveys(Various issues between 1995 and 2004), CSA
 4. Development Planning and Research Department (DPRD), Ministry of Finance and Economic Development (MOFED) 2008 .Dynamics of Growth and Poverty in Ethiopia(1995/96-2004/05)Addis Ababa, Ethiopia