

Chapter 5
Employment-Intensive Growth and Poverty Reduction
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in
Growth, Inequality and Poverty in Armenia
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The role of employment in reducing poverty has not been emphasized enough in national poverty reduction strategies, particularly in the Poverty Reduction Strategy Papers now being prepared in many countries. This is surprising given the obvious importance of employment. Much has been written on the relationship between growth and employment, and in particular on the need for employment-intensive growth. Less has been written, however, on the relationship between employment and poverty reduction.

The challenge for national policy makers is not only to link growth to productive employment, or “decent work” as the International Labour Office calls it, but also to ensure that the growth in employment is concentrated among poorer workers. Many of the poor in Armenia work, but they work in low-productivity, low-income sectors of the economy, such as small-scale agriculture, rural non-farm trade and urban informal-sector services. Much of this work is only part-time.

Thus many of the poor are not unemployed, but are “working poor”. Officially they might be registered as unemployed but unofficially they cannot afford to remain without a job. Those who are registered as officially unemployed are usually workers, such as women who normally work in the household economy or youths who lack experience, who have the greatest difficulty in obtaining a paid job, even in the informal sector.

Employment-intensive growth alone usually is not sufficient to reach the poor, both employed and unemployed, although it is necessary. Policy makers must also be concerned about whether the poor have the necessary capabilities and skills and the access to assets, resources and services for them to take part in whatever growth in employment may occur.

Broadly based growth can provide opportunities for employment but in the absence of other direct job-related public interventions, the poor might not be able to take advantage of these opportunities. These interventions could include training for the newly created paid jobs and access to credit for those who wish to establish micro-enterprises. These forms of support often are components of a national poverty reduction strategy and are complementary to more general economic and social policies , such as land reforms and universal secondary education.

In Armenia growth has not been employment-intensive; certainly it has not generated widespread productive, full-time employment. And poor workers have had little opportunity to secure access to whatever productive employment has been generated. Hence policies will have to be designed to alter the structural characteristics of the economy that exclude the poor from employment. This should be central to the success of Armenia's national poverty reduction strategy.

The illusion of productive employment

During the early stages of the transition to a market economy, when gross domestic product went into a precipitous decline, employment declined more moderately. In other words, the elasticity of employment with respect to output was low. This created an illusion that productive employment could be sustained in the midst of economic depression. One reason is that medium and large-scale enterprises, which accounted for

most of the country's production, continued to "hoard" labour, i.e., to keep workers on their books even when they were not actually employed and earning wages. Hence, employment figures did not reflect the real misery that industrial workers faced. A more accurate picture of the employment situation is reflected in the precipitous decline of real wages and incomes, which paralleled the drop in industrial output.

Many workers remained nominally attached to medium and large-scale enterprises even when they had little work to do. The 1996 Labour Force Survey revealed, for instance, that almost one-third of the employees still registered as employed in industry were not working or were on extended administrative leave. These workers in practice were forced to seek a livelihood in the informal sector and peasant agriculture. They had already entered the ranks of the "working poor" well before the late 1990s.

After the privatization of medium and large-scale enterprises in the middle and late 1990s, the underemployment hidden by labour hoarding in the early 1990s became more obvious.¹ Industry formally laid off about 100,000 workers between 1995 and 1998. However, conditions had not worsened. The real situation of these workers now made formally redundant by privatization had already worsened in the early 1990s as a result of the industrial collapse triggered by shock therapy and the breakdown of trading relations that followed the collapse of the Council for Mutual Economic Assistance (CMEA). If the extent of employment in the early 1990s had been computed on the basis of hours worked (the intensity of labour), it undoubtedly would have shown an early and dramatic decline.

There is an ambiguity at the heart of the conventional explanation for "growth-resistant" poverty in the late 1990s, when different household surveys came roughly to the same conclusion, namely, that about half of the population remained poor. The

implication of the standard explanation is that the current pace and character of growth will eventually reduce poverty because the delayed shedding of labour as a result of privatization and restructuring has nullified the employment generating and poverty reducing potential of an expansion of output. This view tends to breed complacency about the need to make growth more equitable, and ignores the fact that since 1993 output has increased while employment actually has steadily declined, however employment is measured. In other words, the output elasticity of employment has been negative for nearly a decade and this has contributed to the persistence of poverty.

In fact, industrial enterprises began to shed labour very early. Otherwise poverty would not have become so widespread. This “shedding” took various forms. Not only was a substantial proportion of the industrial workforce driven into survival-level activities in the urban informal sector, a sizeable proportion also swelled the ranks of the agricultural workers. In addition, many left the country for good (especially those with education and skills) and many others left their families behind and emigrated abroad in order to earn income to send home. There was thus a huge displacement of industrial labour to other sectors within the Armenian economy and abroad. Hence, the negative elasticity of employment with respect to output from 1993 onwards --when the economy was growing and employment should have been created -- is really not due to the delayed shedding of labour by state-owned enterprises. It is primarily due to the feeble growth of employment in the new small-scale private sector. The growth of this sector, in turn, has been impeded to a great extent by factors under the government’s control, in particular by a lack of credit, training and public investment in infrastructure.

It is noteworthy that during the transition to a market economy, unemployment has risen to unprecedented levels. Most credible but unofficial estimates place the percentage

of unemployed people above 20 per cent. They are concentrated in urban areas and most of the unemployment is long-term. Armenia's level of unemployment is very high compared to other transition economies. At first glance, this is puzzling since unemployment benefits are low and difficult to obtain. Only about 15 per cent of the unemployed who officially register receive any benefits. In 1996, almost three-quarters of the officially unemployed were women, who indicated that they were normally employed in "home gardens and households". As the economy declined in the 1990s, many women delayed marriage and pregnancy and actively participated in the labour force again in order to help arrest the decline of household incomes. About another 20 per cent of those officially classified as unemployed were youths, who as first-time entrants into the labour force, also had problems finding employment. In urban areas unemployment among youths of 17 to 25 years of age has been about 60 per cent. Many of these young people have to continue to live with their parents well into their 20s.

In contrast, many adult males have not registered as unemployed. They know that benefits are low (less than US\$ 5 a month in 1997) and the chances of finding another job are slim. It is estimated that only one-fourth of all unemployed persons bother to register. The other three-quarters tend to find employment in marginal or informal activities, e.g., in urban petty trade or rural barter transactions. Moreover, about one-third of the officially unemployed are reported to find work, mostly temporary or casual employment. So, while unemployment rates are high, even more important is the extensive underemployment problem in Armenia.

A further problem that complicates the interpretation of official data is the decline in the labour force participation rate of the working age population. This reflects the growing number of discouraged workers who have ceased to search for formal sector

employment. If both registered unemployment and the withdrawal of people from the labour force are taken into account, about half of all working age adults of 25-49 years of age were without employment in 1998. Two-thirds of female workers in this age group lacked employment.²

Trends in employment

Employment had already started to decline in Armenia in the aftermath of the 1988 earthquake and the Karabakh conflict. Later in the 1990s, a “shock-therapy” strategy for the transition intensified the impact of these early external shocks.

Agricultural employment accounted for much of the decline in employment in the late 1980s, dropping by almost eight per cent between 1985 and 1990. However, in the 1990s, industry was responsible for most of the decline in employment, a decline induced by the collapse of CMEA and the introduction of shock therapy. By 1997 industrial employment stood at 44 per cent of its 1990 level.³ Between 1990 and 2000, employment in industry dropped by about 315,000 workers, as can be seen in Table 5.1. The same declining trend characterized the construction sector. Employment in services also declined in the early 1990s but less dramatically than in industry, falling by more than 116,000 workers between 1990 and 1995.

Uncharacteristically, the tertiary sector did not absorb most of the industrial workers who lost their jobs; instead it was the agricultural sector that proved to be the residual source of employment. Employment in agriculture mushroomed by 200,000 workers during 1991-92, the years of land privatization, and continued to increase, albeit at slower rates, until 1996. Between 1990 and 2000, agriculture absorbed over 280,000 new workers. Many of the laid-off industrial workers who had their origins in rural areas returned to their villages early in the 1990s to establish a claim to the privatized land.

As agriculture gained workers released by industry, the average level of labour productivity in the economy declined, since more workers were concentrated in lower value-added activities. Development was thrown into reverse and Armenia became an increasingly agrarian economy.

Table 5.1

**Employment by Sector of Economic Activity
(thousands)**

	Total	Industry	Agriculture	Services
1990	1630.1	494.8	283.8	662.1
1993	1543.3	362.5	519.7	541.2
1995	1476.4	302.9	551.9	545.6
1998	1337.3	209.4	567.8	503.4
2000	1277.7	179.7	566.7	484.8
Percentage change, 1990-2000	-21.6	-63.7	+ 99.7	-26.8

Source: National Statistical Service.

Thus between 1990 and 2000, industrial employment fell by nearly 64 per cent and employment in services declined by nearly 27 per cent; employment in agriculture partially offset these falls by nearly doubling. Total employment declined by 21.6 per cent. These changes in levels of employment led to major changes in the composition of the labour force across the three major sectors of economic activity plus construction.

Table 5.2
The Sectoral Composition of Employment
(percentages)

	1990	1995	2000
Agriculture	17.4	37.4	44.4
Services	40.6	37.0	37.9
Industry	30.4	20.5	14.1
Construction	11.6	5.1	3.6

Source: National Statistical Service.

As can be seen in Table 5.2, between 1990 and 2000 the share of agriculture in total employment rose dramatically from 17.4 per cent to 44.4 per cent. The share of services fell slightly, namely, by 2.7 percentage points to 37.9 per cent of total employment in 2000. The share of industry, in contrast, fell by more than half, from 30.4 per cent of total employment in 1990 to only 14.1 per cent in 2000. Equally remarkable was the fall in employment in construction from 11.6 per cent of the total in 1990 to only 3.6 per cent a decade later. This reflects the collapse of investment that was emphasized in Chapters 1 and 2.

Rough estimates of changes in the productivity of labour in the three sectors of economic activity are illuminating. The data are presented in index number form in Table 5.3. In the industrial sector the productivity of labour declined by 46 per cent between 1990 and 1995 and then rose almost as rapidly, so that by 2000 it was 7.3 per cent lower than it had been a decade earlier. This pattern may reflect the dismissal of labour in the privatized state enterprises that occurred in the middle years of the 1990s. In agriculture there was a steady decline in the productivity of labour throughout the period 1990-2000. This reflects the inability of agriculture to absorb productively the large inflow of

displaced workers that occurred throughout the transition period. By 2000, the productivity of labour in agriculture was little more than half of what it had been in 1990. The pattern in the services sector was similar to that in industry. Productivity at first fell and then rose sharply. By 2000, the productivity of labour in services was actually 31.1 per cent higher than it had been in 1990. The average productivity of labour in the economy as a whole at first fell by nearly 62 per cent and then recovered, so that by 2000 it was only 13.3 per cent below the level of 1990.

Table 5.3

**Value Added Per Worker, 1990-2000
(index: 1990=100)**

	1990	1995	2000
Industry	100	54.0	92.6
Agriculture	100	69.6	52.4
Services	100	70.1	131.1
Entire economy	100	58.3	86.6

Source: Author's calculations based on data from the National Statistical Service.

The ranking of sectors by labour productivity also changed. This is shown in Table 5.4 , where each sector's share in gross domestic product is divided by its share in employment. Thus the data in the table indicate the relative position of each sector at a given moment in time, but they tell us nothing about changes in productivity over time. In 1990, the productivity of labour in industry was roughly 46 per cent above the national average, twice that in agriculture and nearly 2.4 times that in services. In 2000, industry was still at the top and in fact the productivity of labour in industry was 56 per cent above the national average. This indicates that during the transition to a market economy productivity differentials actually widened, the opposite of what one would expect to find

in a well integrated economy. The differential between industry and services, however, narrowed considerably: the productivity of labour in industry was now only 1.7 times that in services. The most striking change occurred in agriculture. Having achieved nearly the national average in 1995, by 2000 the productivity of labour in agriculture was only 52 per cent of the national average and it had been overtaken by services. Indeed the productivity of labour in agriculture was only a third of that in industry.

Table 5.4

**Labour Productivity Across Sectors, 1990-2000
(index: entire economy=100)**

	1990	1995	2000
Industry	146	135	156
Agriculture	72	97	52
Services	61	74	93
Entire economy	100	100	100

Source: Author's calculations based on data from the National Statistical Service.

These movements over time and across sectors do not take account of the informal sector, which obviously is an important part of the service sector. If we take the employment figures at face value, industry and services combined lost about 492,400 workers whereas agriculture absorbed only 282,900. This is a net loss of about 210,000 jobs in the formal economy. Construction did not absorb these workers since the level of employment in construction was declining sharply. There are thus 210,000 workers that are missing. These “missing” workers undoubtedly joined the informal sector, where many other “missing” workers were already engaged in low-income insecure economic activities.

Some of these “missing” workers have probably left the country. Migration to other countries has played a very important role as a safety net for many households with unemployed workers. The 1996 Household Budget survey revealed that about 110,000 people lived temporarily outside Armenia. They came from about 10 per cent of Armenian households. The great majority of the temporary emigrants were of prime working age and three-quarters were men. Most went to other CIS countries, principally the Russian Federation. Many were skilled workers or professionals.

Their economic contribution to Armenia is substantial: official statistics report that in 1996 remittances accounted for 13.2 per cent of current income. Surprisingly, this share rivaled that of wages, which accounted for 13.1 per cent. This comparison underlines the critical importance of the external labour market for Armenia’s development. Without the outlet of emigration, the extent of poverty would have been even more pervasive than it is.

In many developing and transition economies, remittances have a much larger impact on poverty than capital inflows. This could also be true in Armenia, but remittances also appear to contribute to overall inequality in the distribution of income. Because of the financial cost involved in leaving the country, emigrants tend to come from higher-income households. The Gini coefficient for the distribution of income is very high, namely, about 0.59. An examination of the sources of inequality in income in Armenia suggests that while a marginal increase in domestic wages would reduce the country’s high inequality, i.e., lower the Gini coefficient, a marginal increase in remittances probably would increase it. In technical terms, the concentration ratio for wages is 0.36 (i.e. less than the Gini coefficient) whereas the concentration ratio for remittances is 0.78 (i.e. higher than the Gini coefficient) .⁴

The employment trends described above, including work abroad, give an indication of the problems that still plague the Armenian economy. There are few motors of employment-intensive growth. New private small-scale industrial enterprises are few; they are certainly incapable of offsetting the lay-offs resulting from the privatization of the Soviet-era medium and large-scale enterprises. Agriculture has had to absorb redundant workers but can offer only subsistence incomes. The formal service sector has also been losing workers. A substantial informal sector, whose employment is largely unrecorded, specializes in services, but the low income and productivity in the informal sector are unable to stimulate growth in other sectors.

Some new activities, such as computer software and diamonds, have grown rapidly but these activities are limited in number, small in size, and benefit mainly higher-paid workers. The real problem for broadly based growth and poverty reduction lies at the shadowy intersection between the large number of informal sector micro-enterprises and the small number of new small-scale private enterprises, primarily in urban areas but also in rural areas. Successful development will depend on transforming these enterprises into a major source of dynamism.

The current policies of government are poorly designed to facilitate movement (“speed up the traffic”) across this intersection, from the informal to the formal sector. In Armenia (as in many other countries) policy makers regard the informal sector as a brake on development, a haven for unlicensed, untaxed, illegal activities. But most of the workers in this sector did not enter it by choice: given the collapse and ensuing stagnation of the formal economy, they had few other options. Informal sector workers are engaged primarily in survival activities, at low incomes and with insecure employment. Efforts to

reduce poverty will have to focus on the informal sector. Indeed the informal sector should be seen not as a problem for development but as a starting-point for development.

Disqualifying growth

While growth did resume from 1993 onwards, the gains from growth have been unequally distributed. This is reflected in the trends of employment and real wages. The total labour force increased during the late 1990s, but employment continued to decline. For example, the percentage of the working age population that is “non-employed” (either unemployed or not participating in the labour force) grew by over 50 per cent during the period 1995-98. This is an ominous trend for a period of sustained growth.⁵ While employment continued to increase marginally in agriculture, it fell in all other sectors, even in most sub-sectors of services.

Although there was a general decline in employment, the level of real wages rose for many workers who managed to keep their jobs. This happened, for example, in construction, transport and communications, public administration, and health and education. Good indicators of the general trend are what happened to incomes in the well-paying sectors of construction and transport and communications: although they shed labour during 1995-98, the level of real wages in these activities increased significantly. Unfortunately, however, only a small group of workers gained from this. The financial sector, which is one of the highest-paying sectors, cut its workforce by half but raised the already high real wages of those employees who remained. This paradoxical trend helps to explain the continuing high level of income and earnings inequality in Armenia.

Real wages also rose in branches of the public sector, such as in public administration and health and education, but even so these sectors remained relatively

low-paying compared to the urban private sector. The effect of the wage increases in the public sector on reducing overall inequality was not significant.

While employment continued to increase in agriculture during this period, real incomes declined. This was partly due to the declining terms of trade for agriculture, and reflects the fact that prices for agricultural products rose more slowly than the general price level. This is one sign among many that at the bottom of the distribution, incomes were stagnating, and even falling. Combined with rising real wages of small groups of relatively highly paid urban workers, the flattening out of incomes among poorer workers helps to explain why the distribution of income is likely to remain polarized.

The role of the private sector

Growth of output since 1993 has been accompanied by an increase in the share of employment originating in the private sector. From 1996 to 1998, in the aftermath of privatization of large-scale public enterprises, the share of the private sector in employment ballooned from 57 per cent of the total to 76 per cent. This occurred largely as a result of privatization rather than because of a rapid expansion of new small private firms. Instead of an expansion of paid employment in private sector firms, there was an increase in the number of self-employed workers and unpaid family members who work with the self-employed.

In 1998, there were about 50,000 self-employed workers in urban areas, drawing upon a much larger pool of family members (perhaps as many as 200,000 workers) to help with their micro-activities. There were also about 5,000 entrepreneurs who ran firms that hired another 20,000 workers, mostly on a casual basis. The average size of these firms was 4 workers. In aggregate, these workers accounted for only five per cent of total wage employment.⁶ A larger pool of casual workers (perhaps as many as 100,000)

rotated in and out of these small private firms. The very small size of these firms and the precarious nature of the employment that they offer illustrate the primitive level of development of much of the urban private sector in Armenia.

The levels in urban paid employment in small private firms and urban self-employment are low by the standards of other transition economies. The main spurt in the number of registered private firms occurred in 1995-97, when the privatization of small-scale public enterprises occurred. Thereafter, the number of registrations increased more slowly and many new companies soon went out of business. A survey of small businesses by the National Statistical Service in 1997-98 revealed that over half of the registered businesses were no longer operating. As a result of the rapid creation and extinction of small firms, the number of private firms in 1999 was not much larger than the number operating in 1995. While “the new private sector” (excluding the large traditional enterprises) produces about 60 per cent of gross domestic product, family farms and unregistered businesses account for over two-thirds of this total. The output attributable to new small private firms is still marginal.

The unavoidable conclusion is that the private sector still plays a very weak role in generating employment. Unless this role is strengthened, employment will continue to lag behind growth, inequality will remain high and widespread poverty will persist. A priority of government policy should be to stimulate the growth of small-scale private firms. Because their operations tend to be labour-intensive, these firms can be an engine of employment generation as well as growth and the main beneficiaries of their growth will be poorer workers.

Concluding remarks

In order to achieve pro-poor employment-intensive growth, government policies should concentrate on supporting the expansion of small-scale private firms in services and manufacturing. Many of these firms are likely to be more labour-intensive than the large traditional enterprises. Some are also likely to exploit Armenia's comparative advantage in some skill-intensive sectors, such as computers and jewelry. Market forces, both domestically and globally, should be allowed to determine the mix of industries.

This new emphasis will require a re-organization of the banking sector so that more credit is allocated to the small-scale private sector. In addition, special training programs in business skills for small entrepreneurs will be necessary. Instead of restrictions against the creation and growth of informal-sector micro-enterprises, there should be positive incentives to attract entrepreneurs to the formal sector. Higher taxes and tighter regulations are not the answer. Tax revenue will increase automatically but gradually as the private sector grows and generates more employment and income.

It is difficult for government to “pick winners” in particular economic sectors. It is easier for government to create a supportive environment in which the self-employed and small entrepreneurs can take advantage of whatever opportunities exist in Armenia's growing economy. The government already has tried to ensure that the population has equitable access to productive assets. This was evident in the privatization of land in rural areas and in the privatization of housing, which benefited mainly the urban population. But the privatization of state owned enterprises has been less successful.

What is needed now is a spontaneous process of “privatization from below”, nurturing the emergence of a vibrant small-scale private sector, which is better able than the large traditional enterprises to adapt to the rapidly changing economic conditions that

Armenia faces. This will spark more “bottom-up growth,” which is likely to be more intensive in the employment of poorer workers. A national poverty reduction strategy can contribute to such a process by ensuring that the working poor and the unemployed have the necessary skills and access to credit, resources and infrastructure that they need to become integrated into higher productivity and rapidly growing sectors.

Notes

1. See World Bank, Armenia: Growth Challenges and Government Policies, Vol. II: Main Report, Washington D.C.: November 2001, Ch.2.
2. See World Bank, “Armenian Labor Market: Adjustments and Misalignments,” Improving Social Assistance in Armenia, Report No. 19385-AM, June 8, 1999, World Bank: Washington D.C., Annex 3, p.4. The section on unemployment in this chapter draws extensively on this publication.
3. See Astghik Mirzakhian, The Labour Market in Armenia: Analysis and Policy, publication of the United Nations Office, Yerevan, 1999, p. 8.
4. See World Bank, Improving Social Assistance in Armenia, loc. cit., p. 14.
5. See World Bank, Armenia: Growth Challenges and Government Policies, loc. cit., Ch.2.
6. Ibid., p. 28