PRO-POOR ECONOMIC GROWTH RESEARCH STUDIES

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Discussion Session II: Lessons from Country and Sector Studies

Pro-Poor Economic Growth Research Studies

Discussion Session II

July 1, 2003

Table of Contents:

1. Discussion Session Agenda 1
2. The Pro-Poor Research Team 3
3. Presentation Materials: Lessons from Three Labor Abundant "Asian-Type" Economies, Gus Papanek 5
4. Presentation Materials and Executive Summary: Agriculture Sector Study, C. Peter Timmer 11
5. Executive Summary: Educational Sector Study, Jere Behrman 17
6. Executive Summary: Ukraine Country Study, Al Berry and Karin Schelzig 21
7. Executive Summary: Egypt Country Study, Samira Salem 24
8. Recommendations: Health Issues Paper, James C. Knowles 27
9. Issues Paper: Privatization and the Poor, Lee Jones 31
10. Executive Summary: Uganda Country Study, John R. Harris 41

Pro-Poor Economic Growth Research Studies
Discussion Session II
July 1, 2003, 9:00 – 4:30 pm
The Willard Hotel

9:00 Welcome and Introduction: Tim Mahoney (EGAT/PR), F[illegible] (EGAT/AA), and Al Berry (BIDE/University of Toronto).

THEME 1: Lessons from Country Studies

9:20 Lessons from Asian Countries (Indonesia and [illegible] experience)
Presenter: Gus Papanek (BIDE)
Commentator: Bob Aten (ANE/SPO)

10:15 Coffee

10:25 Lessons from African Countries (Uganda and Zambia)
Presenter: John Harris (BIDE/Boston University)
Commentator: Juan Buttari (AFR/SD)

11:20 Lessons from Latin American Countries (Peru and Brazil)
Presenter: Sam Morley (BIDE/IFPRI)
Commentator: Clarence Zuvekas (MSI)

12:15 Lunch

THEME 2: Lessons from Sector Studies and Issues Papers

13:15 Privatization and the Poor
Presenter: Gus Papanek (BIDE)
Commentator: Tim O'Hare (EGAT/PR/PASSN)

13:40 Education
Presenter: Jere Behrman (BIDE/Universityof Pennsylvania)
Commentator: Don Sillers (EGAT/PR/PASSN)

14:25 Agriculture
Presenter: Peter Timmer (DAI)
Commentator: Susan Thompson (EGAT/AFS)

15:10 Coffee

15:20 Finance
Presenter: Al Berry (BIDE/University of Toronto)
Commentator: Kate McKee (EGAT/PR/MD)

16:05 Closing: Al Berry, Gus Papanek, and James Elliott (EGAT/EG).

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Presentation Materials:

Lessons from Three Labor Abundant "Asian-Type" Economies

by Gus Papanek

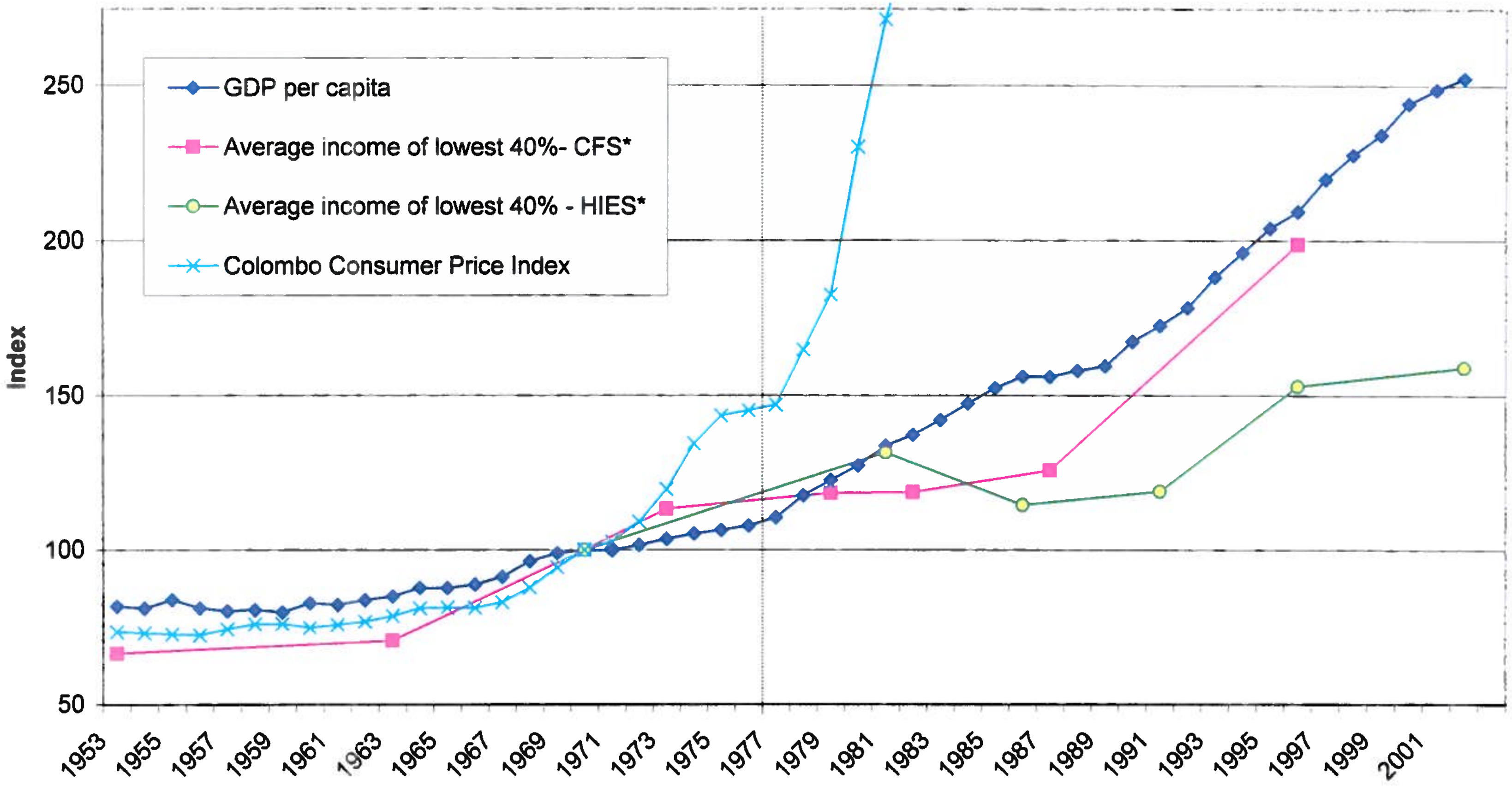
1. Sri Lanka: Growth, Investment and Exports in More Market-oriented and Dirigiste Periods
2. Growth in GDP Per Capita and in the Average Income of the Poorest 40%
3. Sri Lanka: Relationship of Growth, Income of the Poor, and Inflation
4. Egypt: Relationship of Growth, Incidence of Poverty, and Wages of the Poor
5. Indonesia: GDP Per Capita Growth and Poverty Incidence

SRI LANKA
Growth, Investment and Exports in More Market-oriented and Dirigiste Periods

Broad Policy period	Strategy/ party in power	Growth Rate (%)		Investment/ % of GDP	ICOR	Export/ % of GDP
		GDP	GDP Per capita			
1956- 77	More dirigiste	3.5	1.3	13.6	3.9	19.8
1977- 01	More market	4.7	3.3	24.9	5.3	25
Policy sub-periods *						
1952-56	UNP	3.2	0.3			
1956-60	SLFP	2.6	-0.2			
1960-65	SLFP	4.1	1.6			
1965-70	UNP	4.8	2.4			
1970-77	SLFP	3.1	1.4			
1977-82	UNP	5.9	4.2			
Summing up policy periods						
SLFP-more dirigiste	56-65; 70-77	3.2	1			
UNP- more market	52-56; 65-70; 77-82	4.7	2.4			

NOTE: Sub-periods end with 1982 after which the two parties have followed quite similar strategies

SRI LANKA
Growth in GDP Per Capita and in the Average Income of the Poorest 40%
[Indexed to 1969-70]



*CFS = Consumer Finance Survey of the Central Bank of Sri Lanka, starting in 1953
HIES = Household Income and Expenditure Survey of the Bureau of Census and Statistics, first done in 1969-70

SRI LANKA

Relationship of Growth, Income of the Poor, and Inflation

Time Period (or single year)	Annual % rate of change			Share of poorest 40% in last year in period	Inflation Rate (%) (CCPI)
	GDP per capita	Income of Poorest 20%	Income of Poorest 40%		
1953				*14.5*	
1953 -1963 *	0.4	0.9	0.6	14.7	0.6
1963 -1973 *	1.8	4.4	4.4	19.3	3.9
1973 -1978/79 *	2.5	0.8	0.6	16.6	6.2
1969/70				*21.5*	
1969/70 - 1980/81 #	2.4	2.3	2.3	21.4	8.5
1978/79 - 1981/82*	3.2	0	0.1	15.3	12.8
1980/81 - 1985/86 #	3	-3.2	-2.3	16	9.6
1981/82 - 1986/87 *	2.3	0.3	1	14.2	8.2
1985/86 - 1990/91 #	1.9	-1	0.6	14.8	10.5
1986/87 - 1996/97 *	3.2	4.4	4.3	15.7	10.9
1990/91 - 1995/96 #	3.3	5	4.3	15.3	9.5
1995/96 - 2002 #	2.2	0.3	0.6	13.9	8.6

* CFS = Consumer Finance Survey of the Central Bank

HIES= Household Income & Expenditure Survey of the Bureau of Census and Statistics

Number of Periods when the Poor Benefited Proportionately from Growth

	Poor Benefited		
	Less than	Proportionately	More than
Slow Growth [<2%]	1	1	1
Medium Growth [2-3%]	3	1	0
High Growth [>3%]	1	0	2

EGYPT

Relationship of Growth, Incidence of Poverty, and Wages of the Poor

Time period	Growth Rate GDP per capita	% Average Annual Change in Poverty Incidence	% Average Annual Change in Real Wage
1975-80	7.2		
1980-90	3.3	0.8	2.3
1991-95	1.4	-0.4	-1.7
1996-2000	3	-0.4	

Calculated from Salem, Samira and Jane Gleason, "An Examination of Poverty Reduction in Egypt: Contributing Factors, Sustainability, and Lessons," Pro-Poor Economic Growth and Research Studies, deliverable 10, USAID/BIDE/DAI, March 2003, (unpublished)

INDONESIA
GDP Per Capita Growth and Poverty Indicators

Years	Annual % rate of change			
	GDP per capita	Plantation wages	Rice Agric. wages	Per capita income of poorest 40%
1955-60	-0.7*	-7.55		
1960-67	-0.1	1.1		
1967-76	5.1	1.3		
1976-81	5.7		1.3	6.6
1981-87	2.4			2.8
1987-96	5.4			5.0
1996-99	-4.3		-9.9	-2.2
1999-02	3.8		4.7	2.0

1954-63	-0.7	-8.65		
1963-67	0.1	4.2		
1967-70	6.2			
1970-76	4.5			5.5
1997-99	-7.8		-14.9	

*approximate estimates from various sources

Presentation Materials and Executive Summary:
Agriculture and Pro-poor Growth
by C. Peter Timmer

1. Executive Summary
2. Figure 1: Framework for Discussing Agriculture and Pro-Poor Growth
3. Figure 2: Iso-Growth Lines for the Poor, with Historical Examples

Agriculture and Pro-Poor Growth

by C. Peter Timmer

EXECUTIVE SUMMARY

How does growth in the agricultural economy help reduce poverty? In a global economy with open commodity markets, the answer is different from just a generation ago. Then, large Asian economies needed to produce most of their own food. Higher agricultural productivity impacted the poor directly through lower food prices. Their food intake increased significantly. The availability of cheaper food also stimulated investments in labor-intensive industries, speeding economic growth and raising real wages. Where they happened, both contributed to rapid reductions in poverty.

Globalization and the availability of cheap grain in world markets change the story in important ways, but do not alter the importance of gains in agricultural productivity to reductions in poverty. The linkages are less direct, however. Stimulating them requires a far more subtle role for government. Attention is more on the rural economy broadly than on food crop production *per se*. Rural-urban linkages, including migration and remittances, are a major part of the story. Prices for staple grains in world markets are low and stable, and emphasis has turned to diversification and access to supply chains that provide middle class (and foreign) consumers with fruits, vegetables, processed foods, and livestock products. Making agricultural productivity contribute to pro-poor growth is more complicated than during the first decades of the Green Revolution, but the potential is real and among the most cost-effective approaches for reaching the poor.

No country has solved its problem of poverty through agricultural development alone (much less through higher productivity for a single commodity such as rice). At the same time, no country (except Singapore and Hong Kong) has solved its problem of poverty *without* creating a dynamic agricultural sector. The secret is a successful *structural transformation* where agriculture, through higher productivity, provides food, labor, and even savings to the process of urbanization and industrialization. This process raises labor productivity in the rural economy, causes wages to rise, and gradually eliminates the worst dimensions of absolute poverty.

The process also leads to a decline in the *relative* importance of agriculture to the overall economy. And no country has undergone a successful, i.e. sustainable, structural transformation without substantial openness to the world economy. Economists continue to debate the optimal sequencing and degree of openness, but all agree that joining the global economy has the potential to *improve the efficiency of resource allocation* and *speed technological change*, which are the short-run and long-run sources of economic growth. Economic growth is the basic vehicle for reducing poverty. When that growth reaches the poor in a differentially favorable way, it is "pro-poor." Thus the poor have a stake in the rate of economic growth and their connection to it. Agriculture affects both.

Figure 1 shows the framework used in this study to organize the discussion of agriculture and its impact on pro-poor growth. As with the other studies in this project, pro-poor growth is defined in two dimensions, one involving the average rate of growth in the economy, and the other reflecting how well the poor connect to that growth (the "elasticity of connection"). Iso-growth curves can be constructed that show equal rates of growth for the poor according to different

combinations of average economic growth and the elasticity of connection. Figure 1 shows the 3 percent iso-growth curve as an example.

Figure 1 illustrates three basic points. First, the poor prefer to be in the "southeast" quadrant of the possible combinations, where rapid economic growth and a large (greater than one) elasticity of connection lead to very rapid reductions in poverty. A number of countries in East and Southeast Asia have experienced such growth.

Second, even along a given iso-growth curve, the poor will not be indifferent to where on that curve they are. Areas too far to the right, where the poor will have extremely high elasticities of connection, are likely to result from populist or even revolutionary policies that are incompatible with long-run investment incentives and economic efficiency. In the other direction, even rapid economic growth may not be sustainable in political terms if the poor are visibly disconnected from this growth—the situation when the elasticity of connection is too low.

Finally, the role of agriculture in this process seems to depend fundamentally on how well the poor connect to the growth process in the first place, which is directly determined by a country's income distribution. With highly unequal distributions of income, caused to a substantial extent by highly unequal land ownership, agricultural growth actually seems to exacerbate poverty. By contrast, when a country's income distribution is relatively equal, agricultural growth stimulates the rest of the economy at the same time that it strengthens the connection of the poor to that more rapid growth. In such settings, agriculture is truly the "engine of pro-poor growth."

Figure 1. Framework for Disussing Agriculture and Pro-Poor Growth

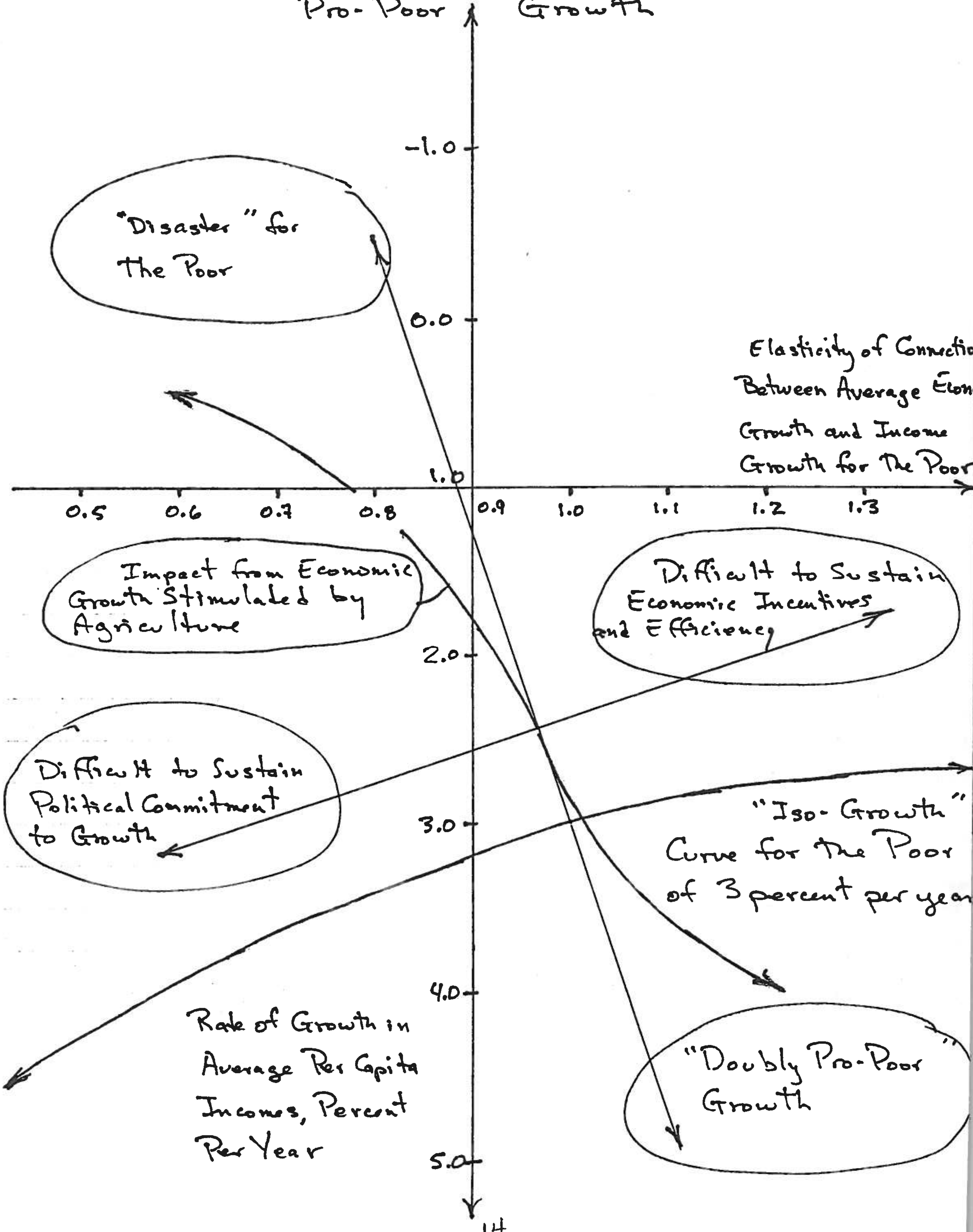
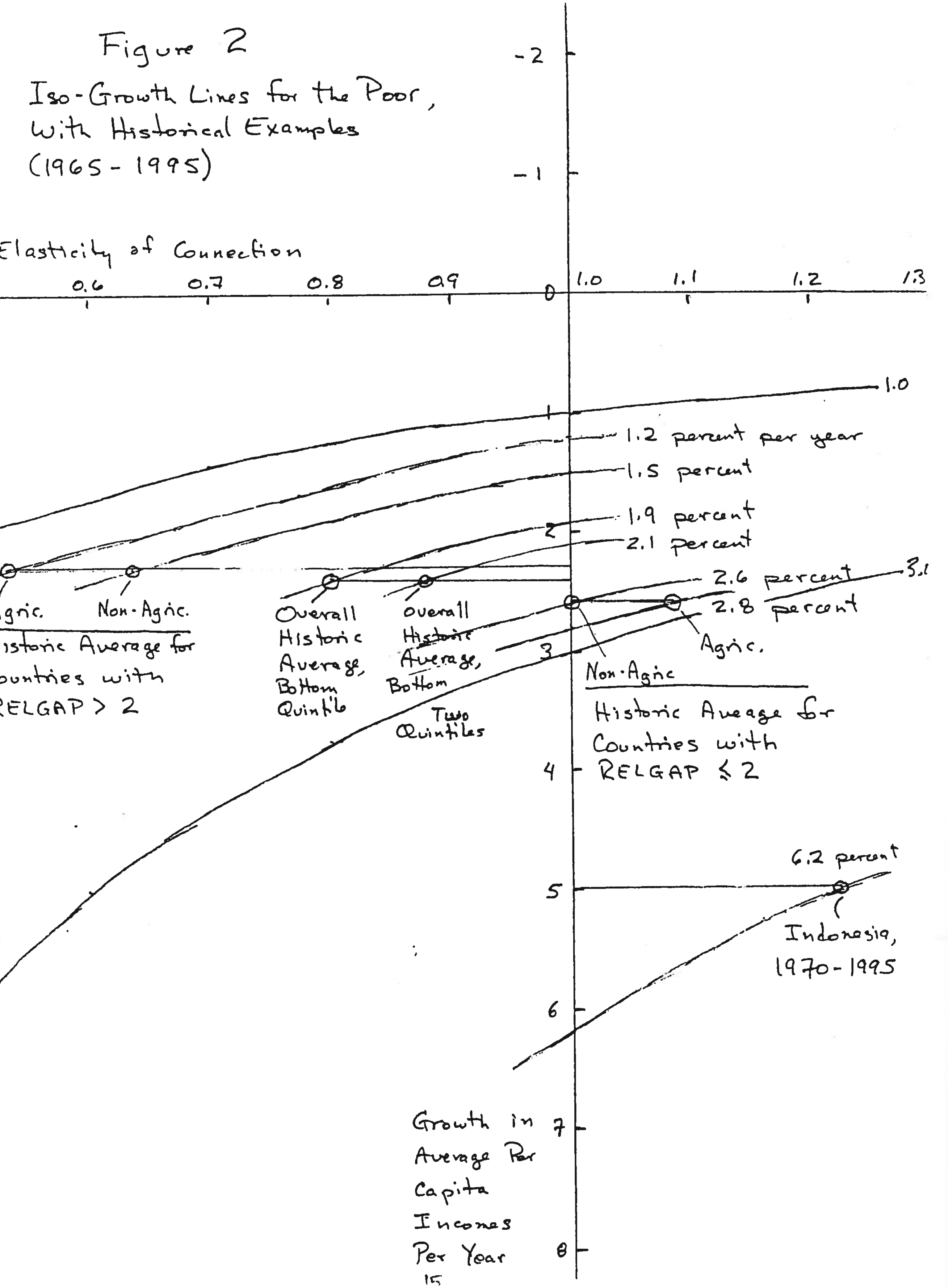


Figure 2

Iso-Growth Lines for the Poor, With Historical Examples (1965 - 1995)



Educational Sector Study: Pro-poor Economic Growth Effects of Policies and Activities
By Jere Behrman

EXECUTIVE SUMMARY

Education is widely thought to be central for promoting efficient growth and for increasing the assets of the poor to bring them out of poverty over time, if not immediately. Education is most usefully defined to include a broad range of learning activities. Formal schooling is the most-emphasized and the most-studied of those activities. But it is important to recognize that education encompasses activities other than just formal schooling—for example, pre-school learning at home and in formal programs, informal and formal general and specialized training programs, and learning from experience all may be important parts of education more broadly defined.

This paper reviews what we know and what we do not know about the pro-poor economic growth effects of policies and activities in the educational sector, drawing on the substantial literature in this area. For this purpose, education is broadly defined as noted, but given the concentration in the literature on formal schooling, this review also concentrates on formal schooling. The paper provides, based on the imperfect available knowledge, recommendations about what to do and not to do in this sector, the prioritization of strategies, and how such recommendations depend on different country conditions and thus the topology of countries as outlined in the project paper by Berry (2002).

Although the focus of the paper is on recommendations regarding what to do and what not to do in the educational sector, such recommendations cannot be made in a vacuum. To understand what we know and what we do not know, some framework for analysis is necessary. Such a framework should address what determines education and the effects of education, what are the problems in making inferences about the causal determinants of education and the effects of education, and what are the key motives for policy. Chapter One lays the foundation for the recommendation in this paper by summarizing these issues (with elaboration on estimation issues in Appendix A). Chapter Two describes basic aspects of patterns in the most-emphasized form of human capital—schooling—with regard to associations with regions, time, per capita income, and adult women's schooling to provide some perspective (Appendix B provides elaboration). Chapter Three then provides recommendations for the educational sector (with details on one important program that is a useful model for some policies and, more important, for evaluation in Appendix C). The key policy recommendations for educational policy and pro-poor economic growth presented in Chapter Three are:

1. **Recognize that education is more than formal schooling.** If "education" means learning that may increase productivity in activities and improve welfare, the term includes not only schooling but also learning at home, in the community, and on the job prior to, during, and subsequent to schooling and learning through formal training programs. More attention needs to be paid to evaluating education outside of formal schooling as well as to improving the evaluation of formal schooling.

2. **Distinguish between private and social rates of return to different types of education and be conscious of policy hierarchies.** The basic policy motives are to increase efficiency

(in the sense of more welfare for the same resources and technology) and to attain better distribution (which often, and in this project in particular, focuses on reducing poverty). It is important to consider policy alternatives with regard to both of these basic objectives. There may be some policies that are win-win by improving efficiency and benefiting the poor. The reduction of the impact of capital market restrictions on human capital investments is a likely example. But other policies involve tradeoffs between efficiency and distribution that should be considered in assessing policy choices. And just because some policies, such as those that increase schooling, have productivity gains does not mean that such policies are desirable in terms of efficiency—what is central for that assessment is the difference between the social and the private rates of return, which may be small or negative even if the private rates of return are high (as, for example, for most forms of tertiary schooling).

3. **Recognize that the rates of return to investing in the education of the poor appear substantial in many cases—comparable or exceeding those to many other investments, with those for investing in females often at least as high as those for investing in males.** The relatively small number of studies that evaluate the benefit-to-cost ratios for education in developing countries suggest that these ratios are greater than one, thus indicating that the returns to increasing education are relatively high in comparison with many other investments. Some careful studies also suggest that such returns are likely to be at least as high for investments in the education of females as of males because of gender specialization in tasks such that female education has greater impact on important outcomes related to health and nutrition and perhaps the education of the next generation. These studies, however, are limited to a few forms of education (primarily formal schooling) in a relatively few contexts. Although their results suggest the possibility that there may be relatively high rates of returns to expanding education in other developing country contexts, it is important that careful evaluation of educational policies be undertaken in the particular contexts in which a policy is being considered and, if the policy is implemented, that the evaluation be updated with new information that becomes available from careful monitoring of the policy.

4. **Recognize that rates of return to education depend importantly on market, policy, and cultural contexts.** The rates of return to education are likely to be higher in contexts in which there is an ongoing stream of market and technological changes as a result of more extensive integration into world markets. The rates of return to female education, for example, are likely to be higher in societies in which females have more flexible choices regarding time use and occupations.

5. **Focus on the parts of the lifecycle in which the returns are likely to be highest and include health and nutrition support among the policy tools.** The rates of return appear to be relatively high for early education and for complementary human capital investments in health and nutrition from conception onward. In many developing countries, therefore, there are likely to be win-win pro-poor policy improvements possible through shifting resources away from high per-student subsidies for tertiary schooling (where most of the students are from middle- and upper-income families) toward basic education (including pre-school programs) and infant and early childhood health and nutrition.

6. **Improve school access for basic education.** Currently, in most parts of most developing countries, primary schools are accessible for most children, although significant pockets remain where primary schools are not available, which is likely to be costly in terms of pro-poor growth policies. Nevertheless, the margin at which questions of school access are

increasingly important is for secondary schooling. Also, schooling policies should consider options that are not limited to certain classes of ownership such as public schools. Policies are likely to be much more effective in terms of pro-poor growth objectives if they are neutral with regard to ownership of school suppliers, thus encouraging a variety of new providers to increase competition.

7. **Consideration should be given to improving educational quality, not just to increasing the quantity of education.** School quality includes multiple dimensions—class size, teacher-to-student ratios, teacher education, curriculum development, supplies of textbooks and other materials, and decentralization so the provision of education is sensitive to local conditions. In many developing country contexts, the returns to improving some dimensions of school quality appear to considerable. But there are not magic formulas that fit everywhere. Consideration of policies that might improve school quality need to be evaluated with careful attention to local conditions, with monitoring and updating of the evaluations of those policies that are implemented, and policies directed toward all potential providers of educational services (not just a subset such as public schools), if resources are to be used best for pro-poor growth.

8. **Before using mandates to attempt to increase education, obtain more information about their effects.** Policy makers, in education as in most other areas, often think that mandates, perhaps in some legal form. are relatively effective ways of inducing desirable changes. If more schooling is desired, for example, why not mandate a higher level of compulsory schooling? But the associations between such mandates and the level of schooling over time or across societies for the most part do not indicate that the mandates caused more schooling but that, apparently, the mandates reflected market and cultural pressures that increased schooling. Moreover, such mandates often impinge particularly on the welfare of poorer members of society. The message here is not that such mandates never should be used but that their effectiveness should be considered carefully in comparison with alternatives, such an increasing incentives to attain the same objectives.

9. **Consider using incentives in the form of scholarships for students from poor families to increase their education.** A particular form of incentives that seems to have been effective in increasing schooling in several cases recently is to provide scholarships for students from poor families. Such programs might be emulated more broadly. But, as with other policies, they need to be evaluated and monitored carefully over time and not just blindly transplanted. In some contexts, for example, they may have significant negative congestion effects through inducing increased enrollments in schools that are already overcrowded. And that poor households would increase schooling of their children much less if the same transfers were to be provided without being conditional on school attendance raises the question of whether such resources are increasing the welfare of the poor as much as they might were they unconstrained. From the point of view of decisions makers in poor households, the answer seems clearly that schooling children more is not as high priority as are other uses of such resources. Possibly, such constraints are justified on distributional grounds because household decision makers do not weigh enough (from a social point of view) the interest of their children. But redistribution from poor parents to their children is not obviously a pro-poor policy (although it may be pro-growth) because most (not all) children in the developing world can expect to grow up in higher per capita income economies than did their parents.

10. **Improve information about what educational providers are providing.** Imperfect information about what educational providers are doing is the basis for some central tendencies in the educational sector, such as favoring public over other providers and mandating changes that are thought to be in the interests of the poor, although they may not understand this. However, in such situations there are likely to be alternatives that are higher in the efficiency and pro-poor policy hierarchies. Examples include the alternatives of improving the information on which parents and students make their educational decisions and developing mechanisms so they can use such information effectively (for example, by making choices among educational providers).

11. **Improve information and evaluation of the rates of return to alternative strategies for increasing education.** Good systematic evaluations of educational policies are rare and probably are biased toward more successful programs. These evaluations, moreover, do not necessarily provide sufficient information for simply transplanting apparently successful programs in one context to other contexts. The resource costs of good evaluations, moreover, are small compared with the resource costs of the policies being evaluated. Therefore, there are likely to be high returns to adopting the policy that the systematic evaluation of educational policies is the norm, rather than the exception.

Economic Collapse, Poverty, and Inequality During Ukraine's Difficult Transition

by Albert Berry and Karin Schelzig

EXECUTIVE SUMMARY

The transition process in Ukraine has been very painful, involving a sharp economic collapse, a significant increase in inequality, and hence a major rise in poverty. After a full decade of stagnation, growth returned from 2000 to 2002 and hopes have risen that the country has turned the corner.

On the eve of the country's independence, prospects for successful transition to a market economy seemed bright because of Ukraine's strong industrial and agricultural resource base combined with a highly educated population. Despite these outwardly favorable conditions, however, Ukraine has been one of the poorest performers among the countries in the process of transition away from the former central planning system. This result is blamed on a combination of a sluggish reform process, negative exogenous shocks, and a high level of corruption. An intractable political setting in which there has been strong opposition to the transition from powerful groups has contributed directly and indirectly to the slowness, the lack of coherence, and the corruption associated with the process.

The depth of the post-reform economic decline remains a matter of debate because official figures on the performance of the economy are misleading and much depends on the inevitably imprecise estimates of the changing size of the unofficial (that is, underground or unregistered) economy. Any discussion of what has gone wrong and what has gone right must begin with an attempt to sort out the question of what has happened to the economy, to income levels, to inequality, and to poverty.

In the initial period of independence, massive shortages appeared when the state regulated prices at artificially low levels; when prices were liberalized in 1992, prices took off into hyperinflation. It took some time to bring inflation under control, and the economy shrank sharply during this process. The unofficial sector expanded rapidly, as far as can be judged, so true gross domestic product fell less (probably 35-45 percent) than the official figures indicate (60 percent). Since 2000, the economy has rebounded, with growth of about 20 percent through 2002, according to official figures.

There was a large net increase in inequality over the 1990s. This contributed, along with the considerable fall in average income, to a dramatic increase in poverty. The precise record on the evolution of poverty during the 1990s remains ambiguous, pending further in-depth analysis and attempts to reconcile the various sources of information. Over the recent growth period, the data point to nearly constant consumption distribution and hence falling poverty incidence, suggesting that growth has been at least modestly pro-poor.

A lack of governance spawned a slow and in many ways ineffective reform process in Ukraine. An underlying cause has been the division of political power among reformers, anti-reform Communists, and rent-seeking opportunists. This division has contributed to an erratic reform process and to weak implementation.. It is unclear whether a sequencing of reforms could have been designed in such a way as to prevent the extreme levels of corruption that have emerged. Another deterrent to rapid progress toward reform is the institutional inertia of the former command economy, which leads to the maintenance of many policies that are counterproductive

in the context of a market economy, including a dense network of regulations and an oversized group of bureaucrats in charge of them.

The Ukrainian system of social safety nets has been modestly successful in alleviating poverty but at the same time seriously inefficient, in terms of the degree of leakage to the non-poor through lack or poor targeting and in terms of internal inefficiency in program delivery. An important pro-poor decision was the Soviet one to make sure that any family wishing to have a household plot for the production of food items would get it, and the subsequent expansion of the size of those plots in Ukraine over the 1990s. This helped keep rural incomes at or even above the level of urban incomes through the mid-1990s and undoubtedly prevented or ameliorated much poverty.

The objective of moving from a large-scale state and collective farm system (complemented by small household plots) to a system of individual family farms has made only modest progress, both because of strong opposition from some quarters (the Communist and opportunistic groups) and because, institutionally, the distance is long from the one system to the other. The process runs the risk of creating something closer to a Latin American style *latifundia-minifundia* system of land concentration than a more egalitarian family farm system. The closer it comes to the former, the more anti-poor will the agricultural evolution have been.

The non-agricultural SME sector is expected to play an important role in transition economies such as Ukraine. This role is similar to that sought in many other developing countries, but the benefits from a rapid growth of a healthy SME sector are likely to be greater in these transition economies than in most market-oriented developing countries. At the same time, the impediments to such healthy growth are more numerous and more severe. The challenge of SME development in Ukraine is parallel to that of small agriculture: moving away from a command economy built on large enterprises by encouraging new entrepreneurs and developing the markets and other elements of the support system that make the SME sector flourish. SMEs currently account for a majority of non-agricultural employment, and their share has been rising. The years since 2000 provide the first test of how enterprises will react to macroeconomic growth. In 2000, there was rapid growth of value added by firms of all sizes, but whether this growth will be sustained after the Ukrainian economy moves beyond the recovery phase remains to be seen. SMEs, like other firms, complain vigorously about the high rates and complicated and unstable structure of taxes and the excessive regulation intertwined with serious levels of corruption and bureaucratic inertia.

There is an important debate about the source of the recovery since 1999. Some observers credit the last set of reforms (in 1999-2000); others, the good crops; and others, the return of some positive inertia after the economy finally hit bottom. The most persuasive view, we believe, is that the accidental devaluation of the hryvnia relative to other currencies than the Russian ruble (accidental in that it was the result of Russia's financial crisis in 1998) provided a major and general stimulus to the production of tradeables (both exports and import competing goods). This stimulus was complemented by a substantial underutilization of capacity. Further analysis is required to identify the relative importance of this factor and of each of the others. Which of them have in fact played the key roles in the turnaround has important implications for the appropriate course of economic policy in the future, both in Ukraine and in other reforming countries.

While the dearth of relatively accurate data has not prevented our concluding that Ukraine suffered a traumatic economic collapse during the 1990s and that poverty rose sharply, failure to quickly rectify the remaining data problems will have more serious costs in future as it becomes important to know exactly how well given policy choices are working. The national accounts figures remain weak, partly as a result of the need to shift from central-planning concepts to market concepts, partly because of the continuing importance of the hard-to-measure informal sector, and partly because of the need to build up the relevant human capital to maintain the information system. Figures relating to income and consumption inequality and to poverty also remain problematic, though the institution in 1999 of systematic household surveys means that the key step has been taken. Now it is a matter of gradually improving the quality of the data collected and the feed-back between analysts and data collectors. Much progress has been made but a considerable distance has yet to be covered.

Underestimation of the complexity involved in a reform process/transition like that of the Ukraine is damaging because it leads both to some bad policies being adopted and to delays in the implementation of needed ones. The most striking example of oversimplification was that of the Western economists who confused lack of restraints on markets with well-functioning markets. Put another way, they failed to recognize that many markets, if they are to work well, do require the constraints of an adequate legal system, of transparency, of minimum levels of competition, and so on. Failure to recognize these needs contributed to the delay in embarking on the institution-building that must accompany such a major transition.

An Examination Of Poverty Reduction In Egypt: Contributing Factors, Sustainability, And Lessons

by Samira Salem

EXECUTIVE SUMMARY

Over the last decade, Egypt has been transitioning from a state-led, inward-oriented economic system to an outward-oriented market system in which the private sector plays a dominant role. The first years of economic reform (1991-1993) were characterized by economic stagnation. Afterward, a relatively healthy growth rate resumed. Critics of the economic reform process argued that such reforms would have a negative impact on the poor. Available evidence suggests the contrary: the incidence of poverty between 1990-1991 and 1999-2000 actually decreased from 19 percent to 17 percent.

Reductions in poverty in the 1990s resulted largely from employment creation in the non-tradable service sector. Revenues from oil, which represented well over 40 percent of merchandise exports, stimulated employment creation in this sector and also resulted in employment opportunities in the Persian Gulf states for unskilled Egyptian labor. Labor migration, in turn, generated remittances that financed increased demand in the economy. Indeed, remittances averaged more than $3 billion in the 1990s, representing more than one quarter of Egypt's total exports of goods and services. In addition to these foreign sources of income, aid (which averaged nearly 20 percent of central government expenditures in the 1990s) helped finance Egypt's deficit on current account. Finally, receipts from tourism, another sector linked to volatile global forces, represented more than 20 percent of total exports in the 1990s.The rapid growth of the Egyptian economy, at least in the 1990s, largely stems from these four sources of income.

Egypt's dependence on these sources of income leaves the country vulnerable to unpredictable and volatile global forces. In addition, the proceeds from these sources of income have been used to finance consumption rather than investments in productive assets. Remittances have demonstrated substantial volatility over the last three decades and since 1989 there is evidence of a secular decline. To compound the issue there is a correlation between oil revenue and remittances: a booming oil market creates employment opportunities for Egyptian labor in the region and vice versa. While a country such as Egypt cannot afford to turn away from these potentially more volatile sources of income and employment, its domestic policy should aim at: 1) channeling whatever income the country derives from these sources toward investments in productive assets so even short- or medium-term income produces long-term benefits for the country; and 2) diversifying its economy so that it develops other substantial sources of income and foreign exchange that are not as potentially volatile.

Cross-country evidence suggests that an important way to achieve sustainable growth and poverty reduction in labor-abundant countries such as Egypt is by promoting a pattern of growth that emphasizes labor-intensive production for export and import substitution. This study shows that exchange rate management is key to export promotion; job creation; and, ultimately, poverty reduction. This is because "Dutch Disease" in Egypt has resulted in weakened competitiveness of these sectors in export markets and in competing with imports. This is problematic because the non-oil tradable sectors are more labor intensive than the oil sector. The upshot is that the

overvalued exchange rate has dramatically limited the growth of labor-intensive sectors. Although Egypt achieved poverty reduction despite flat merchandise exports, achieving sustainable poverty reduction despite flat or declining remittances will require that the country significantly expand its exports of labor-intensive goods. Sound exchange rate management is an important tool that can aid in achieving expanded exports.

In addition to shedding light on the relationship among growth, poverty, exports, and exchange rate management, the case of Egypt demonstrates the importance of recognizing and dealing with issues of political economy that inevitably emerge in the process of reform. Because the Government of Egypt was highly cognizant of the potential political opposition to both privatization and tenancy law reform, it appeased potential opponents. In the case of privatization, it provided financial incentives for workers to retire or resign, provided a three-year guarantee against dismissal, and controlled the speed of privatization. The government's actions in this regard were largely responsible for jumpstarting the previously stalled process. In the case of tenancy reform, the government provided reclaimed land to farmers who were negatively affected.Thus, the government contributed greatly to the acceptance of the reform.

Although international financial institutions have pressured Egypt to increase the flexibility of its notoriously rigid labor market, labor market reform has not occurred. This is in part because this is not a high priority for most domestic businesses. Although de jure labor legislation in Egypt is rigid, in reality domestic firms have developed mechanisms by which to largely avoid compliance. Labor legislation is more of a problem for international firms because they have a higher profile and thus are an easy target for inspectors. Also, these firms have not developed mechanisms that allow them to effectively avoid compliance. With more flexible labor legislation, Egypt would be a more attractive destination for badly needed foreign direct investment. Inadequate investment, both domestic and foreign, is a major obstacle to increased employment for unskilled workers. Every reform that contributes to increasing investment is therefore desirable, but labor market reform may not be as central in Egypt as is often assumed.

Reform in the agriculture sector has had a positive impact on the poor because it has generated a significant number of jobs in rural areas, where poverty is highest. The case of liberalization of rice, which positively affected nearly half of all rural households, illustrates the poverty-reducing potential of such reforms. Prior to economic reform, all stages of rice production and processing, from farmers to consumers, were controlled by the government. By 1991, the government eliminated most restrictions. The response to the liberalization of the rice sector was immediate and huge: the area planted to rice expanded by about 45 percent between 1990 and 1997 (most of the increase came from an expansion in total cultivated area and more intensive use of existing land); there was a 30 percent increase in the number of jobs created, resulting from more intensive agricultural production and private investments in milling and trading; and private sector, small-scale, low-technology mills began successfully competing against the remaining public sector mills. Private trading of rice also appreciably increased employment in the rice sector, including domestic trading and exports. Indeed, nearly 4,000 annual job (s of the approximately 57,000 jobs created annually in the rice sector) were generated in milling and trading because of economic reforms in the sector. Other positive effects of liberalization of rice are as follows: farmers received 20 percent more for their rice, increasing their total revenue by approximately 80 percent; and the price of rice to consumers declined and exports of rice increased. Ultimately, rice liberalization resulted in substantial employment generation, but it also raised farmers' incomes and increased the welfare of rural and urban consumers.

In terms of the economy as a whole, the absolute employment and production effects of reform in rice were not large. But reforms had similar, although less dramatic, effects on other agricultural crops. Reforms in the agricultural sector during the 1990s generally improved the environment for private sector investment and agricultural production. This has been the basis for the employment growth that has occurred in the sector and has contributed to a reduction in poverty in Egypt since the mid-1990s. Evidence from the agricultural sector confirms that getting the prices right and letting private incentives work led to increased economic activity at all steps in the production-processing-consumption chain. The liberalization permitted private sector investors to invest in new equipment and new mills and to hire new employees.

The Egyptian government has not developed a national strategy to reduce poverty. As a result of the legacy of earlier populist policies, the government does possess a sophisticated social protection system that is highly inefficient and transfers most benefits to the better-off rather than to the poor. Some programs, notably bread subsidies, have had a positive impact on the poor through the introduction of self-targeting to reduce leakage.

Egypt's experience with asset transfer in the Mubarak Project has been disappointing. Poor program design, implementation, and supporting services make it difficult, if not impossible, for the targeted beneficiaries to earn a living. This project has demonstrated that transfers must be de jure and de facto if the beneficiaries are to have a chance of success. Without a title, it is impossible for the beneficiaries to obtain credit for inputs and ultimately to make needed investments. Finally, human capital development, whether in the form of education or training, is key to ensuring that Egypt is successful in its pursuit of a labor-intensive growth strategy and, ultimately, that poverty reduction in Egypt is sustainable.

Health Issues Paper
by James C. Knowles

RECOMMENDATIONS

Recommendation #1: Adjust health sector priorities in individual countries (if necessary) so they better reflect the contribution that improved health can make to pro-poor economic growth.

The information presented in this paper suggests that health sector priorities that contribute most to pro-poor economic growth (1) increase the supply and productivity of labor and land, (2) complement human capital investments, and (3) reduce the dependency burden. In some cases, the health disorders that limit progress in these areas are already effectively targeted by interventions supported by public health systems (for example, HIV prevention and treatment; the prevention, detection, and treatment of sexually transmitted diseases; maternal health interventions; tuberculosis detection and treatment; malaria prevention and treatment; and micronutrient supplements). The main concern is that current public health systems place a very strong emphasis (at least in official policy statements) on programs targeted to children under age 5. Such an emphasis can be justified on many grounds, including targeting. However, when the emphasis shifts from relatively narrow public health objectives (that is, getting the largest health impact per dollar spent) to a broader objective, such as poverty reduction, focusing health resources on children under age 5 is less clearly a priority.

Adjusting health sector priorities to reflect the potential contributions of improved health to pro-poor growth may mean giving more attention to health disorders that cause disabilities and less attention to health disorders that result in mortality. However, the appropriate balance needs to be carefully struck on an individual country basis because there can be important differences among countries in the social impact of adult mortality.

Some health disorders have probably received too little attention in the past. For example, mental health disorders (and particularly unipolar depression) are important causes of disability among both working-age adults and school-age children. Treating some mental disorders (such as, depression and schizophrenia) may be cost-effective from the standpoint of poverty reduction, even though it may not be cost-effective from a narrower public health perspective—that is, in terms of cost per disability-adjusted life year gained (Shah and Jenkins, 2000; Whiteford et al., 2001; Institute of Medicine, 2001; WHO, 2001).

The prevention of injuries, which are an important cause of death and disability among both working-age adults and school-age children, may also provide opportunities for cost effective poverty reduction investments. Unfortunately, there is little information on the cost effectiveness of injury prevention interventions in developing countries. However, in the case of road injuries (which are a rapidly increasing cause of injuries in most developing countries), many of the injuries involve public transportation. More effective regulation of public transportation (for example, stricter licensing requirements for drivers and safety checks of vehicles) is likely to be a cost-effective approach to reducing injuries. Other possibly cost-effective approaches to reducing road accidents include regulations requiring the use of helmets by motorcycle and bicycle riders and stricter measures designed to reduce the consumption of alcohol and drugs by persons operating motor vehicles.

Recommendation #2: Give higher priority to health investments that prevent poverty directly.

Investments that reduce the prevalence of long-term disabilities among working-age adults—that is, investments that reduce a household's effective dependency burden—can directly contribute to poverty reduction. In addition to cost-effective investments to improve mental health and reduce injuries, such investments might include those designed to prevent and/or treat blindness and other visual impairments (such as cataracts), adult hearing loss, and osteoarthritis. The knowledge base in this area is currently weak, and its expansion should be another research priority.

Investments that reduce a poor or near-poor household's vulnerability to the risk of catastrophic health care costs can also reduce poverty. The easiest way to do this in the short run may be by increasing the share of public funding allocated to public hospitals. This recommendation contrasts with the conventional public health prescription that the hospital sector should be starved while the bulk of public funding is allocated to primary (and particularly preventive) health care. Another practical way to reduce vulnerability to the risk of catastrophic health care costs (and to improve access to needed care) is to expand opportunities for rural saving and access to affordable rural credit (such as through rural microcredit and savings schemes). Another approach that has been successfully piloted in Cambodia is the use of publicly financed equity funds to pay for the hospital costs of the poor (van Damme and Meesen, 2001; De Loof and Bonnet, 2001; Knowles, 2001). Community health insurance (as well as other community health financing schemes) is another approach that has been used in many countries (with varying success) to reduce vulnerability to the risk of catastrophic health care costs (Preker et al., 2001).

Recommendation #3: Make efficient investments that are complementary to health investments made by poor and near poor households.

Complementary investments include investments in education, food security, rural infrastructure (particularly roads and water and sanitation), access to improved housing, and improved environmental conditions. Absence of these complementary investments increases the cost of health investments to the poor. Economic evaluation of the benefits and costs of these investments should include health benefits, although in most cases the health benefits alone will be insufficient to justify the investment. Many of these complementary investments already figure prominently in developing country poverty reduction strategies (for example, formal education, rural roads, and water and sanitation). However, in education, more attention should probably be given to adult basic education and literacy training because (1) their effects are immediate, and (2) they are self-targeted to the poor. In the environmental area, more attention ought to be given to policies that promote efficient alternatives to the indoor use of biomass- and coal-burning stoves (von Schirnding et al., 2001).

Recommendation #4: Make efficient investments that remove or reduce barriers to health investments made by poor and near poor households.

Investments that are likely to help in removing or reducing barriers to effective health investments by the poor and near poor include:

- Better health education for the poor and near poor (such as through adult basic education and literacy programs);
- More effective regulation of private health care (for example, control of unlicensed drug vendors, regulation of the sale of potentially harmful prescription drugs without a prescription, and reducing the prescription and/or direct sale of unnecessary and/or excessively expensive drugs by private providers);
- Adoption of transparent fee and exemption policies in public health facilities (for example, use of a simple fee schedule that is prominently displayed in a hospital, adequate funding of exemptions, and use of formal targeting mechanisms for exemptions);
- Targeted demand-side subsidies (such as vouchers and subsidized health insurance) to improve access by the poor to key health services (see Recommendation #1);
- Targeted subsidies for health care-related transportation costs, including reimbursement of costs from home village to primary care facilities and subsidized ambulance (or public transportation) costs from primary care facilities to referral providers;
- Use of pro-poor formulas for the geographic allocation of public health resources; and
- Contracting out the operation (or the management) of public health facilities to NGOs or commercial providers.

Unfortunately, there is relatively little evidence (or the evidence is limited to one or only a few countries) establishing the effectiveness of policies, such as those listed above, that are designed to improve access and utilization of health services by the poor and near poor (Wagstaff, 2001). This suggests that initiatives such as those listed above should be implemented on a national level only after careful evaluation has established their effectiveness.

Privatization and the Poor: Issues and Evidence

By Leroy P. Jones

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Table of Contents

Issues 1

Consumer Impact 1

Labor 2

Indirect Effects 3

Relative Impact 4

Implications 5

Bibliography 6

Issues

Does privatization harm the poor? More specifically, what is the distributional impact of privatization? The efficiency effects of privatization are well-known, substantial, and overwhelmingly positive, as shown by a survey in the *Journal of Economic Literature* (Megginson and Netter, 2001). The equity effects, however, are less well-understood and far less uniform. This is obviously unsatisfactory for those who care about equity, but it also matters to those concerned with generating further efficiency gains. The momentum of privatization, which accelerated through the 1990s, has recently slowed considerably in most, if not all, countries. In part, this is because the "easier" countries and companies have been "done." It is also because widespread public perception persists that privatization's benefits have not been shared equitably, with the rich gaining at the expense of the poor. The poor are said to suffer absolutely as consumers faced with increased prices and as workers who are laid off. In addition, they are said to be made relatively worse off as the benefits of efficiency gains go to corrupt officials, rich domestic businessmen, and foreigners.

To what extent are these charges substantiated by empirical findings? The impact on consumers, workers, and overall distribution are addressed below. Indirect effects (fiscal and macroeconomic activation) are then considered, followed by a section on the special problems of transition economies and consideration of the implications for future research and policy.

Consumer Impact

This discussion focuses on the utility sectors, because these sectors probably account for more than half the value of privatizations, and because privatizing tradable/competitive goods cannot harm consumers. Furthermore, the poor consume little of other privatized goods and services, such as air travel, banking, and steel. Most important, we focus on the utility sectors because they involve price increases, a popular concern. This is only natural, because fear that private monopolists would exploit consumers is a major reason these sectors were made public in the first place.

Post-privatization price regulation is not always done well (witness electricity in California and electricity and rail service in the United Kingdom). Even if regulators succeed in preventing exploitive pricing, consumers could still lose if a subsidized price changes to an efficient price that covers all costs. This could result, however, in a trade-off between a higher price and wider access, as higher revenues permit capacity expansion once constrained by a lack of funds under government operation. In this scenario, existing consumers lose but new consumers gain, as they are given, for the first time, access to water, electricity, or phone service.

Which effect dominates? Intuitively, one would expect that the gains to a household that obtains access would be much larger than the losses to a household that pays a little more. Yet how many households are there of each type? A balanced evaluation of the impact on consumers must ask questions such as this, but few do.

A notable exception is a set of recent studies done for Argentina (Ennis and Pinto, 2002), Bolivia (Barja, McKenzie, and Urquiola, 2002), Mexico (Lopez-Calva and Rosellon, 2002), and Nicaragua (Freije and Rivas, 2002) and summarized in McKenzie and Mookherjee (2003).[1] Using household-expenditure survey data and Engel curve theory, the authors econometrically estimate the welfare effects of changes in price and access for 10 expenditure deciles. Results vary widely by country, region, sector, and assumption, but some of the more interesting results follow:[2]

Did prices rise? Only in half the cases. The biggest rise was 48 percent; the biggest fall, 33 percent. No prices were unchanged.

Where prices rose, did the price or access effect dominate? In Bolivia, there were net gains for 9 of the 10 deciles in both electricity and telephone service; all deciles gained from water in La Paz and El Alto, but all lost in Cochabamba, where privatization failed after one year and there were zero access effects. In Nicaragua, half the deciles had a net gain in electricity.

Where results varied by decile, who won and who lost? It depends on who already had access and where the expansion margin falls in income distribution. In Nicaraguan electricity, the four richest deciles lost because they already had access, and the poorest decile lost because either its take-up rate was low or service was not extended to where residents live. The winners were the poor, but not the poorest of the poor. In both Bolivian telephone service and electricity, the single losing decile was the richest, because it already had access and had nothing to gain.

While these results are preliminary, they at minimum call into question the validity of popular wisdom once access effects are taken into account. This is reinforced by the fact that similar conclusions were reached in the one other set of studies that have looked at both price and access effects (Galal et al., 1994, which is discussed later). Given the small country samples involved, what might similar studies reveal elsewhere? An important factor to consider is that many of the world's poor, in Sub-Saharan Africa or South Asia, currently have no electricity, telephone service, or clean water service, so access effects could be even more important there.

LABOR

State-owned enterprises (SOEs) are typically overstaffed. The best available survey of the impact of privatization on labor (Kikeri, 1998) cites worldwide redundancy rates of 20 to 50 percent and corresponding layoffs of up to 50 percent of the preprivatization labor force (in Argentina). There is high variance, however. In Malaysia, for example, in an effort to disarm labor opposition, the government forced bidders to agree to keep the entire work force for three years, and there were few, if any, firings. How much of the world is like Argentina and

[1] For more information on this subject, one may download this paper from www.bu.edu/econ/ied/dp/papers/dp128.pdf.

[2] Mexican results are not included in their current, interim draft.

how much like Malaysia? We do not know. Studies for individual companies and countries abound, but no one seems to have assembled statistics for more than a handful.

For someone who is laid off, the impact depends on the magnitude of severance payments and the length of time the individual remains unemployed. Here again, experience is all over the map, but no broad survey exists. What is the poverty impact of someone losing his or her job and not finding another? This seems like a silly question, but in Zambia, a study found that despite losses in income, laid-off workers were less likely to be poor than the average for the country (London Economics, 1996). The explanation is that poverty is a function of household income, and SOE workers often come from politically well-connected households that can absorb the loss of one wage without falling into poverty. Finally, one needs to assess the impact not just on the individual, but on the labor market as a whole. Such an assessment reveals good news and bad news. The bad news is that whether or not a particular individual finds a new job, the person who would have otherwise gotten the job is worse off; what matters for distribution purposes is the loss of the job. The good news is that privatized enterprises often grow and create jobs, with a lag. Some workers lose now, others gain later, and the net present value of the latter can outweigh that of the former.

INDIRECT EFFECTS

Indirect effects are difficult to measure, and only one study has seriously attempted to do so in this area; therefore, this section is brief. The first indirect effect is fiscal. Data on government sale revenue are widely available, but one must also take into account the decrease in subsidies and increase in taxes. Sheshinski and Lopez-Calva provide considerable data on the magnitude of this effect. One of their studies (1999) that combines all effects finds that the subsidy/tax effects usually exceed the sale effect. Even if these data were available, however, it would be difficult to estimate the distributional impact, which depends on the use to which the fiscal gains are put. If they are used for rural roads, schools, or health-care services, the poor benefit. If they are used to reduce taxes, the poor do not benefit. Some suggest that when sale proceeds are earmarked appropriately (such as Bolivia's contributing 45 percent to a pension plan), the poor can benefit. If, however, funds are fungible and the pension plan might have been done anyway, then while this might be an excellent public relations ploy, it does not necessarily measure the true economic impact of privatization.

A second indirect effect of privatization is the macroeconomic activation effect. How many jobs for the poor are created elsewhere in the economy because electricity is now reliably available without brownouts and blackouts or because some of the gains to government and domestic buyers result in greater investment? A third set of indirect effects involves externalities. Of these, probably the most significant is the health impact of improved access to water. A study in Argentina estimates that privatization of water caused a 5- to 7-percent fall in child mortality rates (Galiani et al., 2002).

The one notable attempt to incorporate indirect effects is a computable general equilibrium model for Argentina (Chisary et al., 1997). Of primary interest here is that the model showed that all elements of the income distribution gained.

Relative Impact

Thus far, we have focused on absolute gains and losses by particular groups. Here, we look at the relative impact across groups as revealed in two sets of studies. First, the studies summarized in McKenzie and Mookherjee (2003) calculated the impact of price and access on the Gini coefficient and several other measures of inequality and poverty. Their first conclusion was that with the single exception of Cochabamba, privatization either improved income distribution and reduced poverty or had no significant effect. Their second conclusion was that because of the small budget shares of the goods and services, and because price and access worked in opposite directions, the net effect was quite small. For example, improvements in the Gini were all less than .02.

The other set of studies looked at privatization of a sample of 17 firms in Chile, Malaysia, Mexico, and the United Kingdom (Galal et al., 1994) and Côte d'Ivoire (Jones et al., 1999). It first used traditional Harbergarian benefit–cost analysis to estimate the net gains of the difference between a constructed counterfactual (what would have happened without privatization) and what actually happened. An extension of the methodology then permitted decomposition of the total into net benefits accruing to consumers, workers, competitors, the government, and the new domestic owners and foreign owners. Key results were as follows:

- Consumers were made worse off in 5 cases and better off or neutral in 12 cases. Three of the negative cases were in Mexico and resulted from moving to something like international efficiency pricing from highly subsidized prices.

- Labor in no case lost as a class: workers who lost their jobs were worse off, but this was more than compensated for by the gains to the remainder through some combination of higher wages, eventually increased employment, and appreciating share values.

- The government gained in 14 cases, with the 3 cases of losses being small. In general, the biggest source of such gains was not from the initial sale price itself, but from increased tax revenues from (and reduced subsidies to) the newly profitable firms. In several cases, revenue from deferred tranches also exceeded that from the initial sale.

- Domestic buyers did well, suffering net losses in only a single case.

- Foreign buyers also did well, gaining in all cases where they existed.

- How big were the gains and losses of each group? There is high variance, but as measured (badly) by a simple average of the percentage gains, the biggest winners were the government and domestic buyers (about 20 percent lower than the government).[3] Worker and consumer gains were much smaller (at 20 or 30 percent of the government's). Finally, 80 percent of the benefits went to domestic groups and 20 percent to foreigners.

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[3] Some unknown share of the new owners' gains often goes to corrupt officials, but both businessmen and bureaucrats are at the top of the income distribution, so this makes no difference for our present purposes.

If these results are seen as broadly positive, what explains them? There is a clear sample bias. The authors' methodology required access to detailed financial accounts of the firms involved for at least three years before and after privatization, plus extensive and intrusive interviewing to develop a believable counterfactual. Governments and companies cooperated only when they thought they had a very good tale to tell. So, the results can by no means be generalized to other cases. The results only say that, done well, privatization need not have a significantly deleterious distributional impact. A contrary example is electricity in Britain, where Newbery and Pollitt (1997) found small gains for consumers and government and large gains for owners.

IMPLICATIONS

This review suggests that popular opinions on the negative distributional impact of privatization are not broadly supported by the available empirical literature. However, the literature is sparse and spotty enough that very–well-informed observers can take the opposite view. Birdsall and Nellis (2002) know as much about privatization as anyone and "conclude that most privatization programs appear to have worsened the distribution of assets and income, at least in the short run."[4]

This review, then, has three implications. First, we need to know considerably more. Second, we might need to do a better job of informing the public of what actually happened. Third, we need to help future privatizations apply best-practice techniques to enhance equity without sacrificing efficiency. A good deal is already known in this area, as illustrated by the following. To benefit poor consumers, one must focus on access effects by requiring bidders to commit to extending service at some specified rate. Also, carefully targeted lifeline pricing schemes are needed to subsidize poor consumers. Both cases will yield a price in terms of government gains, but that will be a transfer and may often be worthwhile. To benefit poor workers, privatizers should consider banning layoffs of at least unskilled workers for three years, but with a clear provision that work rules can be reformed so efficiency gains will not be imperiled. Again, there will be a price in terms of government sale revenue, but where labor redundancy is not egregious (say, less than 20 percent), the price will often be small, because redundancies will be eliminated through natural attrition and the labor demands of an expanding enterprise. Finally, privatizers should enhance government returns by retaining some shares (in nonvoting shares, so as not to reduce efficiency gains) and earmark the proceeds for projects to help the poor.

[4] The difference is in part due to the authors' inclusion of the transition economies. To assess their evidence, go to www.cgdev.org/wp/cgd_wp006.pdf.

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Reconstruction and Poverty Alleviation in Uganda, 1987-2001

by John R. Harris

EXECUTIVE SUMMARY

Uganda was a "basket case" in 1986, when the National Resistance Movement under Yoweri Museveni came to power through a successful guerrilla war. The country had suffered from more than 15 years of misrule, violence, and pillaging of economic resources by Idi Amin, Milton Obote, and short-lived military regimes. Real GDP had declined by more than 40 percent, and the response of the populace was to retreat from formal-sector economic activity into primarily subsistence production. The government lost the ability to mobilize resources through an orderly fiscal system, foreign exchange was unavailable, and high levels of inflation were the result of uncontrolled expansion of the money supply through financing deficits. The influential Asian commercial group had been expelled by Amin in 1972, resulting in capital flight and a collapse of the country's established trading systems.

The Museveni government, which has been in power for the past 16 years, has made remarkable progress. First, order was restored in most of the country and a relatively disciplined army was created. Then, early reconstruction, particularly of devastated coffee-producing areas, was undertaken. Gradually, economic growth became positive, inflation rates declined to moderate levels, private investment expanded, and coffee exports recovered.

A critical step was taken in 1992, when a strategy for macroeconomic policy was adopted and implemented by an extraordinarily capable group of "technocrats" within the Ministry of Finance, Planning, and Economic Development. The key policies were adopting a floating exchange rate, which eliminated the parallel-market premium; instituting a strict program of budget control, which also limited the expansion of the money supply; and dismantling the previous system of official controls on marketing coffee and cotton through monopsonistic cooperatives and marketing boards to allow free, private trade in purchasing and exporting crops. These, of course, are the standard policies that have been advocated in many structural adjustment programs in Africa and elsewhere, many of which have been unsuccessful.

From 1992 to 2000, per-capita real GDP in Uganda grew at almost 8 percent per annum. There was a bit of "good luck" with a temporary surge in world coffee prices as a result of frost in Brazil. It is clear, however, that the increase in world prices was transmitted to peasants through the newly competitive marketing system, and that there was a rise in marketed output. Private investment increased, as did government investment, particularly in infrastructure rehabilitation, with the help of international-donor assistance. The proof that this has been more than mere good luck is that even since coffee prices fell drastically, Uganda's growth has been sustained.

We have excellent data on household consumption from a series of national surveys that allow us to assess the degree to which poverty has been alleviated as a result of this growth. Using household measured consumption, a poverty line was constructed consistent with consumption of 3,000 calories daily per adult male equivalent. The proportion of Ugandans having consumption below this poverty line declined sharply, from 56 percent in 1992 to 35 percent in 2000. For rural areas, the decline was from 60 percent to 39 percent, and in urban areas, 28 percent to 10 percent. This remarkable achievement is not sensitive to the arbitrary choice of the poverty line because real per-capita consumption increased in every decile of income

distribution. Inequality, measured by Gini coefficients, remained stable within both rural and urban areas, although the overall measure of inequality increased slightly as a result of net transfer of population from lower-income rural areas to higher-income urban areas. Poverty reduction arose from growth rather than from redistribution, and the benefits of growth were widely distributed.

Poverty rates declined in all sectors, but agricultural progress was the dominant factor. Between 1992 and 1996, 48 percent of the overall decline in poverty was experienced in the cash-crop sector, which accounted for 19 percent of the total population. This is not surprising, given the coffee boom of 1994 and 1995. However, between 1996 and 2000, the poverty rate declined dramatically in the food-crop sector and fell further in the cash-crop sector. Other sectors, being significantly smaller, accounted for much smaller shares of overall poverty reduction (for example, manufacturing, 3.7 percent; construction, 1.0 percent; and government services, 7.6 percent).

The primary channels through which policies have affected poverty reduction are the exchange rate and increased competitiveness in the liberalized trading system. Together, these caused prices received by peasant producers to increase dramatically, which both increased their income from existing production levels and provided incentives for expanded production. These effects were quite evident for producers of export crops. However, the even more important poverty reduction for food-crop producers is a bit surprising. It appears that the general improvement in transport and competitiveness of traders provided opportunities for peasant farmers to increase their production and marketing surpluses. In addition to increasing income from agricultural production, they also diversified their production and increased their participation in rural nonfarm activities (principally trading and services).

Why has Uganda succeeded in reducing absolute poverty as a result of adopting "Washington consensus" structural-adjustment policies, when so many other countries have failed? First is the Ugandan commitment to the program and the fact that it was actually implemented. The structure of the economy also proved favorable. Uganda is overwhelmingly agricultural: Some 84 percent of the population is still classified as rural, and within the rural sectors, production is almost exclusively undertaken with family labor by smallholders. Land is relatively available, and the response to the crises of the 1970s and 1980s was the retreat into subsistence production. Even today, more than 80 percent of food grown by peasant families is for their own household consumption. The typical unit grows food for its own consumption and markets surpluses when market opportunities arise. Many also grow some cash crops. When inputs are available in markets, smallholders purchase implements, fertilizer, pesticides, and improved seeds and livestock. In addition to agriculture, the families engage in other small-scale trading and fabricating activities. Wage labor in rural areas is not widespread, and many agricultural families have members working elsewhere (principally in towns) and receive remittances from them.

In a crude sense, Uganda is highly rural and relatively egalitarian in terms of access to land. Therefore, increasing opportunities to produce surpluses for the market at prices that provide incentives have resulted in higher real income and consumption for peasants who have been able to respond. However, it is likely that the "easy" gains have been realized. Those remaining in poverty probably have specific characteristics that make them less able to respond.[1] There is also

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1 See Bevan and Ssewaya (1995), for an interesting analysis of the social dimensions of poverty, and Republic of Uganda (2000a), for contemporary reports on which people are most disadvantaged.

evidence that those who have increased their incomes the most in rural areas have had more education, better health care, and more assets such as livestock and land (Larson and Deininger, 2001). This is consistent with evidence from other countries in that poverty reduction is more widespread in regions where education and health-care levels are high and landlessness relatively low.

Uganda has adopted a well–thought-out poverty reduction strategy that has four pillars: sustaining economic growth and structural transformation, ensuring good governance and security, increasing the ability of the poor to raise their incomes, and improving the quality of life among the poor. The first two pillars are responsible for most of the progress that has been made in Uganda's poverty reduction. The restoration of security has played an important role, and the persistence of insecurity in the North explains its higher levels of poverty and lower rates of progress in reducing poverty.

A set of programs is now in the early stages of implementation for increasing the ability of the poor to raise their incomes. The programs include transport improvements, increased access to markets, microfinance, agricultural research and extension, and education. These represent the beginning of special programs targeted to the poor. It is too early to say how effective they will be, but the low performance of public institutions and the prevalence of corruption will pose obstacles to success. The existence of many locally based voluntary organizations may play a role. These institutions have been significant in dealing with the HIV/AIDS pandemic and represent a largely unrecognized pool of social capital that can be harnessed to help the poor.

Major programs, many with considerable donor assistance, have been devised to provide primary education, health-care services, and clean water and sanitation for the poor. So far, expenditures have increased considerably, but concerns remain about the effectiveness of these programs to increase the level and quality of services reaching the poor.

Uganda stands out in terms of the remarkable achievement it has made in recovering from violence, civil war, and economic collapse. Its high rates of growth in the 1990s have resulted in significant reductions in the incidence of extreme poverty. The government has been forthright in making poverty elimination its principal goal and formulating a coherent strategy for achieving it. However, the remaining challenges are enormous, but there is reason to be optimistic and believe that progress can be maintained and even accelerated.

The goal of the USAID-funded Pro-Poor Economic Growth Research Studies and Guidance Manual Activity is to identify and disseminate policies, reforms, and activities that USAID decision makers can incorporate into their programs and that they can recommend to countries wishing to pursue strongly pro-poor, poverty-reducing, economic growth objectives.

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