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External Constraints to Poverty Reduction and Employment Creation in Africa: Implications for International Policy

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> Work is central to …people's lives and the main test by which they judge globalisation. It is the source of dignity, stability, peace and credibility of governments.
>
> (Juan Somavia, Director-General of the ILO, *International Herald Tribune* 27 February 2004, p. 6)

Executive Summary

Overall perspective

The principal focus of this report is on the relationship between external factors and the quantity and quality of wage employment in Africa. A majority of households, both urban and rural, derives income from self-employment as well, and this also requires consideration. Both the rate of economic growth and its distribution across sectors and households are influenced by the integration of each country into the world market. Since economic growth and its distribution affect the growth and structure of employment, and the quantity and quality of employment affect poverty, it follows that external factors influence poverty reduction to varying degrees in every country.

The general argument of the report can be summarised as follows. While poverty in the sub-Saharan region has strong supply-side causes, relieving the supply constraint would not in itself increase employment if working time is demand constrained. And even if demand is not binding, poverty will not be reduced if earnings per unit of time are well below the poverty level. Translating growth into increases in wages is a necessary condition for poverty reduction; increases in employment alone are unlikely to be sufficient. Increases in wages and improvement in working conditions are not automatic market outcomes, but require the invention of the organisations of the social partners. Thus, human rights and the rights of workers are an essential link in poverty reduction.

Analytical Framework

There are two broad theoretical approaches to macroeconomic analysis, demand constrained frameworks and price constrained frameworks. *A price constrained economy* is either in a unique full employment general equilibrium, or prevented from achieving that general equilibrium by private or public price 'distortions'. *An economy is demand constrained* when its level of output limited is by one or all of the components of aggregate demand: consumption, private

investment, government expenditure, or exports. The theoretical differences between the two frameworks imply profound policy differences.

The economic justification of the ILO's approach to employment and livelihoods is that economies are demand constrained. Were economies price constrained, unemployment would be voluntary implying that assistance to the unemployed need only be for short-term. As a corollary, differences in incomes among workers and between workers and non-workers would reflect allocative efficiency, so that interventions to promote equity would be 'distortionary'. The demand constrained framework predicts and accounts for unemployment, concludes some inequalities to be inefficient, and calls for effective public sector intervention to achieve social objectives.

Poverty Reduction and Employment

Notable gaps in the discussion of poverty reduction in developing countries in general, and for the sub-Saharan region in particular, are the role of distribution and employment. These are both areas of long-standing ILO expertise and policy emphasis. Recently, theoretical and empirical work has gone some way to correct the absence of the former, but discussion of employment as such is almost totally absent in the poverty reduction literature. This absence is perhaps most glaring in the documents arising from the Poverty Reduction Strategy process (PRS, and the document itself will be referred to as the PRSP), which purports to be the basic policy framework for medium term achievement of the Millennium Development Goals. It would not be valid to justify this absence on the grounds that the MDGs do not include explicit employment targets, though this omission is quite serious.

In the sub-Sahara, increasing decent work faster than the growth of the labour force, and thereby decreasing poverty, is a problem that must be addressed by the combination of faster growth and a more equitable distribution of income and wealth. Since these two economic mechanisms cannot, even in logic much less practice, be separated, the long-standing emphasis of the ILO on economic equity can appropriately be extended to an emphasis on growth. In other words, it is neither logical nor practical that there be a 'division of labour' among international organisations, in which the ILO is limited to equity concerns. Its remit for decent work and poverty reduction requires stress on the determinants of growth as well.

External Constraints

While access to developed country markets provides potential benefits to African producers, the realisation of these benefits involves many necessary links, particularly with respect to poverty reduction. They are as follows: 1) the access provided must apply to the products exported from the sub-Saharan region, 2) there are minimal 'fallacy of composition' effects, 3) producers of the products in question, as proprietors or workers, include poor households, and 4) increased export of the products results in a net income gain for the poor via increases in time worked if the poor are underemployed, and/or in earnings per unit of time. Were all these benign effects to be realised, it is likely that non-tariff instruments of protection make the net effect of developed country trade policy quite negative. The more important are anti-dumping measures, coercive bilateral agreements, and domestic trade subsidies.

Industrial country financial policies tend to have a smaller direct effect on the sub-Saharan region than in Latin America or Asia, due to the underdeveloped nature of the region's financial markets. However, these policies indirectly affect the region through their emphasis on a restrictive monetary policy, which manifests itself in loan conditionalities of multilateral organisations. Especially detrimental to growth in the region is the practice of inflation targeting.

While official development assistance (ODA) plays a positive role in most sub-Saharan countries, it falls below requirements to meet the MDGs, and is rarely linked to the decent work agenda. Further, current ODA practice leaves much to be desired (see UNCTAD 2000). Discussion of aid effectiveness has tended to stress the appropriateness of recipient government policies, issues of governance, and recipient commitment to key objectives, especially 'sound macro policy' (see World Bank 1998). As a result, this literature tends to issue the overall message that problems with aid effectiveness arise from the behaviour of recipient governments. This emphasis is unbalanced, and reflects the perspective of donors and lenders. From the recipient point of view there are several quite important reforms that would substantially reduce the resource constraints of sub-Saharan governments: harmonisation of ODA with recipient budget cycles, reduction of conditionalities, and donor and lender flexibility to allow ODA to be used as a counter-cyclical instrument.

Despite it being a central PRSP principle, only limited progress has been made in recipient ownership of development assistance programmes and projects. As a result, development assistance can foster aid dependency. The most obvious manifestation of this dependency is heavy reliance on development assistance for the national budget. Perhaps even more debilitating in the long run are policy conditionalities, the short term financing perspective of donors and lenders, and experts that answer to donors and lenders rather than the government.

The characteristic of global commodity markets that constrains growth in the sub-Saharan region is the volatility of primary commodity prices over the economic cycle, which is particularly serious for the region with its high dependence on such commodities and low degree of export diversification. The countries of the region also tend to suffer from a lack of competition on the import side.

Of considerable importance to the region are the institutions and regulations associated with the transfer of technology. The sub-Saharan region has less indigenous capacity for technological development than any other, primarily due to the level of underdevelopment, the long-term decline of university education, and the virtual collapse of regional and sub-regional research institutes. The constraining effect of external dependency on technological development could be made worse by the trade related 'intellectual property' rights (TRIPs) regulations of the WTO. Also deleterious might be a rejuvenation of the Multilateral Agreement on Investment (MAI), underway within the WTO framework.

The links between FDI and poverty reduction are highly conditional, implying that no general conclusion can be drawn. Further, even when the scenario is inclusive of the poor, the effect is likely to be relatively small, since on average FDI represents approximately two percent of GDP across sub-Saharan countries. The majority of this investment goes into the petroleum sector and extraction of minerals, activities than generate relatively little employment. These are not arguments against FDI; they counsel caution that the gains form FDI should not be exaggerated.

Poverty reduction will be achieved through the growth of employment at above poverty level wages, and by increases in the incomes of the self-employed. The stagnant per capita growth rates in the sub-Saharan region translate into rising unemployment and stagnant or falling incomes for those productively employed. Over the twenty years, 1983-2002, the growth of output per member of the labour force was negative in more years than it was positive.

Poverty, Employment and the PRS Process

The PRS process is very much a work in progress, and numerous reports have identified its shortcomings. First, while in most PRSPs there is a coherent growth strategy; this strategy is not always pro-poor, and is rarely linked to employment. The focus on poverty issues is frequently a step forward from previous national documents, but the poverty diagnosis typically lacks a link to poverty reducing employment policies. In other words, many PRSPs do not integrate poverty and growth. Second, and related to the first, PRSPs tend to be *macroeconomic frameworks* constrained by Bretton Woods conditionality with discussion of poverty reduction, rather than *development strategy frameworks* for poverty reduction. Third, the partnerships among development agencies, including the UN system, tend to be dominated by the World Bank. In great part this results because the PRS document itself is a pre-condition for initiating a Bank programme (which is not the case for the IMF, bilaterals and the UN system).

The ILO can make an important contribution to overcoming these shortcomings. Through emphasis on poverty reducing employment through growth and redistribution, it can help define the links among poverty diagnosis, policies, and poverty reduction. For this to have an effective impact on the PRS process, a restructuring of partnerships among development agencies is necessary, in which the UN system establishes itself as an equal partner in defining the framework more broadly, fostering flexible fiscal guidelines that accommodate public investment, and influencing the basic goals of the process, especially national ownership of development strategy.

National Policy

For the sub-Saharan countries, perhaps the most effective instrument for promoting and investment-led employment strategy for poverty reduction is fiscal expansion through increasing public investment. While such fiscal expansion can generate government deficits, there is no longer a consensus that these are necessarily inflationary. As long as inflation is kept within a moderate range, it does not necessarily dampen growth or directly harm the poor. Moreover, growth stimulated

by fiscal expansion in the long run can generate the fiscal revenue needed to reduce budget deficits via the elasticity of taxes with respect to GDP.

While advocating for greater flexibility on stabilization policies, the ILO supports forms of public investment that can provide a more long-term, durable basis for employment growth and poverty reduction. This implies capital accumulation and technological innovation that can deliver lasting gains to the poor. Fiscal policy should foster sustainable growth, and emphasis in national poverty reduction strategies from short-term targeted interventions to longer-term programmes that alter the underlying structure of people's access to resources and technology.

Policies of International Institutions

Major constraints on employment creation and poverty reduction by the IMF are the lending conditionalities that restrict the policy space of governments. 'Policy space' means the extent to which governments are allowed policy options to pursue their goals. IMF conditionalities restrict policy space in two ways: 1) in general, by basing their policy packages on a special case of economic theory, that economies are price constrained; and 2) specifically, through deficit limits and inflation targeting that reduce the scope for fiscal expansion and a growth-accommodating monetary policy. Employment growth and poverty reduction are also constrained by excessive performance criteria and waiting periods for HIPC II debt relief.

Specific changes to enhance employment creation and poverty reduction would include: 1) the end of inflation targeting in favour of setting target rates derivative from desired growth performance; 2) reducing the number of conditionalities and the focus upon stabilisation; 3) allowing flexibility on deficit limits, consistent with growth targets; and 4) institutionalising independent formulation and evaluation of policy programmes. The foregoing would allow for fiscal and monetary policy to be used as counter-cyclical tools

The World Bank's loan conditionalities have limited policy space by governments through excessive conditionalities, frequently in areas beyond the institution's core mandate. In recent years these constraints have been compounded by a narrow approach to the PRS process, which treats the poverty reduction strategy as derivative from Washington Consensus-type macro frameworks. The first step towards relieving the constraints of World Bank programmes would be to limit the

institution's operations to its core mandate of medium and long term development finance, including budget support.

A more general and systemic problem with both IMF and World Bank programmes is the inherent conflicts of interest that characterise the operations of the institutions. Because the two institutions design programmes in varying degrees of cooperation with the borrowing governments, the IFIs are active parties to the national policy process. This is true even if the governments fully endorse the elements of the policy package. As active participants, the Fund and the Bank have a vested interest in the success of the programmes, and are contributors to the success or failures of those programmes. However, decisions on compliance with conditionalities and fulfilment of the elements of the programmes are made by the Fund and the Bank alone, as if they were neutral parties.

Like the Fund and the Bank, the WTO would relieve the constraints on its members, and sub-Saharan countries specifically, by restricting its operations to its core mandate, international trade. Most strong supporters of 'freer trade' argue that the WTO should not involve itself in labour issues or environmental regulations, on the grounds that these involve 'protectionism' in thin disguise. If labour and environment issues are beyond the mandate of the WTO, it is not clear why the organisation should dedicate itself to the enforcement of copyrights and patents (TRIPs), especially since the legislation regulating these varies across countries. Similarly, access to domestic markets in service provision (GATS) would seem no more (or less) related to international trade than the working conditions and wages of the workers involved in those services. Seeking to regulate access of foreign capital to domestic markets would seem another WTO practice that is a step too far beyond commodity trade.

1. Introduction

The principal focus of this report is on the relationship between external factors and the quantity and quality of wage employment in Africa. A majority of households, both urban and rural, derives income from self-employment as well, and this also requires consideration. Both the rate of economic growth and its distribution across sectors and households are influenced by the integration of each country into the world market. Since economic growth and its distribution affect the growth and structure of employment, and the quantity and quality of employment affect poverty, it follows that external factors influence poverty reduction to varying degrees. The extent and manner in which external factors impact on employment, and, therefore, poverty, are not natural, immutable characteristics of external integration. They result from many structural and conjunctural aspects of national economies, including policies pursed by a government, those of other governments, and those of international institutions.

The purpose of this paper is to prove a framework for considering the complexity of the interaction between employment and poverty outcomes at the national level, and external factors. On the basis of this framework, the paper considers the stimuli and constraints arising from external factors, then moves to policy measures to enhance the stimuli and manage the constraints. The discussion is in the context of the Copenhagen social agenda, reviewing the policies of donors and lenders, as well as of national governments.

A major issue of focus is the Poverty Reduction Strategy process and its associated documents (PRSPs). Fostered by the World Bank, this formal process increasingly represents the policy agenda for national governments PRSP framework for poverty reduction. The PRS documents have been interpreted as the medium term instruments for realisation of the Millennium Development Goals. Their limited success in realising these can partially be explained by the short duration of the PRSPs compared to the time scale of the MDGs. The PRSPs suffer from a major omission in the context of poverty reduction, namely the absence of explicit goals or targets for employment, workers' rights and quality of employment ('Decent Work'). Suggestions are made to correct these omissions.

2. Theoretical Framework

2a. The Macroeconomic Framework

There are two broad theoretical approaches to macroeconomic analysis, demand constrained frameworks and price constrained frameworks. *A price constrained economy* is either in a unique full employment general equilibrium, or prevented from achieving that general equilibrium by private or public price 'distortions'. *An economy is demand constrained* when its level of output limited is by one or all of the components of aggregate demand: consumption, private investment, government expenditure, or exports.

The theoretical differences between the two frameworks imply profound policy differences. Consider the simple case of a closed economy with no public sector that produces only one product (see Weeks 1989). In the price constrained framework, all markets clear in an instantaneous process in which no exchanges occur at prices other than those in the price set which prevails at full employment general equilibrium. In this theoretical circumstance, consumers and producers take prices as 'signals' to determine the quantities they consume and produce. If all markets clear automatically at the unique full employment price set, then it follows that any action by private or public agents to inhibit market adjustment in prices will result in an outcome below full employment. Assuming there to be no private constraints to price adjustment (e.g., no market power by private agents), the full employment equilibrium price set is unique, and all markets are fully developed, it follows that the role for public policy is extremely limited. The price constrained framework implies that fiscal policy should be 'neutral' and 'passive'.

Fiscal policy should be 'neutral' in that it should not alter the incentives of private agents from making the choices that would yield the general equilibrium price set: 1) taxes should not affect the decision of private agents between income and 'leisure' (e.g., no income tax); 2) neither taxes nor expenditures should affect the relative profitability of commodities (no tariffs, export levies or subsidies); 3) expenditures should not impact on the consumption allocation decisions of households (no sales taxes that discriminate among commodities and no subsidies to commodities); and 4) government should not 'distort' capital markets by competing with private agents for funds (no funding of the fiscal deficit through bond sales). As a practical matter, governments must tax, spend, and sometimes run deficits. The

price constrained framework accepts this and counsels that the inherently-distorting operations of the public sector should be minimised: levy taxes on a uniform basis (a single tariff rate for all imports, for example); minimise fiscal deficits; and restrict government operations to national security, social services, and general administration.

The theoretical basis for the price constrained framework is quite weak. It cannot be demonstrated that there is a real world process that ensures the realisation of the full employment price set. Nor can it be demonstrated that the full employment price set is unique. The latter is a quite serious problem, because if the price set is not unique, the concept of 'distortions' is called into question. A distorted outcome is defined in relation to a non-distorted one. If there is more than one non-distorted outcome, one cannot be sure that the prices in an economy with public sector interventions are substantially different from some non-distorted outcomes.[1]

While price constrained systems may seem abstract curiosities, they are the basis for any statement that governments 'distort' the economy. One cannot allege the existence of distortions without simultaneously asserting the existence of a unique non-distorted economy. Consider apparently simple statement, 'tariffs distort profitability between importables and exportables'. The validity of this statement requires the prior demonstration of the existence of a unique full employment general equilibrium. Since this cannot be demonstrated generally, even in theory, the correct statement would be, 'tariffs alter profitability between importables and exportables'. The practical difference between using the two words, distort or alter, is the core of policy debate. If public sector actions distort the economy, that results in inefficiency that should be avoided or minimised. If the actions alter the economy, then a subjective policy assessment is required to determine whether the alteration is net beneficial to society.[2]

If economies are demand constrained, then the existence of a general equilibrium price set becomes a moot point, because relative prices derive from the level of aggregate demand, and change as aggregate demand rises and falls. Therefore, relative prices are not 'signals' to producers and consumers, but result

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[1] If the general equilibrium price set is unique, it is not necessary to know what it is, since by definition any price intervention prevents it from being realised.

[2] 'Subjective assessment' is used in the sense that the economics profession defines 'positive' and 'normative' statements.

from their production and consumption decisions. Since prices do not determine quantity choices by consumers and producers (they are derivative *from* them), they are not indicators of efficient allocation. This implies that public sector interventions should be judged on a pragmatic basis in terms of social cost and social benefit. In the case of fiscal policy, active macroeconomic interventions are justified to move the economy towards full employment and foster growth. Taxes and expenditures should be similarly judged, and not by whether they violate abstract principles of efficient allocation (since the 'efficient' price set is unknowable). The criterion for judgement should be whether taxes and expenditures achieve the goals set by society, and when those goals conflict, an empirical analysis of trade-offs is required.

It is not too much to say that the economic justification of the ILO's approach to employment and livelihoods is that economies are demand constrained. Were economies price constrained, unemployment would be voluntary implying that assistance to the unemployed need only be for short-term; that is, all unemployment would be 'frictional'. As a corollary, differences in income among workers and between workers and non-workers would reflect allocative efficiency, so that interventions to promote equity would be 'distortionary'. In contrast, the demand constrained framework predicts and accounts for unemployment, concludes some inequalities to be inefficient, and calls for effective public sector intervention to achieve social objectives.

2b. Employment and Poverty Reduction

Notable gaps in the discussion of poverty reduction in developing countries in general, and for the sub-Saharan region in particular, are the role of distribution and employment. These are both areas of long-standing ILO expertise and policy emphasis. Recently, theoretical and empirical work has gone some way to correct the absence of the former (see Dagdeviren, van der Hoeven and Weeks 2002), but discussion of employment as such is almost totally absent (see Islam 2004). This absence is perhaps most glaring in the documents arising from the Poverty Reduction Strategy process (PRS, and the document itself will be referred to as the PRSP), which purports to be the basic policy framework for medium term achievement of the Millennium Development Goals. It would not be valid to justify this absence on the

grounds that the MDGs do not include explicit employment targets, though this omission is quite serious.

Even in the absence of employment MDGs, it should be obvious that no meaningful discussion of poverty reduction policies is possible without specifying the employment link between growth and distribution, on the one hand, and poverty reduction targets on the other. While some of the MDGs, such as child health, can be considered without explicit reference to employment, those associated with income measures of poverty clearly cannot be. For the vast majority of households in developed and developing countries, incomes derive from work, and it cannot be assumed that growth will impact equally on all forms of employment. Further, a substantial portion of the population may be unemployed or suffering form involuntary limits to working time ('underemployment'). Thus, consideration of employment, by skill and sector, is an essential link in the development of policies to reduce poverty. Indeed, the different poverty reduction outcomes associated with similar rates of growth can largely be explained by inspecting the employment-poverty link (Islam 2004, v).

The analytical consideration of employment links in this section is divided as follows: first, we specify the more important links between employment and poverty reduction; second, we identify the major constraints on employment and poverty reduction arising from external factors; and third, we consider in detail the link between trade and poverty, and between foreign investment and poverty.

Table 1 summarises the key links between poverty reduction and growth and distribution, operating *via* the employment link. The table lists the categories of the poor in the left hand column, and the mechanisms of poverty reduction in the next two columns. The important point to note is that a reduction in poverty in consequence of economic growth is *conditional*, rather than automatic, and the conditions derive from the operation of the labour market. The first labour force category we consider is the poor who are 'fully-employed'. This is the analytically straight-forward case of low earnings per unit of time. For poor households that achieve full use of their human resources (the 'working poor'), poverty reduction for the wage employed requires that productivity gains be in part converted into pay increases. International experience suggests that this conversion is unlikely to occur automatically. Rather, it requires workers to assert bargaining power through their organisations to bring about poverty reducing labour market outcomes. For growth to translate into less poverty among the

wage employed, it is necessary for governments to ensure basic workers' rights, as specified in the ILO core conventions. The right to organise and bargain with employers is not a luxury for a small elite of the labour force, but a mechanism fundamental to converting economic growth into poverty reduction. For the self-employed poor, poverty reduction requires an increase in the demand for their products, productivity increases, or lower input costs.

A second category of poor households is those whose poverty results from both low earnings per unit of time, and involuntary limitation on total working time. To an extent the limits on work may arise from the supply side, for example, from physical debilitation associated with HIV-AIDS. These supply constraints must be addressed through improvement and extension of public health programmes, which in themselves could be employment generating. Relieving the supply constraint would not in itself increase employment if working time is demand constrained. Even if the demand constraint is not binding, poverty will not be reduced if earnings per unit of time are well below the poverty level. Again, translating growth into increases in wages is a necessary condition for poverty reduction; increases in employment alone are unlikely to be sufficient.

For the third category, the unemployed, poverty reduction requires an increase in wage employment and higher wages if earnings are below poverty level. Such an increase requires a growth-enhancing macro policy. For the urban self-employed training and credit may be required, but these would be to no purpose in the absence of an accommodating macro policy. A key element of such a macro policy would be public investment, which would be directly employment generating, as well as indirectly stimulating employment through demand effects.

The table demonstrates more than the central role of employment generation for poverty reduction. It makes clear that the role of labour markets in bringing about increases in earnings is essential to moving households out of the working poor, and this requires the guarantee and enforcement of core workers' rights. Self employment, in both rural and urban areas, is of great importance in the sub-Saharan region, and many poor household that may be sustained primarily though this means also derive income from wage employment. Thus, even for self-employment wages and working conditions are central to poverty reduction.

Table 1: Labour Force Categories for Poor Households and Poverty Reduction Linkages in Africa

	Poverty reduction?	
Labour force categories of the poor	Economic growth in excess of labour force growth	Redistribution from poor to non-poor
Full-time work ('working poor')	Iff: 1. for the wage employed, productivity gains are in part passed to workers (increase in the demand for labour in low-wage sectors); 2. for the self employed, output price rises, productivity increases, and/or input costs fall	Indirect mechanism: shift in the structure of employment towards sectors hiring the poor Direct mechanisms: 1. minimum wages 2. fiscal transfers
Involuntarily limited working time ('underemployed')	Iff: 1. for the wage employed, employment increases & productivity gains are in part passed to workers 2. for the self-employed, demand for output increases	Indirect mechanism: shift in the structure of employment towards sectors hiring the poor Direct mechanisms: improvement & extension of public health programmes, especially for HIV-AIDS
Involuntarily without work ('unemployed')	Iff: Demand for labour increases in sectors employing the poor	Same as above

Iff – if and only if

2c. External Constraints to Employment Growth and Poverty Reduction

The integration of national economies into the world market creates constraints to poverty reduction as well as benefits. In recent years, the latter have received the greater stress in the mainstream development literature, reflecting an enthusiasm for so-called globalisation that only recently has been called into question:

> The current path of globalization must change. Too few share in its benefits. Too many have no voice in its design and no influence on its course…
>
> We are at a critical juncture, and we need to urgently rethink our current policies and institutions. (WCSDG 2004, Part II.2)[3]

[3] This acronym refers to the World Commission on the Social Dimensions of Globalisation.

This section contributes to that 'urgent rethink' by identifying the major mechanisms through which poverty reduction is constrained by external factors impacting on national economies. While all of the mechanisms apply generally to developing countries, the discussion focuses on the sub-Saharan region. The sub-Saharan countries have the following characteristics that differentiate them from countries other regions: 1) low-income status almost without exception, including a majority of the Least Developed Countries (using World Bank and UN definitions); 2) great dependence on primary commodity exports, 3) inefficient domestic commodity markets due to poor and deteriorating infrastructure; 4) underdeveloped financial sectors; 5) dependence on concessional development assistance (ODA) that is heavily conditional, especially from the World Bank; and 6) a near-catastrophic incidence of HIV-AIDS. While in other regions there are countries with these characteristics, in no other region are all six so generalised.

The mechanisms are summarised in Table 2, organised into three categories: developed country policies, policies of multilateral institutions, and the operation of global markets. While access to developed country markets provides potential benefits to African producers, the realisation of these benefits involves many necessary links, particularly with respect to poverty reduction. These links are discussed in more detail below. Stated briefly, they are as follows: 1) the access provided must apply to the products exported from the sub-Saharan region, 2) there are minimal 'fallacy of composition' effects, 3) producers of the products in question, as proprietors or workers, include poor households, and 4) increased export of the products results in a net income gain for the poor via increases in time worked if the poor are underemployed, and/or in earnings per unit of time.

Even were all these benign effects to be realised, it is likely that non-tariff instruments of protection make the net effect of developed country trade policy quite negative. The more important of these are anti-dumping measures,[4] coercive bilateral agreements, and domestic trade subsidies. The most important of the latter are agricultural subsidies, which keep world prices low. While the analysis upon which this conclusion is based is generally accepted, it is probably the case that the effect of agricultural subsidies on sub-Saharan exports, and especially poverty, is exaggerated beyond its relative importance to the region. Most of the important sub-Saharan

[4] An example is the retaliatory actions allowed in the United States if the International Trade Commission rules that a company has suffered from 'unfair' competition.

agricultural exports are not produced in the developed countries. This has quite important public policy and advocacy implications. The demand by many political progressives, including key NGOs, for the elimination of these subsidies implicitly endorses the view that increased trade itself is a powerful instrument for fostering growth and reducing poverty. This is strongly advocated by the mainstream proponents of 'freer trade' within the WTO framework.

This approach to relieving an external constraint on export growth for the sub-Saharan region may be one-sided. It would appear that the governments of developed countries would only reduce these subsidies, if, indeed, they would, in exchange for government of developing countries extending and deepening market access by developed country products, and less public regulation of the investment regime. Because the sub-Saharan countries are net importers of food, it may be the case that reduction of developed country subsidies will have an overall negative effect on the region, should the reduction result in an increase in grain prices. Serious consideration should be given to the possibility that developing countries, and sub-Saharan countries especially, would gain more from a trade regime involving commodity agreements and scope for domestic industrial policy, than elimination of developed country subsidies for agriculture within WTO-regulated trade and investment.[5]

Industrial country financial policies tend to have a smaller direct effect on the sub-Saharan region than in Latin America or Asia, due to the underdeveloped nature of the region's financial markets. However, these policies indirectly affect the region through their emphasis on a restrictive monetary policy, which manifests itself in loan conditionalities of multilateral organisations. Especially detrimental to growth in the region is the practice of inflation targeting, which is discussed below.

While official development assistance (ODA) plays a positive role in most sub-Saharan countries, it falls below requirements to meet the MDGs and is not linked to the decent work agenda. Further, current ODA practice leaves much to be desired (see UNCTAD 2000). Discussion of aid effectiveness has tended to stress the appropriateness of recipient government policies, issues of governance, and recipient

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[5] All trade is regulated in some manner, and given the importance of copyright enforcement and access rules for services, it is not clear that the WTO framework represents a move towards 'freer trade'. More accurate would be to say it represents a change in the regulatory framework. A useful journalistic discussion of the options before developing countries can be fund in an article by Robert Wade in the *International Herald Tribune*, 2 August 2004, p. 6.

commitment to key objectives, especially 'sound macro policy' (see World Bank 1998). As a result, this literature tends to issue the overall message that problems with aid effectiveness arise from the behaviour of recipient governments. This emphasis is unbalanced, and reflects the perspective of donors and lenders. From the recipient point of view there are several quite important reforms that would substantially reduce the resource constraints of sub-Saharan governments.

First, development assistance is not coordinated or harmonised with the policy cycle of recipient governments, nor are the reporting procedures of donors harmonised or coordinated. As a result, sub-Saharan governments expend considerable scarce human resources on fulfilling donor and lender reporting requirements. Second, little or no attempt is made by donors and lenders to make ODA flows counter-cyclical, and key conditionalities prevent governments from doing so. Conditionalities requiring an open capital account combined with the absence of effective bond markets imply that sub-Saharan governments have no policy tool for sterilising ODA flows. This precludes using development assistance to counter downturns in the economy, and on the up-swing can result in the combination of inflationary pressures and nominal currency appreciation, which is lethal for export incentives.

Despite it being a central PRSP principle, only limited progress has been made in recipient ownership of development assistance programmes and projects. As a result, development assistance can foster aid dependency. The most obvious manifestation of this dependency is heavy reliance on development assistance for the national budget. Perhaps even more debilitating in the long run are policy conditionalities, the short term financing perspective of donors and lenders, and experts that answer to donors and lenders rather than the government. These practices of donors and lenders tend to undermine the incentives for governments to develop 'home-grown' policies that have the support of the citizenry. The dysfunctional nature of much donor and lender practice was epitomised by the requirement that Poverty Reduction Strategy Papers must be reviewed by the boards of the World Bank and the IMF, but there was no requirement that they be reviewed (much less approved) by national legislatures. It would appear that multilateral and bilateral agencies now place more emphasis on the role of parliaments.

With these points made, the analysis can turn to the effect of global markets on employment and poverty. Here the linkages are quite nuanced, but a few

generalisations are possible. The characteristic of global commodity markets that constrains growth in the sub-Saharan region is well-documented, that primary commodity prices are notably volatile over the economic cycle, which is particularly serious for the region with its high dependence on such commodities and low degree of export diversification. The countries of the region also tend to suffer from a lack of competition on the import side. While in principle almost all agricultural and manufacturing commodities have many potential international suppliers, imports are frequently commercialised through oligopolistic companies, especially in the small countries. For a few countries, bilateral trading agreements are quite important, in which relative bargaining power is asymmetrical.

As noted above in the discussion of developed country policies, the majority of the sub-Saharan countries have little involvement in international capital markets. Few governments enter the international bond market, and commercial bank lending in the past has been to a few petroleum and mineral exporters (e.g., Nigeria). None-the-less, financial markets do have some impact even on the poorest countries, through the cost of commercial export and import credits, and the indirect instability effects of currency speculation outside the region.

Of considerable importance to the region are the institutions and regulations associated with the transfer of technology. The sub-Saharan region has less indigenous capacity for technological development than any other, primarily due to the level of underdevelopment, the long-term decline of university education, and the virtual collapse of regional and sub-regional research institutes. The constraining effect of external dependency on technological development could be made worse by the trade related 'intellectual property' rights (TRIPs) regulations of the WTO. Also deleterious might be a rejuvenation of the Multilateral Agreement on Investment (MAI), underway within the WTO framework.

Table 2: External Constraints to Employment Growth and Poverty Reduction in Developing Countries

External constraints on growth & poverty reduction	Constraining Mechanisms	Impact
1. Industrial	Country Policies	
a. Trade	trade protection, anti-dumping, coercive bilateral agreements, domestic trade subsidies **[Important for the sub-Saharan Region]**	**Trade distorting** limited access to markets, especially for manufactures, perpetuating primary commodity dependence
b. Financial	high interest rates, financial 'standards' [Important primarily for South Africa]	**Financial compression** pressure for restrictive monetary policy, capital outflow
c. ODA	tied ODA, conditionalities, onerous reporting requirements, convertibility **[Important for the sub-Saharan Region]**	**Policy autonomy reduced** ODA pro-cyclical, obstacles to national ownership of policies, diversion of resources into excessive ODA management
2. Multilateral	Policies	
a. WTO	copyrights, 'equal access' & 'non-discrimination', other constraints to industrial policy **[Important for the sub-Saharan Region]**	**Unfavourable trade regulation** export barriers, prohibition on most forms of industrial policy (e.g. local content regulations), constraints to fostering national enterprise
b. IMF & WB	pro-cyclical macro conditionality (budget deficits & inflation targeting), 'independent' central banks, bias against public investment **[Important for the sub-Saharan Region]**	**Growth depressed & national ownership undermined** growth constraining monetary & fiscal policy, discouraging of directed credit, barriers to counter-cyclical macro policy
3. The Global	Economy	
a. Commodity markets	market power by large enterprises, price instability **[Important for the sub-Saharan Region]**	**Export & growth instability** weak bargaining power in negotiations, instability in export earnings
b. Capital markets	financial speculation, bond 'ratings', emphasis on portfolio 'investment' [Important primarily for South Africa]	**Reduction of policy space** pressure for restrictive monetary & fiscal policy, low social protection & low taxes, decline in productive FDI
c. Technology transfer	control of key technologies, technologies rarely adapted to local factor supplies **[Important for the sub-Saharan Region]**	**Limits to industrial policy** high cost or lack of access to key technologies, reduction in employment/output elasticity

2d. Impact of External Liberalisation on Poverty Reduction

Trade Liberalisation

Strong arguments are made that liberalisation of trade and the external account have favourable impacts on growth,[6] thus indirectly contributing to poverty reduction via 'trickle down' mechanisms. Sometimes it is argued that these liberalisations directly contribute to poverty reduction because of clear links to the livelihoods of the poor. When these arguments are made for particular countries over specific periods, their validity is an empirical question. When presented as general arguments, as if they were general laws of development, they must be considered analytically. As we show below, arguments for particular countries at specific times may be valid. However, the general applicability of the arguments cannot be established.

The logic of the trade argument is summarised in Table 3, in which the sequence begins with generalised trade liberalisation (tariff reduction and reduction of non-tariff barriers). If liberalisation results in exchange rate appreciation, domestic tradeables are discouraged, and there is no trade-stimulating effect that might impact on the poor.[7] Exchange rate appreciation might result if the liberalisation of trade is combined with opening of the external capital account. If the exchange rate depreciates, the potential increase in the relative price of tradables may not be realised, due to ineffective market mechanisms (e.g., monopolies or lack of information), or because of key factors being immobile geographically or across sectors. If this is case, poverty is not reduced.

If exchange rate depreciation stimulates export production, poverty reduction still requires a net increase in demand. However, the liberalisation may result in an inflow of imports that replace domestic production, leaving the impact on demand neutral or negative. If aggregate demand rises, employment may fall or not increase if the employment elasticity of export commodities is less than for the non-tradables and import substitution commodities which would have been produced had exports not increased. If the employment elasticity of exports is favourable, poverty reduction depends on whether the net increase in employment is at above or below poverty

[6] These are summarised and inspected analytically in UNCTAD (2002a).

[7] It is possible that exchange rate appreciate would reduce poverty if consumption expenditure of the poor has a large import content. However, this is contrary to the argument made by the supporters of the policy, and can be ignored.

wages. It is not sufficient that the net employment include the poor; employment at poverty level wages remains poverty.

One can summarise by presenting two polar scenarios, the *exclusion* of the poor scenario and the *inclusion* of the poor scenario. In the former, trade liberalisation fails to touch the poor or leaves them in poverty because: a) the exchange rate appreciates; b) any in exports does not raise aggregate demand; c) any in aggregate demand goes to sectors of relatively low labour absorption; and/or d) any employment created is poverty perpetuating rather than poverty reducing. In the inclusion scenario exchange rate depreciation stimulates exports, exports growth increases aggregate demand, with output expanding in sectors of high labour absorption, and the jobs created are at above poverty wages.[8] It should be clear that whether trade liberalisation decreases poverty must be answered empirically. In other words, trade liberalisation will reduce poverty in some countries, increase it in others, and in still others leave it unchanged.

Opening the External Capital Account

In the discussion of opening of the capital account and its impact on poverty, the possibility of financial crises that stimulate capital flight and economic collapse is ignored, due the complexity of the scenario. For most sub-Saharan countries, financial markets are not sufficiently developed for such crises to be a major threat. South Africa is the exception. While the other countries can also suffer form capital flight, this has typically been the result of internal and cross-border conflict.

Table 4 summarises the scenarios, which begin with policy changes that allow for full convertibility of the currency. Even in the sub-Saharan region, much capital inflow is for the acquisition of assets, usually via privatisation, and in some cases through take-overs of national companies. If this form of foreign investment dominates, employment does not increase, and typically falls. The effect on poverty is neutral or negative. Should foreign investment involve construction of new plant, it may crowd-out private domestic investors, especially if foreign investors receive benefits not available to national firms. If the crowding out coefficient is close to unity net output may fall. Again, poverty increases or remains unchanged. If net output effect is positive, employment will decline if FDI firms are less labour

[8] The same scenarios can be generated for self-employment.

absorbing than national firms. As in the case of trade liberalisation, a net increase in employment is not sufficient to reduce poverty. The increase in employment must be at wages above the poverty level.

As in the case of trade liberalisation, the impact of the opening of the capital account on poverty must be assessed on a case-by-case basis. The links between FDI and poverty reduction are highly conditional, implying that no general conclusion can be drawn. Further, even when the scenario is inclusive of the poor, the effect is likely to be relatively small, since on average FDI represents approximately two percent of GDP across sub-Saharan countries. The majority of this investment goes into the petroleum sector and extraction of minerals, activities than generate relatively little employment. These are not arguments against FDI; they counsel caution that the gains form FDI should not be exaggerated. They further imply the central importance of public investment, discussed in Section 4.

Though the discussion above has treated the issue of the elasticity of employment with respect to output, it is necessary to consider this matter further. In the trade and foreign investment literature, it is frequently argued that greater export orientation and foreign direct investment will automatically be associated with high employment elasticities: that sub-Saharan countries are 'labour abundant', so that labour market forces will dictate 'labour-intensive' techniques to private investors. As empirical support for this argument, its adherents frequently cite the experience of Southeast and East Asian countries, whose growth they allege to have been based on 'labour intensive' exports.

This general policy prescription is flawed on several grounds. First, it cannot be demonstrated as a general theoretical law that lower wages result in the choice of techniques that use more labour per unit of output, or per unit of capital. This indeterminacy results from the possibility of a phenomenon called 're-switching', in which a technique that was abandoned as wages fall is re-adopted when they fall further. While 're-switching' has been little mentioned in the economics literature over the last twenty years, the theoretical proof of it generality has not been disproved (see Weeks 1989, Chap. 10). Second, were it possible to banish 're-switching', the argument that techniques derive from relative prices (between wages and interest rate in this case) requires that an economy be price constrained. The theoretical inconsistencies of this framework were discussed above.

Third, and of great practically significance, that some techniques are more labour intensive than others cannot be established theoretically. As astounding as this assertion may seem, given the frequency with the concept is used, it is easily demonstrated. The basic problem is one of measurement. Because of the unreliability and ambiguities associated with the measurement of capital, direct calculation of capital-labour ratios is rarely possible.[9] As a result, proxy measures are used, with the most common being the wage rate itself, the value added-employment ratio, the ratio of wages to value added, and the ratio of value added to gross output. None of these directly measure the crucial variable, how much employment is generated by a given amount of investment. Indeed, these measures typically given inconsistent orderings of sectors and sub-sectors. The observable measure is the elasticity of employment with respect to output, though even the measurement of this is sensitive to the theoretical basis on which the calculation is made.

It is indisputable that the expansion of soon economic sectors generates more employment than the expansion of others. However, theoretical inconsistencies and empirical ambiguities mean that no general, *a priori* argument can be made about the choice of techniques by private agents in response to changes in relative prices. One can conclude that fostering employment generation, and especially employment generation with decent work, requires informed and effective government policy, designed in consultation with the social partners.

[9] In developing countries there are rarely data on the capital input into production at any level of aggregation. When such data exist, their reliability are open to doubt because of the different times at which machinery, equipment and buildings were purchased, even within a single firm. This pricing problem is more difficult still because of technical change, which affects the relative and absolute prices of means of production.

Table 3: Liberalisation of the Current & Capital Account: Poverty Impact via Trade

Exchange rate appreciation - capital inflows - inflation effect	Exchange rate depreciation				
↓	Exchange rate depreciation has no impact on exports - no change in $\frac{Price(TC)}{P(NTC)}$ - factors immobile	Exchange rate depreciation stimulates exports			
↓	↓	net exports have neutral/negative effect on aggregate demand - imports displace domestic goods	net exports increase aggregate demand		
↓	↓	↓	employment elasticity of output ≤ zero - XC less labour using than NT&MS - MC displace MSC	employment elasticity of output greater than zero	
↓	↓	↓	↓	employment increases - at below poverty wages - for the non-poor	employment increases at above poverty wages
no poverty reduction	no poverty reduction	no poverty reduction	no poverty reduction	no poverty reduction	net poverty reduction

Legend:
XC - export commodities
MC - imported commodities
NTC - non-tradable commodities
MSC - import substitute commodities
TC - traded commodities

Table 4: Liberalisation of the Current & Capital Account:
Poverty Impact via Foreign Direct Investment

No net productive investment - asset acquisition - portfolio invest't	Net direct investment in new plant				
	FDI crowding out effect near unity	FDI crowding out effect less than unity			
↓	↓	Net employment effect is negative - FDI displaces domestic output	Net output effect is positive		
		↓	employment elasticity of output less than or equal to zero	employment elasticity of output greater than zero	
			↓	employment increases at below poverty wages	employment increases at above poverty wages
no poverty reduction	no poverty reduction	no poverty reduction	no poverty reduction	no poverty reduction	**net poverty reduction**

3. Reducing Poverty in Practice

Poverty in Africa is intimately related to growth performance, and the distribution of the marginal increase in income created by growth. In market economies, livelihoods, either through self-employment or employment by owners of capital and land, are determined by the actual or anticipated level of output and the composition of that output (which determines the technology used). A fundamental characteristic of market economies is their dynamism, responding to changes in demand, technology, and other influences. This dynamism results in a continuous change in the composition of output, thus in the structure of employment and distribution of income. In real economies, as opposed to abstract models, the distribution of income is always changing as working people shift among sectors.

Other things equal, the two most important economic factors that can foster a sustainable expansion of employment are economic growth and redistribution to make income more equal across households. Economic growth does so by increasing the demand for labour through raising the level of output. A more equal distribution of income raises employment through two channels: a) since the rate of household saving typically decreases as one moves down the distribution, greater equality increases aggregate demand for any level of national income; and b) empirical evidence suggests that the employment intensity of output is greater for the goods the poor purchase than for those purchased by the rich, implying greater labour intensity in the aggregate when income is more equally distributed.

One frequently reads that while redistribution may be relevant for poverty reduction in other regions, in the sub-Sahara it is not, because the level of per capita income is so low in most of the countries. This opinion is false: as long as income is not equally distributed, which it never is, redistribution, either of current income or the growth increment, is a more effective instrument for poverty reduction than distribution neutral growth alone. The issue is not whether redistribution would be effective in poverty reduction, but whether and how it could be achieved.

If growth is associated with increased inequality, as in Ethiopia (Geda, Simeles and Weeks 2002), the effectiveness of redistribution decreases. The basis of this conclusion should be obvious. Distribution neutral growth by definition maintains the *status quo* level of inequality, and the elasticity of poverty reduction with respect to growth is unchanged. If the growth increment is more equally

distributed than current income, the elasticity rises, for that increment and all subsequent ones.[10] The inter-relation among growth, distribution and employment can be summarised with algebra. If one assumes that employment (E) is homogeneous, and the economy produces only one product in quantity Y,

$$E = Y^{\alpha}$$

The elasticity of employment with respect to output is the coefficient α, which reflects the current factor intensity of the economy. Let α be determined by per capita income (y), the distribution of income (π), and the composition of the capital stock (β). A higher per capita income, both initially and over time, implies greater capital intensity and a higher capital output-ratio. We assume that the consumption of the poor and the investments they make are less capital intensive than the economy as a whole. Policy makers can select public investments such that the resulting capital formation is more labour intensive than for the private sector (exclusive of the investments of the poor). The elasticity of employment with respect to output can then be written as follows, using an exponential form,

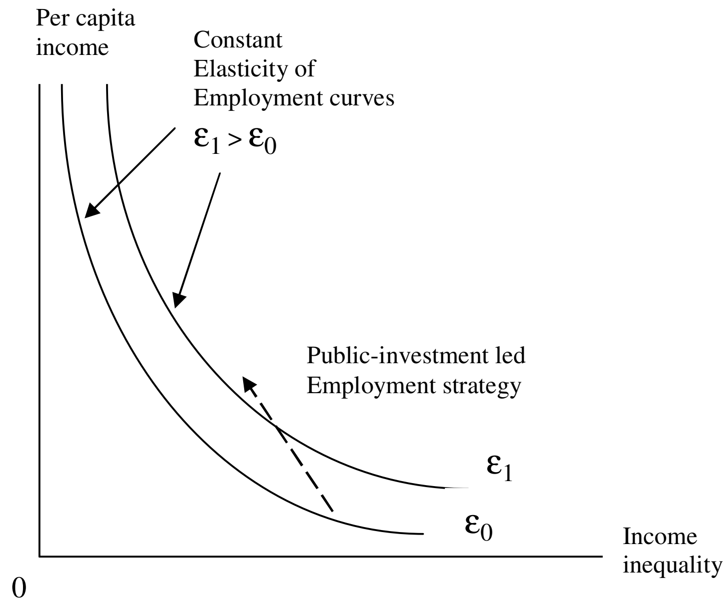
$$\varepsilon_{e,y} = y^{\alpha_1} d^{\alpha_2} r^{\alpha_3}$$

Where y is per capita income, d is a measure of income distribution, and r is the ratio of the public to the private capital stock, α_1 and α_2 are negative, and α_3 is positive.

If one holds the composition of capital constant in the short-run, the elasticity of employment with respect to per capita income and distribution can be represented by a series of 'iso-elasticity' curves, as in Figure 1. The diagram shows that in order to maintain a given elasticity of employment with respect to output, a rising per capita income must be accompanied by decreased income inequality. However, higher per capita income and a greater employment elasticity can be achieved through selecting public investments that are pro-poor; i.e., investments that are labour-intensive and designed to create employment or foster the incomes of the poor (shown by the dashed arrow).

[10] The elasticity is permanently raised because the following period's distribution is more equally distributed. If the subsequent growth increment is more unequally distributed that the new current income, the elasticity declines.

Figure 1: Iso Employment Elasticity Curves for Varying Per Capita Income and the Distribution of Total Income



Policies of redistribution pass from being an option for governments to a necessity when the placed in the context of the Millennium Development Goals. While some of the MDGs might be achieved on the basis of past economic performance, and in almost no sub-Saharan country could the income poverty targets be reached by 2015. In light of past performance, per capita growth of 2.5 percent per annum would be both a considerable achievement and quite optimistic. The average per capita growth rate in the sub-Saharan region had a declining trend from the early 1960s through the early 1990s, then recovered and stagnated in the range of zero to one percent. A per capita growth rate of 2.5 percent, requiring 4.5 to five percent for GDP when population increase is included, would still leave most countries short of the millennium poverty targets in 2015.

Poverty reduction will be achieved through the growth of employment at above poverty level wages, and by increases in the incomes of the self-employed. The stagnant per capita growth rates shown in Figure 2 translate into rising unemployment and stagnant or falling incomes for those productively employed. Over the twenty years, 1983-2002, the growth of output per member of the labour force (GDP growth minus labour force growth) was negative in more years than it was positive.

Therefore, unless the Millennium poverty targets are abandoned, for most countries growth must be combined with redistribution, at least in the growth increment. Fostering poverty reduction through the creation of productive employment in Africa requires a purposeful combination of policies to raise growth rates that produce a pattern of growth that is increasingly pro-poor.[11] It is important to note that the stagnation in the growth of per capita income cannot be attributed primarily to poor export performance. As Figure 3 demonstrates, since 1990, overall exports have grown at slightly less than four percent per annum. However, non-fuel exports have expanded at almost five percent per annum. While this is not a spectacular rate, it probably corresponds to the sustainable rate for the region. During 1995-2002, exports averaged approximately thirty percent of GDP. Very few countries, except quite small ones, show percentages as high as forty percent. This would suggest that a rate of growth of exports well above the rate of growth of GDP could not be sustained over several decades. Over the same period, government expenditure accounted for an additional eighteen percent of GDP, and most observers would judge this to be below what was necessary for achieving substantial poverty reduction. It is likely that another ten to fifteen percent of GDP represents efficient import substitutes, primarily in the agricultural sector. Thus, if the cross-country export share rose to thirty-five percent of GDP and government expenditure to twenty-five, this would leave only twenty-five to thirty percent of GDP for private non-tradables (transport, services, and commerce). One can conclude that while circumstances vary across countries, the sub-Saharan region is approaching a limit to export production set by the minimum size of the non-tradables sector.

Increasing decent work faster than the growth of the labour force, and thereby decreasing poverty, is a problem that must be addressed in the sub-Saharan region by the combination of faster growth and a more equitable distribution of income and wealth. Since these two economic mechanisms cannot, even in logic much less practice be separated, the long-standing emphasis of the ILO on economic equity can appropriately be extended to an emphasis on growth. In other words, it is neither logical nor practical that there be a 'division of labour' among international organisations, in which the ILO is limited to equity concerns. Its remit for decent

[11] A recent UNCTAD report (UNCTAD 2004b) focuses in detail with a central problem of sub-Saharan trade, commodity dependence.

work and poverty reduction requires that it consider the determinants of growth as well.

Figure 2:

Growth of GDP and the Labour Force in the Sub-Sahara, 1961-2001

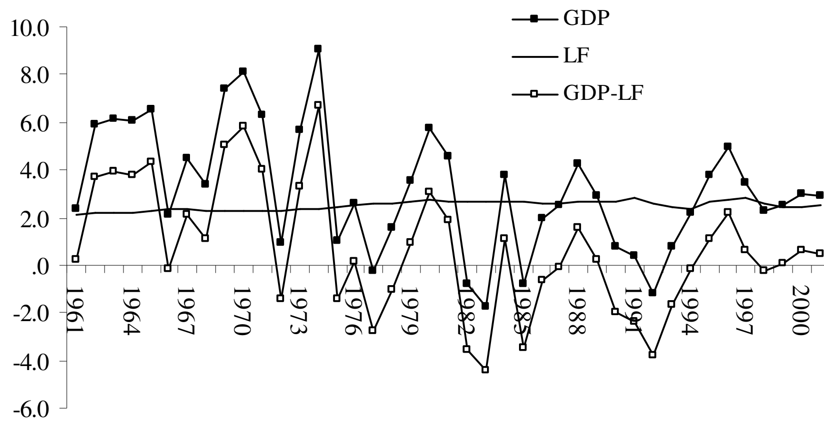
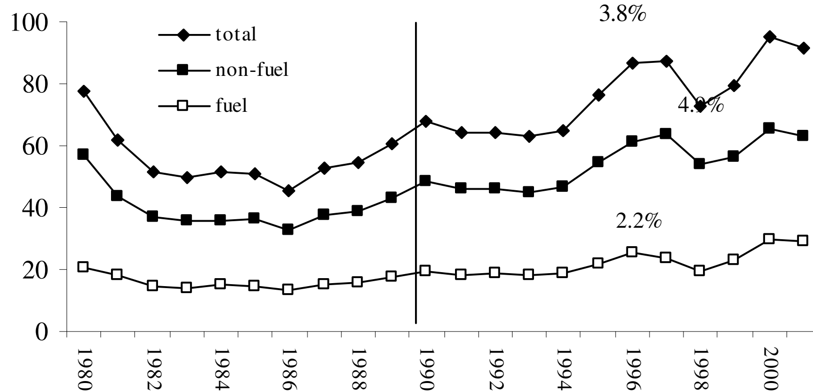


Figure 3:

Sub-Saharan Exports in Current Prices, fuel & non-fuel, 1980-2001 (constant price US$ billions)



4. Policy Implications after Copenhagen

4a. The PRSP Process, the MDGs and Employment

The international community has sought to address problem of poverty in Africa with many, largely unsuccessful, initiatives. The current approach derives from the World Summit for Social Development (WSSD) held in Copenhagen in 1995, where heads of state and representatives from 180 countries committed themselves to 'formulating or strengthening national poverty eradication plans to address the structural causes of poverty'. The Poverty Reduction Strategy Paper process reflects, or should reflect, this general commitment, and arose first in the context of low income country debt relief (the Highly Indebted Poor Countries Initiatives). Formally, it is a 'partnership-based' approach to reducing poverty in low-income countries. Its purpose is to empower country stakeholders, both in government and civil society, in designing their strategies. Nationally owned poverty reduction strategies are at the heart of this new approach, with an explicit rejection of the previous 'donorship' approach.

The IMF established the Poverty Reduction and Growth Facility (PRGF) in 1999, replacing the Enhanced Structural Adjustment Facility. Programmes supported by the PRGF and IDA (International Development Association, the World Bank's concessional window) must be framed around a comprehensive, nationally owned PRSP prepared by the borrowing country. The PRSP is then reviewed by the Boards of the IMF and World Bank, in their respective areas of responsibility, as the basis for the institutions' concessional loans and for relief under the enhanced HIPC Initiative. The PRS approach also stresses the underlying principle that national poverty strategies should foster domestic and external partnerships that improve the effectiveness of development assistance. Many bilateral donors have joined the partnerships in support of the PRS approach. When successful, the PRS process promotes poverty reduction strategies that are country driven, comprehensive, set clear priorities, partnership based, and framed within a long-term perspective.

Since this IFI-initiated instrument has become a central, if not *the* central, development strategy document in most low income countries, it is important that the ILO integrate itself into it. The important question is on what basis this integration should be undertaken in order that the goals of the ILO and its core mission are not undermined as the result of that integration. The PRS process is very much a work in

progress, and numerous reports have identified its shortcomings. The ones relevant to the ILO are several. First, while in most PRSPs there is a coherent growth strategy; this strategy is not always pro-poor, and is not clearly linked to employment and household livelihoods. The focus on poverty issues is frequently a step forward from previous national documents, but the poverty diagnosis typically lacks a link to poverty reducing employment policies. In other words, many PRSPs do not integrate poverty and growth.

Second, and related to the first, PRSPs tend to be *macroeconomic frameworks* constrained by Bretton Woods conditionality with reference to poverty reduction, rather than *development strategy frameworks* for poverty reduction (UNCTAD 2002b, Chapter 5). Third, the partnerships among development agencies, including the UN system, tend to be dominated by the World Bank. In great part this results because the PRS document itself is a pre-condition for initiating a Bank programme (which is not the case for the IMF, bilaterals and the UN system).

The ILO can make an important contribution to overcoming these shortcomings. Through emphasis on poverty reducing employment through growth and redistribution, it can help define the links among poverty diagnosis, policies, and poverty reduction. For this to have an effective impact on the PRS process, a restructuring of partnerships among development agencies is necessary, in which the UN system establishes itself as an equal partner in defining the framework more broadly, fostering flexible fiscal guidelines that accommodate public investment, and influencing the basic goals of the process, including and especially national ownership of development strategy.[12]

4b. National macroeconomic policy

Governments of the sub-Saharan region can and do attempt to increase the employment generating effect of private sector investment, but the instruments available to them to do so are few and frequently ineffective. In the case of the private formal sector, influencing investment choice through policies that effect relative prices is unlikely to have any significant impact. In most sub-Saharan countries wages are low and labour market regulations, to the extent they exist, typically are not enforced (van der Hoeven 2000). Thus, ‘deregulation’ of labour

[12] These points are discussed in detail in UNDP (2003, volume 1: Main Report).

markets, even if one believes that it fosters more efficient factor prices, has little scope for affecting private sector investment choice. Scope for policy influencing investment choice is further limited because much of the interest in the sub-Sahara by foreign investors is in the exploitation of natural resources. Investment choice is technologically limited in this sector, and in key products employment generation is quite small (for example, petroleum and natural gas).

While governments should attempt to induce private sector behaviour that is more employment generating, the most effective way it can generate employment is through public investment. Public investment has a direct employment effect, which can be increased through an employment-focused policy strategy, in part by drawing on decades of work in the ILO on labour-intensive public works. These investments also have indirect employment effects, for example, through reducing transport costs in the case of road construction.

The aggregate share of investment in the sub-Saharan region is well below what would be necessary for economic growth that would have a substantial and sustained impact on poverty reduction through employment generation. As argued above, a rate of growth of per capita income of about 2.5 percent per annum would be necessary to generate sufficient employment to achieve substantial poverty reduction and come close to the Millennium goals. Given population growth, this implies an overall growth rate of GDP of about four to five percent per annum. If one takes an optimistic estimate of the cross country gross capital output ratio of four, a gross investment rate of twenty percent is implied.

As Figure 4 shows, this investment rate was only achieved for a brief period over the last forty years, during 1974-1982. After 1982, investment performance was well below this, falling into the range of fifteen to eighteen percent of GDP,[13] and the movement appears cyclical with no rising tendency. For the five countries with large populations and continuous data over the forty years (Figure 5), the performance was notably worse. The average for the entire period of these five countries, with about forty percent of the sub-Saharan population, fluctuated below eighteen percent.

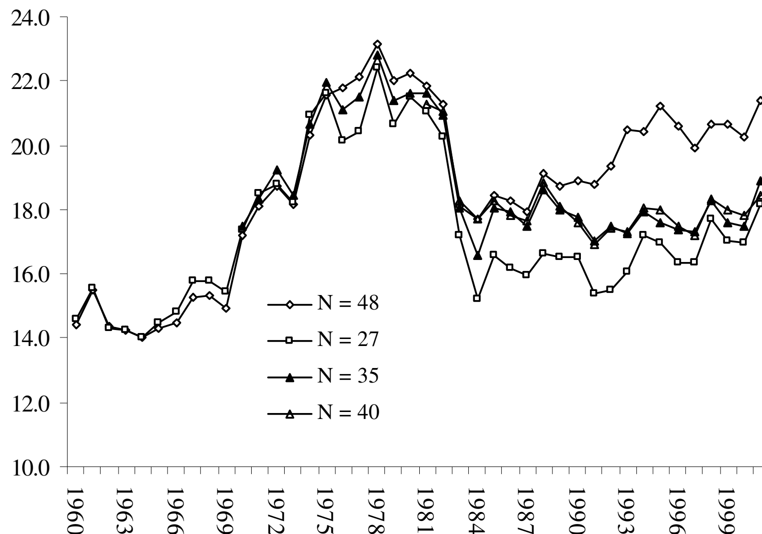
[13] In Figure 4 the average for all countries rises above twenty percent in the 1990s, but this is an anomaly of the data, resulting from the inclusion of countries with non-continuous data series. In all three of the series in which the inclusion of countries is consistent across time, the cross-section averages are well below twenty percent (that is, the series indicated as N = 27, N = 35, and N = 40).

During 1990-2001 the average fell to barely fourteen percent, an investment share inconsistent with an economic growth rate to match population increase.

The poor investment performance after the early 1980s may be explained in great part by a drastic fall in public investment. Table 6 gives the share of public investment in GDP in fifteen countries for which it is possible to obtain a continuous time series. The data for these countries show an almost continuous decline after the late 1970s, to settle in the range of three to four percent during 1990-2001. If one had an accurate estimate of depreciation, it is doubtful that this low share of public investment would be sufficient to match the infrastructure needs of the countries, much less to contribute to and investment-led employment and poverty reduction strategy. The low level of overall investment in sub-Saharan countries suggests the necessity for a public investment strategy focussing on 'crowding in' private investment. The 'crowding in' element of the strategy implies both increases in public investment, and for governments to assume a greater degree of strategic leadership than is presently the case.

Figure 4:

Sub-Saharan Countries: GDCF as percent of GDP, 1960-2001



Notes: The letter N refers to number of countries in the series. 'All' and 'N=27' are for all years. 'N=35' includes 1970-2001, and 'N=40' covers 1981-2001.

Figure 5:

GDCF/GDP: Sub-Saharan High Population Countries, 1960-2001

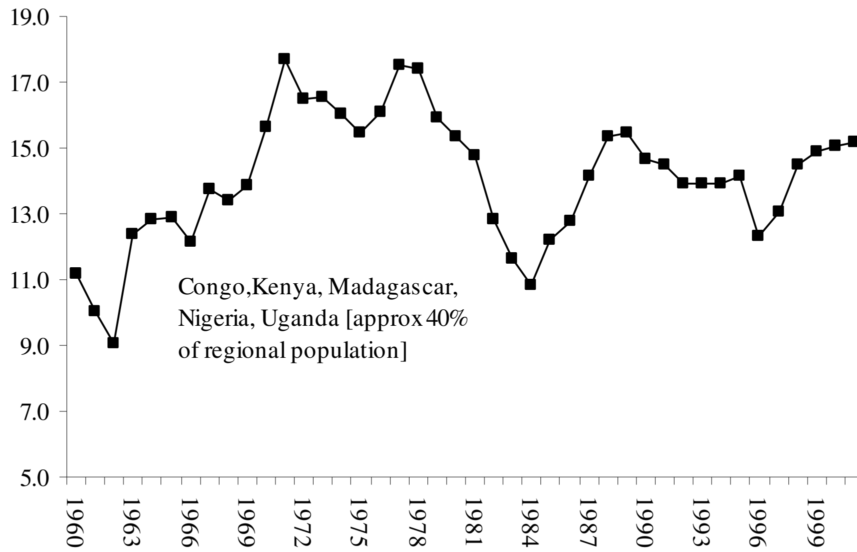
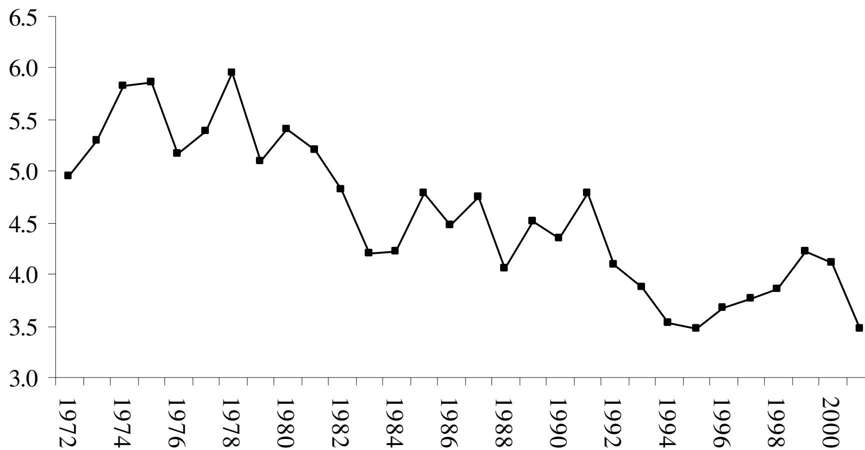


Figure 6:

Sub-Saharan Countries: Public Investment as
Percentage of GDP, 1972-2001 (15 countries)



Countries: Botswana, Burkina Faso, Cameroon, Congo, Cote d'Ivoire, Ethiopia, Ghana, Kenya, Madagascar, Malawi, Mauritius, South Africa, Swaziland, Uganda, Zimbabwe.

4c. Role of public investment

In the sub-Saharan countries perhaps the most effective instrument for promoting and investment-led employment strategy for poverty reduction is fiscal expansion through increasing public investment. While such fiscal expansion can generate government deficits, there is no longer a consensus that these are necessarily inflationary. Also, as long as inflation is kept within a moderate range, it does not necessarily dampen growth or directly harm the poor. Moreover, growth stimulated by fiscal expansion can generate the fiscal revenue needed to reduce budget deficits via the elasticity of taxes with respect to GDP.

While advocating for greater flexibility on stabilization policies, the ILO supports forms of public investment that can provide a more long-term, durable basis for employment growth and poverty reduction. This implies capital accumulation and technological innovation that can deliver lasting gains to the poor. Fiscal policy should foster sustainable growth, with emphasis in national poverty reduction strategies from short-term targeted interventions to longer-term programmes that alter the underlying structure of people's access to resources and technology.

Public investment is the necessary ingredient in a pro-poor macro strategy, serving three benign purposes: demand management, capacity creation, and redistribution. In the absence of a robust public investment programme, the pro-poor element in fiscal policy is reduced to counter-cyclical interventions, progressive taxation, and redistributive expenditure, all from the current budget. While each of these is important, in many developing countries the capacity to implement the latter two is quite limited. The progressiveness of the tax system is typically constrained by the relative low contribution of the formal sector to income generation, and redistributive current expenditure may be beyond the administrative capacity of the public sector.

Perhaps most important, basing a redistribution strategy on the current budget is not a growth strategy. If sustained, it may create a new, more equal distribution which the economy will approach. However, except for a possible one-off impetus resulting from the positive incentives to the poor of redistribution, it has little impact on the sustainable growth rate. For this reason, public investment is the *sine qua non*

of a pro-poor growth strategy, and the reduction of public investment undermines that strategy.

The emphasis placed on public investment in this report requires consideration of one of the major arguments against it, so-called crowding out.[14] The argument that public investment in Africa would crowd out private investment is somewhat surprising. It is typically the case that those who make this argument also urge governments to undertake major policy changes to encourage inflows of foreign investment, usually without expressing strong concern that the latter might crowd out private domestic investment.

In general, 'crowding out' would occur when an economy is near full employment. When there are unutilised resources, there is economic space for an increase in all types of expenditure, both public and private. Even if 'crowding out' occurs in under these circumstances, it is unlikely to be complete. That is, the elasticity of private investment with respect to government expenditure of any type will be less than minus one. As a consequence, public investment would be growth-inducing both in its demand and capacity effects, unless the return on the marginal private component were sufficiently higher than on the public component such that the growth impact were negative. This can be shown formally using the simple Harrod-Domar model, where y is the rate of growth, v is the incremental capital-output ratio, and *i* is the share of investment in output. Let the subscripts *pr* and *pu* be private and public investment, respectively. Without public investment, the warranted (potential) rate of rate of the economy is:

$$y_o = [v_{pr}][i_{pr}]$$

Let the 'crowding out' ratio be α (the faction by which public investment reduces private investment). Then, the new growth rate with public investment is:

$$y_1 = [v_{pr}][\, i_{pr} - \alpha i_{pu}] + [v_{pu}][i_{pu}]$$

Subtracting y_1 from y_o, one gets:

$$y_o - y_1 = i_{pu}[\alpha v_{pr} - v_{pu}]$$

Crowding out will reduce the rate of growth if and only if, $v_{pu} > \alpha v_{pr}$. If the capital-output ratio for public investment is smaller than for private investment, public investment never reduces the growth rate, no matter what the value of α, assuming its

[14] The crowding out phenomenon applies to all expenditure, but here we consider only the case of investment.

upper limit to be unity ('total crowding out', one hundred percent). If crowding out is total, the growth rate falls only if public investments are more capital-using than private ones. Thus, public investment having a negative impact on the capacity-creating source of growth occurs only under the very restrictive conditions that crowding out is total and private investments use less capital per unit of output. The former is unlikely and the latter can be avoided by public choice of investment projects. Considerable ILO work on employment intensive public works can provide practical guidelines to ensure that public investments are not excessive capital using. Thus, theory and practice suggest that 'crowding out' is unlikely to have a negative impact on growth.

4d. Policies of International Institutions

National policies can be facilitated or undermined by the policies of external agencies. In this section the discussion is limited to the policies of the institutions which are the major actors in the regulation of key aspects of the international economic environment: 1) short term stabilisation at the national level (the International Monetary Fund); 2) multilateral development assistance (the World Bank); and 3) international trade (the World Trade Organisation). Explicitly political issues of internal governance of these organisations are not treated. The central proposal for all three institutions is that each should restrict itself to its core mandate.

The major constraints on employment creation and poverty reduction by the IMF are the conditionalities associated with lending that restrict the policy space of governments. In this context 'policy space' means the extent to which governments have policy options to pursue their goals. IMF conditionalities restrict policy space in two ways: 1) in general, by basing their policy packages on a special case of economic theory, that economies are price constrained (see Section 2); and 2) specifically, through fiscal deficit limits and inflation targeting that reduce the scope for fiscal expansion and a growth-accommodating monetary policy. Employment growth and poverty reduction are also constrained by excessive performance criteria and waiting periods for HIPC II debt relief.

To relieve the policy constraints set by IMF conditionality, two general steps could be taken that would require no change in IMF rules. First, the IMF could restrict itself to its core mandate, price stability and balance of payments adjustment.

This would involve abandoning forays into areas such as central bank governance, organisation of financial markets, and capital account regulation. Second, the IMF could foster a 'HIPC III', in which qualification for relief would be quicker and involve fewer performance conditionalities.

Specific changes to enhance employment creation and poverty reduction would include: 1) the end of inflation targeting in favour of setting target rates derivative from desired growth performance; 2) reducing the number of conditionalities and the focus upon stabilisation; 3) allowing flexibility on deficit limits, consistent with growth targets; and 4) institutionalising independent formulation and evaluation of policy programmes. The foregoing would allow for fiscal and monetary policy to be used as counter-cyclical tools

As in the case of the IMF, the World Bank's loan conditionalities have limited policy space by governments through excessive conditionalities, frequently in areas beyond the institution's core mandate. In recent years these constraints have been compounded by a narrow approach to the PRS process, which treats the poverty reduction strategy as derivative from Washington Consensus-type macro frameworks. The first step towards relieving the constraints of World Bank programmes would be to limit the institution's operations to its core mandate of medium and long term development finance (including budget support). While the World Bank's movement beyond economic policy into public administration, governance, and social policy might be seen by some as a more holist approach to development, in practice this expansion has resulted in excessive conditionalities in areas where the comparative advantage of World Bank expertise is not obvious. The second step would be to provide leadership among development agencies for more rapid and extensive debt relief. With regard to specific measures, the World Bank could reform its lending procedures to conform to the goal of national policy ownership, which is stressed in its *PRSP Sourcebook*. It is not clear that any conditionality is consistent with national ownership, and these should be kept to a minimum.

A more general and systemic problem with both IMF and World Bank programmes is the inherent conflicts of interest that characterise them. Because the two institutions design programmes in varying degrees of cooperation with the borrowing governments, the IFIs are active parties to the national policy process. This is true even if the governments fully endorse the elements of the policy package. As active participants, the Fund and the Bank have a vested interest in the success of

the programmes, and are financial contributors to the success or failures of those programmes. However, decisions on compliance with conditionalities and fulfilment of the elements of the programmes are made by the Fund and the Bank alone, as if they were neutral parties. In other words, several actors frame policy, but the external actors disclaim any responsibility should the outcome be partial or complete failure. This disclaimer has a very concrete consequence: no matter what the outcome of a policy package, the loan associated with it must be totally repaid by the borrower. This arrangement, in which the lender participates but incurs no liability, is not accepted by civil courts in the private sector of developed countries. A basic reform is required to end the conflict of interest in which the final judgements over design, implementation, monitoring, and evaluation are assumed by the same, external institution.

Unlike the Fund and the Bank, the WTO is generally recognised as a work in process, an organisation evolving through the action of its members. In principle, this makes it more flexible to reform than the Bank or the Fund, though reform would occur in a context of unequal power across the membership (not withstanding the nominal one-country, one-vote arrangement). Like the Fund and the Bank, the WTO would relieve the constraints on its members, and sub-Saharan countries specifically, by restricting its operations to its core mandate, international trade. Most strong supporters of 'freer trade' argue that the WTO should not involve itself in labour issues or environmental regulations, on the grounds that these involve 'protectionism' in thin disguise. If labour and environment issues are beyond the mandate of the WTO, it is not clear why the organisation should dedicate itself to the enforcement of copyrights and patents (TRIPs), especially since the regulation of these varies across countries. Similarly, access to domestic markets in service provision (GATS) would seem no more (or less) related to international trade than the working conditions and wages of the workers involved in those services. Seeking to regulate access of foreign capital to domestic markets would seem another WTO practice that is a step too far beyond commodity trade.

The importance of these incursions into control of markets (TRIPs), service provision, and capital inflow is that they have the danger of severely restricting the ability of governments to implement industrial policies. In the sub-Saharan, where manufacturing is extremely underdeveloped for most countries, public sector policy is key to industrialisation. Industrialisation, in turn, will be the basis for drawing labour

from poverty-perpetuating livelihoods into sectors of productivity growth. To facilitate this, the WTO could focus on its core mandate, and extend the current specific treatment of low-income countries.

Table 5: Constrain-reducing Policy Options for International Organisations

Institution:	Constraining Mechanism/Policy	Relieving the constraint
International Monetary Fund	Conditionalities that limit policy space, and extension of conditionalities to non-stabilisation areas Excessive performance criteria & waiting period for debt relief	1.General constraints a. Restrict mandate to stabilisation (appropriate price stability & balance of payments) b. Expedite HIPC-type debt relief 2. Specific constraints a. Allow for greater policy space by ending inflation targeting b. Reduce number of conditionalities & limit these to stabilisation c. Flexibility on fiscal deficit levels d. Support counter-cyclical monetary & fiscal policies e. Independent formulation & evaluation of policy programmes
World Bank	Conditionalities that limit policy space, and excessive extension of conditionalities to non-traditional areas Narrow concept of Poverty Reduction Strategies	1. General constraints a. Limit mandate to medium & long term policy issues b. Expedite HIPC-type debt relief 2. Specific constraints a. Reduce number of conditionalities to support national ownership b. Convert PRSPs from macro frameworks to development strategies c. Independent formulation & evaluation of policy programmes
World Trade Organisation	Limited influence of sub-Saharan countries on negotiations Excessive faith in universal benefits of trade within WTO regulations Extension of mandate beyond commodity trade issues	1. General constraints a. Limit mandate to commodity trade b. Broaden special treatment of low income countries & least developed countries c. Institutionalise efficient industrial policy instruments d. Institutionalise larger role for sub-Saharan & other politically weak countries 2. Specific constraints a. Limit role to commodity trade (exclude services, TRIPs & investment) b. Allow low-income countries to use tariff & non-tariff measures to promote industrialisation

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