

# Paths Out of Poverty

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Guy Pfeffermann

## 1. Introduction

During the past decade, the number of persons living in absolute poverty has remained constant worldwide: about 1.2 billion people. The incidence of absolute poverty has decreased in East Asia and China and has increased almost everywhere else. While the number of very poor people has stayed constant, the population of these countries has increased by about 1 billion. Therefore, the number of persons who are not poor has also increased in every region, except in the former socialist countries of Europe and Central Asia. However, in sub-Saharan Africa the number of nonpoor people has increased substantially. There are 1 billion more nonpoor people in the developing world today than there were ten years ago. These people may never have been poor and were born out of poverty—or, and this is the focus of this paper—they somehow crossed the poverty line. The question, then, is how people escape poverty

Surveys of households and individuals over time, unfortunately very few in number, show a lot of economic mobility, up and down, in developing countries. One survey, done in Venezuela, looks at people who did cross the poverty line: poverty escapist. Most poverty escapist escaped poverty by finding a job in the private sector, the formal sector, the informal sector, or the public sector. Other people escaped poverty by having a member of their family find a job. Finding a job is clearly one way by which people escape poverty.

## 2. The Private Sector: Employment and Services to Reduce Poverty

Where are the jobs? The jobs created are overwhelmingly in the private sector. The reason job creation resides mainly in the private sector is that governments are heavily in debt and cannot afford new hiring. In the years to come, this pattern is likely to be even more pronounced than it is now.

The term “private firms” spans a range of businesses: informal, underground, small, medium, large, local, and foreign firms, in all economic sectors—farming, commerce, and infrastructure. Lyonnaise des Eaux, for example, is involved in manufacturing, mining, services, and anything else one can think of. This paper takes the broadest definition of private: private is anything that is not part of the government or government-owned.

These firms generate jobs, which in turn generate salaries and wages. Very importantly, they also broaden people's choices. An interesting literature is burgeoning about poor people as a market. For example, Unilever in India has a sales force of tens of thousands who have gone into poor areas of towns and villages selling very small packages of soap and other products. Per unit of soap, consumers pay less than they would at present for lesser quality products; therefore, Unilever's sales force allows the poor to increase their purchasing power, saving a little money to buy something else.

The private sector also provides services. A conceptual framework, known as a stakeholder framework, assesses development impact. The rest of society is also very important, e.g., the government; links are in the form of taxes. Private firms are the main source of taxes that the

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*“Corruption topped the list of very serious obstacles to doing business in East Asia.”*

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government uses to pay for hospitals and social safety nets. If proper surveys were available, women only, or both men and women, below a certain income level could be studied as one of the categories.

The International Finance Corporation is at present testing the stakeholder framework at the moment in order to apply real numbers to this concept. The Board of Directors at the World Bank and the Committee on Development Effectiveness discussed and endorsed the stakeholder framework as a way in which to think about creating jobs and broadening choices. Now it is just a matter of resources to continue applying this framework.

One interesting correlation between growth and private investment can be illustrated by studying three kinds of countries: those that have grown slowly over the past 30 to 40 years, those that are average performers, and those with economies that develop very fast and reduce poverty rapidly, like the Republic of Korea. Remember that in 1960 the Republic of Korea exported human-hair wigs and was poorer than Africa is today. Looking at public investment and private investment as a percentage of GDP, economists have observed that faster economic growth stimulates more private investment. The causality works in the other direction as well.

### 3. Fostering Private Sector Development

How then can governments encourage private firms? The World Bank has carried out a couple of surveys of the business environment: one third were small businesses, one third were medium-sized businesses, and the remaining third were large businesses. The survey assessed these businesses' situations, and particularly their relationship with government. Businesses in East Asia were studied in 1999 and 2000. These businesses ranked from 1 to 4 the seriousness of various obstacles to doing business: 1 means the obstacle is not at all a problem; 2, a very minor problem; 3, a moderate problem; and 4, a very serious problem.

Thirty-one percent of East Asian respondents indicated the presence of very serious obstacles to doing business. Corruption topped the list of very serious problems. Businesses, not researchers, were identifying this problem. The information appears in an unweighted

average of East Asian countries. In a weighted average, the People's Republic of China would overwhelm the picture and it would look slightly different.

Political instability or uncertainty was listed as the second most serious problem. This points to the importance of good macroeconomic policies.

Third, street crime, theft, and/or disorder were identified by nearly a third of the firms as a very serious obstacle to business and as a problem that international aid agencies have not previously addressed. This type of crime might be a very worthwhile area to address. Organized crime, inflation, difficulties in obtaining financing, exchange rates, and other issues also appeared on the list of very serious problems.

This list and similar lists for other countries could serve as a very useful starting point for policy loans directed at improving the business environment and the institutions that really are anti-poor, in the sense that they cripple employment formation. Economists largely agree that a lot of jobs need to be created for new entrants into the labor force. Existing jobs also need to be upgraded. This upgrade can only happen if the business environment improves.

In conclusion, private firms are the only sustainable long-term engines of growth and job creation. It is like having just one engine in a car. If it is a bad engine, the car goes slowly. If it is a good engine, the car goes faster. It is worth looking after the engine, changing the oil, and doing whatever else is necessary to make it work well. Bilateral and multilateral aid agencies need to pay much more attention to the linkage between poverty reduction and private firms. Without this linkage, countries are not going to reduce poverty very rapidly.