

Poverty In Focus

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Jobs, Jobs, Jobs The Policy Challenge

FROM THE EDITOR

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Front page: Bicycle factory worker in Haryana, India, March 2002. Photo by Marcel Crozet ©International Labour Organization.

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IPC is a joint project between the United Nations Development Programme and Brazil to promote South-South Cooperation on applied poverty research. It specialises in analysing poverty and inequality and offering research-based policy recommendations on how to reduce them. IPC is directly linked to the Poverty Group of the Bureau for Development Policy, UNDP and the Brazilian Government's Institute for Applied Economic Research (IPEA).

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What is the role of employment in the nexus of economic growth, poverty reduction and progress towards achievement of the UN Millennium Development Goals? Although employment is not an explicit component of the MDGs, it has a key role in economic and social development.

As labour is the main resource that most poor people are endowed with, labour-intensive growth is the most effective way to reduce poverty. Employment is the key source of income, consumption and other material aspects of improved livelihoods. Moreover, it enhances also other dimensions of wellbeing including skills, physical abilities and self-respect.

Sustained poverty reduction requires growing labour productivity of poor women and men, whether as paid or self-employed workers. Economic growth does not ensure poverty reduction; it leads to poverty reduction only when accompanied by rapid growth of productive and remunerative employment. Most countries that have succeeded in reducing poverty have followed strong employment creation policies.

This issue of *Poverty in Focus* illuminates the mechanisms behind successes and failures in achieving pro-poor employment policies, including the basic elements of a high growth rate, high employment elasticity of growth, and increased ability of poor women and men to meet the growing labour demand. Not only labour market policies need to focus on employment creation, but also other relevant economic, institutional and social policies.

Eduardo Zepeda first summarises Mexico's recent experience, which includes periods of crisis, of rapid growth and of stagnation. These various episodes make for a good case study of employment with relevant policy lessons for all developing countries.

Marty Chen highlights the links between informality and poverty and presents a policy framework for addressing informality in ways that will help reduce poverty.

Denis Drechsler et al. find informality to be mainly due to insufficient job creation in the formal economy and to warped incentive structures, and discuss what policy makers should do about it.

Rafael Ribas and Ana Flavia Machado study employment and poverty dynamics in Brazil and find that the informal sector has helped people move out of poverty more than the formal sector.

Louise Fox and Melissa Sekkel examine the slow job creation in Africa and draw lessons for countries wanting to realise the aspirations of their growing, mostly urban, nonfarm labour forces.

Aziz Khan analyses the linkages between employment and the relevant MDGs and proposes policy interventions to promote job-intensive growth and public investment.

Terry McKinley advocates structural policies for poverty-reducing employment, as illustrated by an IPC Country Study of South Africa.

James Heintz considers an alternative approach to macroeconomic stability that is more cognizant of the performance of the real economy and includes a coherent employment policy.

Janine Berg and David Kucera revisit the issue of labour market institutions and employment, arguing that policy makers need to take on re-regulation as opposed to de-regulation.

Per Ronnås looks at labour migration and the case of Moldova, where poverty fell rapidly thanks to the dual impact of remittances and improved domestic job and income opportunities.

Erik Jonasson considers the role of rural non-farm jobs as a pathway out of poverty; investment in infrastructure and education stand out as the foremost policy measures.

Christoph Ernst highlights the importance of youth employment as developing countries struggle with the challenge of offering decent jobs for the large number of young men and women entering the labour market every year.

May these articles contribute to the analysis and policy debate on productive job creation and thus, indirectly, to the advancement towards the MDGs.

Dag Ehrenpreis

Learning from the Past: Mexico's Failed Pro-Market Policy Experience

by Eduardo Zepeda,
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The elusive task of employment creation has been addressed from two different and polarised perspectives. The dominant advice, well summarised by the Washington Consensus (WC), advocates the greatest possible reliance on market forces and macro-economic discipline. Concerning labour markets this means that the core task is making them more flexible, while resorting to complementary programmes if necessary to improve their efficiency.

Proponents of the alternative view argue for treating employment as a key consideration in overall economic policy design. Based on recent successful experiences, they highlight the need for pro-poor growth and pro-employment macro-policies, and emphasise the key role that public investment has to play in growth and development as well as the necessity of industrial policies and massive programmes to strengthen education and training.

Passing judgment on the virtues and limitations of these policies is never an easy or uncontested task. These notes aim to shed light on the employment policy debate by reviewing the performance and policy journey of a single country over a decade and a half.

Mexico presents features that make it a good case study of employment in order to draw policy lessons for developing countries. Despite being a high middle-income country, its acute inequality and large informal sector are reminders of the daunting development challenges the country still faces. Mexico's experience is well suited to studying how the dominant employment policies have fared under diverse economic conditions. On the one hand, Mexico has clearly embraced key employment prescriptions summarised by the Washington Consensus. It has liberalised trade

and investment, abandoned industrial policy, and has done everything within its reach to make labour markets more flexible. On the other hand, it has gone through a variety of economic changes as shown in Figure 1 below, ranging from deep crisis (1994-1996), to fast growth (1996-2000) and stagnation (2000-2008).

At the end of 1994—the first year of NAFTA—a run on the national currency led to a sharp contraction of the economy. Household income decreased by 15 per cent per year between 1994 and 1996, wages plummeted and unemployment rose to 9 per cent. The crisis was severe but it did not last long; by the second quarter of 1996 the growth rate had bounced back to 6.5 per cent. The income of the poor was affected a little less: between 1994 and 1996 household income of the bottom 20 per cent of the income distribution decreased by “only” 11 per cent.

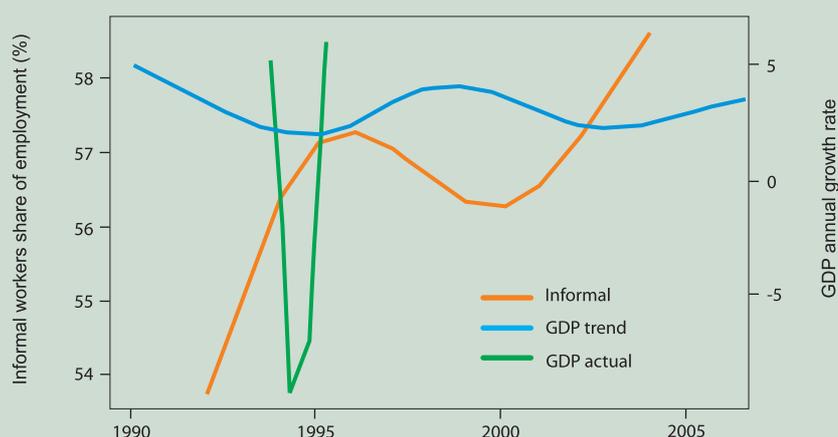
Leaving aside what had caused the crisis in the first place, can the mainstream policy view take credit for the fast recovery and the sheltering of the poor? Only partially; policies

Mexico's economy presents features that make it a good case study of employment with more general policy lessons.

Mainstream policies managed to generate growth that proved neither pro-poor nor sustained.

The Mexican experience shows the need to leave behind the blind faith in market forces and embrace employment-based policies.

**Figure 1
Informality and Economic Growth**



aiming to promote exports helped by cushioning the impact of the crisis and get the economy back to recovery. During the crisis, employment growth in export-oriented plants—known as *maquiladoras*—was not only sustained but its pace actually accelerated. Employment in the whole manufacturing sector grew at an annual rate of 5.6 per cent, significantly faster than in the previous two and subsequent four years (at 3.0 and 4.3 per cent, respectively).

However, this good employment performance cannot be entirely attributed to WC policies. The promotion of *maquiladoras* and NAFTA certainly did enhance the conditions for export-oriented manufacturing. Another very important factor explaining the good export performance was the real exchange depreciation, which was actually induced by the crisis rather than by policy design. The excessive concern of the WC with inflation had led policy-makers to disregard the fact that competitive exchange rates are employment friendly, and to abuse overvalued exchange rates to push domestic prices down.

Did WC policies provide the economic conditions that allowed the poor to cope better with the hardships of the crisis? Most likely not: although the labour incomes of the poor did not fall as much as those of the non-poor and unemployment rates increased equally for both groups, these were not the results of flexible markets. The reduction in the incomes of the poor was limited by the fact that they were already close to the subsistence minimum, so wages and other labour income of the poor could not decrease much further.

Regarding wages, the mechanics of the crisis did not particularly favour the type of work in which the poor typically engage. The earning returns to informal or self-employed workers both fell relative to the returns of formal employees. As for employment, the unemployment rates of the poor and the non-poor increased equally, while the fall of the household incomes of the poor was softened by the scaling up of their efforts to get jobs. Faced with declining incomes, more members of poor households joined the labour force

and took any available job. But more than a market response, the move was a rational survival reaction to the crisis. Poor people chose to fight the crisis by increasing the supply of labour at times of declining wages and labour revenues. Indeed, there was a noticeable increase of women aged 25-40 years among the employed. Thus, the poor took the risk of upsetting the fragile balance of household division of labour. Such emergency actions could and would not be sustained, as our review of the period of economic recovery will show (see Figure 1).

The WC policies can take some credit for Mexico's quick recovery. By the second quarter of 1996, GDP was growing at 6.5 per cent. For the following four years the economy grew at an annual rate of 5.8 per cent. Household labour income increased at an annual rate of 6.1 per cent while unemployment fell by 0.6 per cent per year. Formal jobs in manufacturing and services led the recovery. At the height of the boom, employment in *maquiladoras* grew at an annual rate of 20 per cent. WC policies had finally delivered.

But there were two problems. First, the growth rate started to decline as early as 1998. And second, growth was not pro-poor. Between 1996 and 2000, household labour income of the bottom 20 per cent of the population actually decreased; poor households did not benefit from the boom. Worker's pay and revenues from informal activities decreased at an annual rate of 0.2 per cent. The labour price of activities engaging the poor lagged behind, as exemplified by the negative change in returns to work in agriculture and self-employment.

Despite the still difficult situation and the reduction of unemployment rates, poor households reduced their labour market participation rates (see Figure 1), perhaps in a move to restore the rationality of poor households' economy that was put under stress during the crisis. Experiences in other countries have shown a similar response of the poor during economic fluctuations.

WC policies proved to be able to generate growth, but were not good enough at sustaining it, and were not at

all good at generating pro-poor growth. In the beginning of the 2000s the limits of the WC policies became apparent. Between 2000 and 2007, the annual growth of GDP was down to 2.4 per cent. The deepening of the links between the Mexican and the US economy meant that the slow down in the latter had strong repercussions in the former. But in addition to this, the US slow-down signalled the flight of a flock of *maquiladora* export processing plants to Asia seeking to take advantage of costs, infrastructure and business prospects.

The impact on employment was dismal. In 2007, the number of people employed in *maquiladoras* and in large manufacturing firms was down to the number they had in 1999 and 1996, respectively. Unemployment increased, and so did informality (see Figure 2). In 2004, the share of informal employment was higher than the level it had back in 1996.

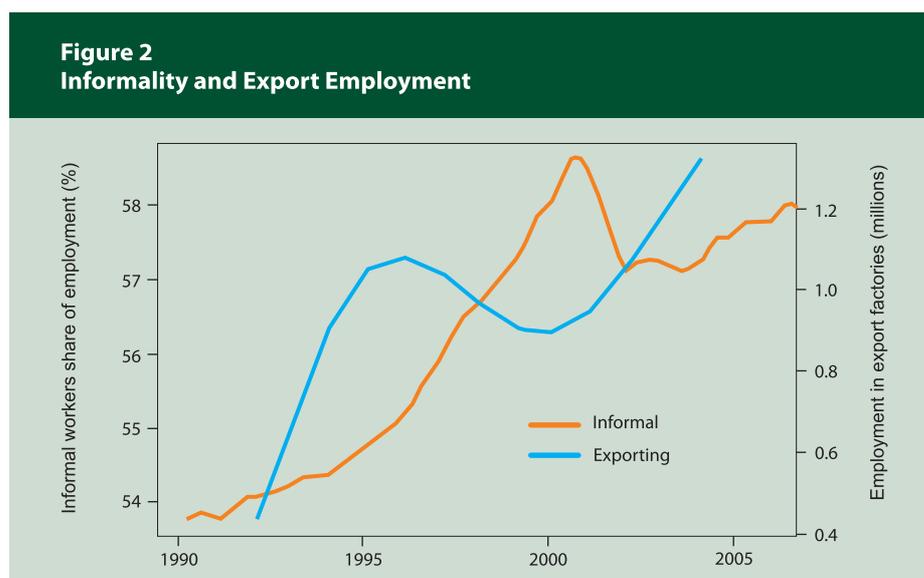
As in previous difficult times, the slowing down of the economy of the 2000s did not affect the incomes of the poor particularly hard. But unlike the 1994-1996 crisis episode, this time there was no survival response on the part of the poor; the employment effort of the poor actually decreased, as unemployment among the poor increased slightly more than among other groups. Instead, the incomes of the poor were this time cushioned by favourable changes in the returns to labour activities where the poor are abundant, notably for rural workers.

Could such pro-poor changes in relative labour prices somehow be attributed to WC policies? Hardly—one of the main determinant factors when the 1996-2000 recovery failed to favour the poor was the increase in the urban/rural relative price of labour. Two possible causes come to mind: first, the acceleration of the NAFTA liberalisation schedule in agriculture, which negatively affected rural low income households; second, the dismantling of support programmes to small farmers after 1995. The ensuing social unrest led the government to re-introduce support programmes to rural areas, which might explain the improvement of relative wages of rural over urban areas after 2000.

It cannot be argued that Mexico has failed to follow WC policies. One of the priorities of macroeconomic policies has been to contain inflation. In this regard they have been successful, but the downside has been uncompetitive exchange rates, pro-cyclical fiscal policies, and slow growth. Slow growth and uncompetitive exchange rates do harm employment creation. The alternative pro-employment policy is to adopt a macro-policy stance conducive to growth, which includes adopting counter-cyclical fiscal policies and sustaining a competitive exchange rate.

Industrial policy was replaced by the differentiated treatment of industries resulting from international trade and investment treaties and by privatisation schemes—including its modalities and sequencing. Policies overlooked the ever important static and dynamic links between leading firms in export markets and technological innovation, on the one hand, and the domestic production process, on the other. The result is that Mexico lacks a critical mass of modern industrial sectors with a diversified portfolio of domestic and foreign markets to support employment creation. The alternative pro-employment policy is to select industries for promotion and to support industries with public investment in productive and business infrastructure. Such policies call for an assertive stance in international trade and investment negotiations, and the use of any provision and loophole in international agreements that could be geared towards the support of selective industries and for the design of clear long term investment strategies by governments.

Labour market policies have also followed the WC script. As a number of studies have found, Mexico's labour laws can be deemed restrictive but in practice they are quite flexible. It is safe to say that WC policies have progressively made labour markets more flexible, as can be seen from the following examples. First, the ratio of effective wages to minimum wages has increased over the last 10-15 years, a sign that minimum wages have progressively had little influence on the level of wages. Second, union membership and its ability to influence wages have been declining. Third, labour law changes and more pro-market law



enforcement have progressively made labour markets more flexible. The alternative employment policy is to progressively recover the role of minimum wages to define a wage-floor, to seek the enforcement of labour laws in a transparent and democratic mode, and to promote democracy in labour unions.

Mexico has also invested resources in programmes to assist the unemployed, while they receive training—and to facilitate the matching of the demand and supply of labour. Programs aiming to improve the matching of supply and demand are helpful, but they can never be the centre of labour policies in a country, like many other developing countries, where informality accounts for half of total employment, where the low open unemployment is an anomaly, and where informal networks play a major role in the hiring process.

After many years of decreasing minimum wages, Mexico in 1997 introduced a conditional cash transfer programme to support the incomes of the poor. The programme grew to cover almost all poor households with a valuable transfer, particularly among the poorest, based on the number of school age children and conditioned to school attendance. Had the programme been in place during the 1995 crisis, poor households could have avoided taking the risk of destabilising their fragile household economies when falling incomes forced them to join labour markets. Perhaps the support that this programme now provides to poor

households helps explain the absence of straining increases in labour market participation during the economic slowdown of the 2000s. Countries adopting employment based development policies should consider including programmes of this sort and scope to support the incomes of the poor while strategies work their way through.

Mexico's training programmes are inadequate. While training of the labour force has increased, its extent and relevance should be carefully scrutinised as no impact is visible on either wages or productivity. Mexico's education system is in need of an overhaul, integrating labour training and formal education. Policies have overlooked for decades the strategic importance of massive public education of high quality and have done very little to tackle the problem. Conditioning cash transfers to the poor on school attendance does not solve the fundamental problem of the low quality of the education on offer to the poor.

The review of the Mexican experience speaks loudly of the urgency to leave behind the faith that dominant policy making has placed on market forces and embrace employment based development strategies. The current global financial crisis dramatically underscores this lesson from Mexico. ■

Zepeda, E.; D. Alarcon; F. Soares and R. Osorio (forthcoming). "Changes in earnings in Brazil, Chile, and Mexico. Disentangling the forces behind pro-poor change in labour markets", Working Paper Series. Brasilia, International Poverty Centre.

by Marty Chen,
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Addressing Informality, Reducing Poverty

A focus on the working poor in the informal economy should be the central pillar of the commitment to decent work and productive employment.

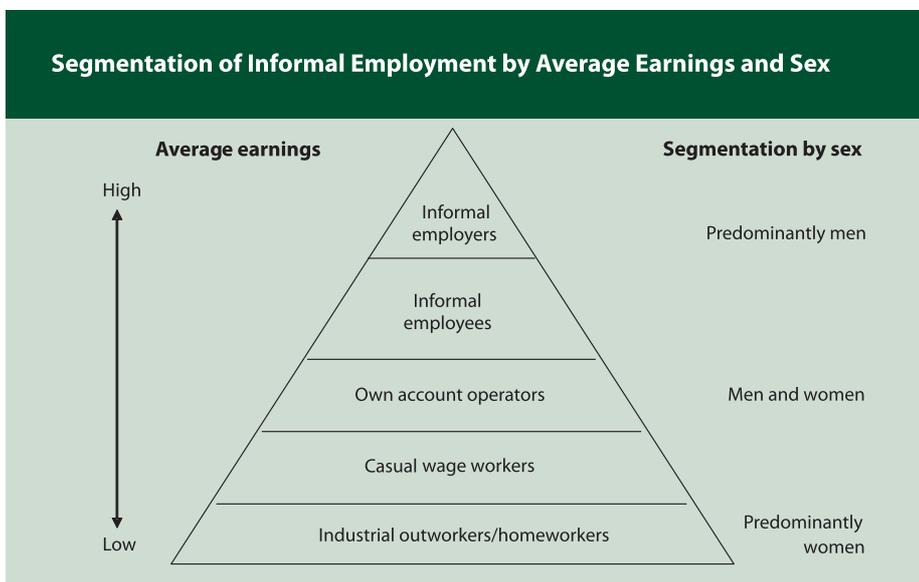
There is increasing recognition that decent and productive employment is an essential pathway to poverty reduction. Most of the working poor are engaged in the informal economy where earnings tend to be low and economic risks tend to be high: making it hard for the working poor to work their way out of poverty. A focus on the working poor in the informal economy should be the central pillar of the commitment to decent work and productive employment.

This article highlights the links between informality and poverty and presents a policy framework for addressing informality in ways that will help reduce poverty.

Informal employment broadly defined, including self-employment in informal enterprises and wage employment in informal jobs, comprises two-thirds to three-quarters of total employment in developing countries: three-quarters or more in South Asia and Sub-Saharan Africa; around 65 per cent in East and Southeast Asia; and around 60 per cent in the Middle East, North Africa, and

Latin America. Informal employment is generally a larger source of employment for women than for men in the developing world, other than in the Middle East and North Africa.

In terms of the linkages between informality and poverty, average earnings are lower in the informal economy than in the formal economy. But there is not a complete overlap between informality and poverty as some informal operators—notably, informal employers—are non-poor and some formal wage workers are poor. Further, there are significant gaps in earnings within the informal economy: informal employers have the highest earnings on average; followed by their employees and informal employees of formal firms; then own account operators; casual wage workers; and industrial outworkers. Around the world, men tend to be over-represented in the top segment; women tend to be over-represented in the bottom segment; and the shares of men and women in the intermediate segments tend to vary across sectors and countries. The latter two facts are depicted graphically in the Figure.



Note: The informal economy may also be segmented by race, ethnicity, caste, or religion.

The available data on poverty risk—that is, the likelihood that a worker from a given segment of the labour force is from a poor household—indicate a similar hierarchy. Workers in the formal economy, particularly in public sector formal jobs, are less likely than workers in the informal economy to be from a poor household. Within the informal economy, informal employees are more likely than their employers to be from poor households, own account operators are more likely than informal employees to be from poor households than informal employees, and so forth down the segmentation iceberg illustrated above. However, analysing the poverty risk of workers, as opposed to their average earnings, is complicated by

whether or not a worker is the sole earner, the primary bread winner, or a supplemental earner in her household.

In sum, there is a significant range of average earnings and poverty risk within the informal economy by employment status with a small entrepreneurial class and a large working class. There is also a significant gender gap in average earnings within the informal economy with women over-represented in the lowest-paid segments and earning less on average than men in most segments.

Since the informal economy was “discovered” in Africa in the early 1970s, there have been debates about what causes it and how governments and other stakeholders should respond to it. These debates tend to be polarized as different observers focus on different parts of the informal economy. One dominant school of thought argues that informal operators or micro-entrepreneurs deliberately choose to avoid taxes or other costs of formality and should, therefore, be regulated and taxed. Another school argues that the working poor eke out a livelihood or try to survive in the informal economy out of necessity and should, therefore, be promoted and protected.

A third view focuses on categories of informal employment which are linked to and, it is argued, deliberately created by formal firms, including: informal wage workers and industrial outworkers for formal firms; and the self-employed who are dependent on a single dominant firm. According to this third school of thought what needs to be regulated are the employment or commercial relationships between these informal workers and the formal firms that they work for or are dependent on. Each of these perspectives is valid for that part of the informal economy that it focuses on.

What is needed is an integrated causal theory and policy response that takes into account the diversity or heterogeneity of the informal economy. The Box depicts an integrated policy framework for responding to informality that takes into account the two main categories of informal employment as well as the three main responses to informality.

Integrated Policy Response to Informality			
Segments of informal economy	Regulation	Protection	Promotion
Self-employment Micro-enterprises Own account operations	Registration licensing Corporate taxes	Commercial law Property rights Social protection	Price policies Procurement Sector policies Infrastructure & services
Wage employment Informal employees Casual day labourers	Labour regulations Payroll taxes Social security contributions	Minimum wages Non-wage benefits Social protection	Skills training Job matching

Regulation is a common response to informality, especially among neo-classical economists. However, those who recommend regulation tend to focus on informal enterprises, not informal jobs. Moreover, many of the observers who advocate regulating and taxing informal enterprises also advocate de-regulating labour markets— in effect, they advocate formalizing informal enterprise but informalizing employment relationships. The long-term impact of these contradictory policies is not clear. In the short-term, the informal economy is growing; as jobs are being informalized at a faster rate than enterprises are being formalized. What are needed are *appropriate regulations* of both enterprises and employment relations that balance economic efficiency and social redistribution goals.

Protection of the working poor in the informal economy was the specific focus of the international Commission for the Legal Empowerment of the Poor which recommended promoting the business, labour, and property rights of the working poor. Social protection is also back on the policy agenda. The current debate centres on *how* (not whether) to extend social protection: notably, on whether to de-link social protection from the employment relationship. Those who advocate for universal social protection do so for either economic or social reasons. Neo-classical economists argue for universal social protection to avoid the labour market distortions and economic inefficiencies that they associate with targeted social protection schemes for the informal workforce. Other observers argue for universal social protection based on principles of equality and solidarity.

Promotion is needed for increasing the productivity of informal enterprises; not only through access to capital but also sector-specific business development services, infrastructure and inputs, and supportive regulations and policies. Increasing the employability of informal workers requires skills training and job matching.

Policy makers should implement an appropriate mix of the policies outlined above for different sectors of the informal economy. To ensure that the appropriate mix of policies is chosen and implemented, the working poor need representative voice, legal validity, and official visibility in the policy-making process.

- **Representative Voice**
The working poor need to be organized into membership-based organizations and these organizations need to be represented in relevant policy-making and rule-setting bodies or processes.
- **Legal Validity**
The working poor need legal identity and rights as workers, entrepreneurs, and as asset holders. They need to be legally empowered through inclusive legal and policy reform processes and appropriate legal and policy reforms.
- **Official Visibility**
To gain official visibility in policy-making, the activities, enterprises, and contributions of the working poor need to be measured and valued through improved labour force and other economic statistics.

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Chen, M. A.; J. Vanek and M. Carr (2004). *Mainstreaming Informal Employment and Gender in Poverty Reduction: A Handbook for Policy-Makers and Other Stakeholders.* London, U. K. The Commonwealth Secretariat.

by Denis Drechsler, Johannes Jütting
and Theodora Xenogiani,
OECD Development Centre, Paris

Is Informal Normal?

Towards More and Better Jobs

The economic and social importance of the 'informal sector' is rising in developing countries.

This is mainly due to insufficient job creation in the formal economy and warped incentive structures.

What should policy makers do about it?

Shoe shine workers in Cairo, street vendors in Calcutta, badly-paid public officials driving their taxis at night in the streets of Moscow—all these are examples of the phenomenon called informal employment. Informal employment refers to jobs or activities in the production and commercialisation of legal goods and services that are un-registered by or hidden from the State, most importantly for tax, social security and labour law purposes. Due to its concealed nature, measuring informal employment is a huge and daunting task, but ignoring it is not an option; the “informal sector” is of major economic and social importance in developing countries.

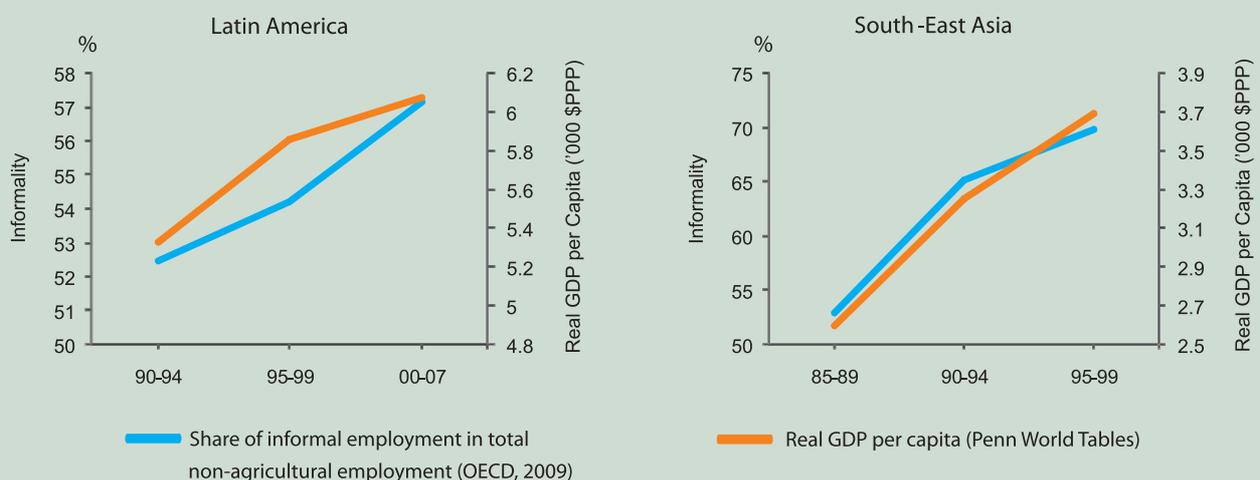
The figures speak for themselves: the worldwide proportion of jobs that are performed outside of a country's formal structures governing taxes, workplace regulations and social protection schemes is high and occasionally even increasing. In developing countries, the

share may be more than half of all non-agricultural jobs, and up to 90 per cent if the agricultural sector is included—despite economic growth in many of these countries. The development in selected countries in South-East Asia and Latin-America is telling in this respect: over the past 30 years growth was accompanied by increasing, not falling, informal employment (see the Graphs).

There are three major reasons why we should care about informal employment:

- **First, equity considerations:** Beyond earning levels, informal employment makes basic rights vulnerable and difficult to defend. As such, it can be a major cause of poverty along dimensions other than income. The majority of those who work informally are insufficiently protected from the various risks they are exposed to: health, unsafe working conditions and possible loss of

Informal Employment and GDP in Latin America and South-East Asia



Note: Graphs based on un-weighted averages of countries in 'Informal is Normal? Towards more and better jobs'(OECD, 2009).

earnings. Pervasive informal employment undermines the ability of the State to ensure that workers have fair working conditions, including appropriate work hours and safety regulations, and receive adequate pay—in the sense of equal pay for equal jobs or skills. Moreover, certain groups such as young people and women require specific attention as they are overrepresented among the informally employed.

■ **Second, productivity considerations:**

It is commonly assumed that the size and composition of informal employment has an influence of the growth pattern of an economy and vice versa. From an empirical perspective, though, there is no common view if indeed informal employment represents a “drag on productivity” or could at least temporarily be an “engine of growth”. Many observers argue that a high degree of informal employment reduces the competitiveness of an economy as informal firms (i) prefer to stay small—or are compelled to do so by the threat of inspections; (ii) have less access to inputs, e.g. credit and training; and (iii) cannot engage in formal business relationships and consequently maintain a lower productivity. In emerging economies such as China, however, informal employment is sometimes considered a positive phenomenon, at least in the short to medium term. Disregarding the validity of these two opposing views—i.e. small firms characterised by low-productivity vs. innovative entrepreneurs with high levels of flexibility—informal employment is an important issue that policy makers need to respond to.

■ **Third, public finance considerations:**

Persistently high levels of informality reduce fiscal revenues and the ability to develop social security systems based on taxes and contributions. What is more, many people are dependent on informal employment as a livelihood strategy. Simply abolishing micro-enterprises or informal wage work is therefore not a sustainable policy response. On the contrary, such measures

would cause significant social costs and represent a huge challenge for public expenditure.

Several reasons explain the strong and occasionally increasing importance of the informal sector that we witness in many parts of the world.

In low-income countries, informal employment is mainly a consequence of insufficient job creation in the formal economy. In middle-income countries, incentive structures are often conducive to driving individuals and businesses out of the formal sector. The increasing share of informal employment in Latin America is a good example of the impact of bureaucratic red tape. Specifically, formal workers are often required to pay for a mandatory bundle of programmes, some of which they do not even want. Likewise, many businesses opt out of formal structure due to inefficiencies in business registration and social security administration.

Even in OECD countries we can witness an informalisation of working conditions, partly due to increasing international competition in the course of globalisation. An example in this respect is the recent phenomenon of “false self-employment”, whereby individuals sub-contract every day to the same employer—voluntarily or involuntarily—and thus operate as self-employed contractors to bypass the legal requirements of a normal working relationship.

What can be done about informal employment?

Effectively addressing informal employment needs to start by reinforcing the advantages of the formal sector. At the same time, a better understanding of the complexity of informal employment and a more nuanced approach to address the specific needs of informal workers are urgently needed. In the past, many reforms have failed to address those who have no choice but to work informally. Such people need a different approach from those who voluntarily opt out of the formal sector.

Policy makers need to develop different policy measures and institutional reforms in order to respond to each group’s

particular needs. For those who have no choice but to work informally—the “lower tier” of informal employment that in most developing countries represent more than 50 per cent of the working population—an enhanced productivity and social protection strategy is required. Such a strategy should aim to raise productivity, improve skills, increase upward mobility and, most importantly, create jobs of a decent quality.

The agenda for the upper tier looks different. Here there is a need for providing appropriate incentives either through lower transaction costs related to business creation and operation, or through increased benefits of formalisation. At the same time, enforcement needs to tighten in order to make tax and social security evasion less attractive. Both cases have in common that they call for a re-definition of a social contract between the State and its citizens.

Policies can go a long way, but they are no substitute for trust. Informality is above all an expression of the lack of trust in public institutions, the negative perception of the role of the State and the limited understanding of the benefits derived from social security.

Long term sustainable change requires a transformation of people’s attitudes and beliefs. Mechanisms that recognise the rights of informal workers and entrepreneurs as economic actors and encourage them to embrace labour protection and formal practices are a means to this end. Providing informal entrepreneurs with tools that enable them to apply business logic and recognise upcoming opportunities will not only increase the profitability of their businesses but potentially the productivity of the economy at large. Besides granting informal workers more rights, access to services and a voice, they should also be reminded of their duties as citizens. Such a strategy will contribute to the economic and social development of a country and bring a society closer together. ■

Jütting, J.; J. Parlevliet and T. Xenogiani (2008). “Informal Employment Re-Loaded”, *IDS Bulletin*, Vol. 39, No. 2, May, pp. 28-37. <http://www.oecd.org/document/59/0,3343,en_2649_33935_39479291_1_1_1_1,00.html>.

by Rafael Perez Ribas, IPC and University of Illinois, and Ana Flávia Machado, Cedeplar/UFMG

Employment and Poverty Dynamics in Brazil

Poor workers usually look for informal jobs in order to improve their income.

Even though such jobs involve higher vulnerability, their contribution to poverty alleviation should not be neglected.

This study finds that the formal sector has not helped people move out of poverty as much as the informal sector.

Since informality is a means of self-protection against poverty, labour market policies should not create obstacles for the informal sector.

Employment is the main determinant of economic mobility in urban areas, at least in the short run. However, it is not every job that takes people out of poverty and provides them a safe condition. Such opportunities are more frequent in the formal sector of the economy, yet scarce for poor workers. Hence, these workers usually look for informal, unregistered jobs in order to improve their income. Even though such jobs involve higher vulnerability, their contribution to poverty alleviation should not be neglected.

In Brazil's metropolitan areas, about 53 per cent of those who are currently poor remain in poverty after a year. This rate is slightly lower than that in developed countries. In the United States and the United Kingdom, for example, about 60 per cent of low-income groups remain in the same circumstances after 12 months. This suggests that Brazil's metropolitan labour market have been at least as effective as those countries in promoting income mobility for poor workers.

To investigate the effects of employment on poverty in the short run, we exploit the Brazilian Monthly Employment Survey (*Pesquisa Mensal de Emprego*, PME), which is representative of six metropolitan areas in Brazil. This is one of few surveys that have the advantage of being a monthly panel, so it allows a more accurate estimate of the relationship between events and poverty dynamics than annual panel surveys. The reason is that associating an annual change with an event that took place at some moment within twelve months is more difficult than associating a monthly change with an event that took place in that same month.

In this article, we use the PME for the period running from March 2002 to March 2008. Our sample is restricted to

those households with active-age head (18-59 years old) and classified according to employment condition of this head. The first group of households comprises those with head employed in the formal sector—registered employees, employers, public servants and registered professionals. The second group consists of household with head working in the informal sector—self-employed and unregistered employees. In the third group are the unemployed household heads, which means those without a job but searching for one, according to the International Labour Organization's (ILO) definition. Households where the head is economically inactive are excluded from the sample for the purposes of this article. Finally, we define as poor those households with monthly per capita income below the poverty line calculated by the World Bank and analyse the monthly rate of households moving into and out of poverty.

Among economically active heads, informal workers as well as the unemployed are overrepresented in poverty, in contrast to formal workers. Indeed, 47 per cent of poor heads are in the informal sector, while about 29 per cent are in the formal sector. These percentages explain why the increase of the average wage of informal workers has a positive effect on the probability of household moving out of poverty. Furthermore, an increase in the average wage of the formal sector has a negative effect on that probability; such an increase leads to an even lower participation of poor workers in the formal sector.

Table 1 shows the monthly rate of households moving out of poverty according to the initial labour condition of their heads. On average, this rate is similar among poor heads formally employed (31 per cent), informally employed (30 per cent), and unemployed

(31 per cent). This means that a household will have the same chance of leaving poverty in the next month, whether a poor head is occupied in the formal sector, occupied in the informal sector or unemployed. Thus, the initial condition by itself seems to play no role in moving people out of poverty.

More important than the initial condition is what happens when households escape from poverty. About 90 per cent of formal workers and 85 per cent of informal workers that leave poverty stay in the same employment condition. Some 9 per cent of informal workers get a better opportunity in the formal sector, while 8 per cent of formal workers that move out of poverty change to informal sector. The latter case may happen when the benefits of being registered do not compensate its costs and poor workers choose to change status for increasing their earnings.

The most interesting result is that only 13 per cent of the unemployed experience upward mobility as a result of finding a formal employment, while informal jobs account for 34 per cent of the upward mobility in this group. This suggests that the formal sector has not helped people move out of poverty as much as the informal sector. The upward mobility of the other half of unemployed might be explained by the entry of other household members into the labour market—the “additional worker effect”.

Downward mobility figures (see Table 2) show that 22 per cent of the unemployed

	Initial head condition			
	Formal	Informal	Unemployed	Total
% of the poor	29	47	24	100
% moving out of poverty	31	30	31	30
Subsequent condition of those who left poverty				
Formal	90	9	13	34
Informal	8	85	34	49
Unemployed	0	2	33	9
Inactive	1	5	20	8

Source: Authors' calculation based on the Brazilian Monthly Employment Survey from March 2002 to March 2008.

and 7 per cent of informal workers who were not poor initially became poor after a month. For workers in the formal sector, the monthly rate of entry into poverty is only 3 per cent. Contrary to upward mobility, initial condition actually matter in downward mobility and the formal workers are the less vulnerable to poverty. As expected, informal workers are more vulnerable than formal workers because their earnings are more uncertain, their risk of being unemployed is higher, and they lack benefits such as unemployment insurance.

Independently of their initial condition, about 66 per cent of household heads who fall into poverty retain the same labour market status; workers stay in their initial sector and the unemployed remain unemployed. However, the percentage of workers who enter poverty

because they lost their job—becoming unemployed or inactive—is higher in the informal sector (28 per cent) than in the formal sector (25 per cent).

Job opportunities are crucial to reducing urban poverty and, obviously, the formal sector provides the best conditions for workers. However, the poor have very limited access to this sector due to their lack of qualification and financial resources. For this reason, informality has been an alternative means of alleviating poverty. The price of being informal is vulnerability. Thus, if a worker increases the probability of leaving poverty getting an informal employment, s/he also increases the probability of returning to poverty in the future.

Policies for poverty reduction by means of formal job creation would be effective if poor workers were qualified enough to meet the requirements of these new jobs; and getting qualification is an investment with returns only in the long run. Short run solutions might include reduction in the cost of registering workers and small business, expansion of microcredit, and expansion of safety nets that protect not only registered workers but also unregistered workers. Since informality is indeed a consequence of self-protection of workers against poverty, labour market policies should not create obstacles for the informal sector. ■

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	Initial head condition			
	Formal	Informal	Unemployed	Total
% of the non-poor	57	40	3	100
% falling into poverty	3	7	22	5
Subsequent condition of those who fell into poverty				
Formal	66	5	1	27
Informal	9	67	8	39
Unemployed	9	12	66	17
Inactive	16	16	25	17

Source: Authors' calculation based on the Brazilian Monthly Employment Survey from March 2002 to March 2008.

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Working Out of Poverty— Job Creation in Africa

Most poor households derive their income from labour, so job opportunities are key for reducing poverty.

In Africa, job creation performance has lagged behind expectations, even in fast-growing countries.

Even under the best scenario the expansion of formal jobs will not absorb the majority of the future urban labour force.

Africa is on the move again; after a decade of falling per capita income, 16 low-income countries in Sub-Saharan Africa have maintained an average economic growth rate of over 4.5 per cent a year since the mid-1990s.

The number of wage and salary jobs over the last decade or more has been disappointing. Formal job creation has lagged behind growth—to the surprise of many, given the extensive reforms implemented. Even in countries which experienced both strong economic growth and rapid poverty reduction, job creation performance has lagged behind expectations. Analysis of the experience of these high growth countries suggests the following reasons:

- The labour force is growing very rapidly, especially in urban areas and when compared to the existing stock of wage and salary jobs, even in countries that are hard hit by HIV/AIDS;
- Some countries have been able to expand private wage and salary jobs quickly, but this occurred while public sector restructuring was closing jobs, so net job creation was low;
- Investment in large scale labour-intensive manufacturing firms has been very weak despite good overall economic performance, owing in part to poor investment climates;
- Despite tremendous progress, Africa's education deficit still looms large relative to competitors. Investors report skill gaps as a major obstacle to investment and expansion.

Most poor households derive their income from labour, so job opportunities are key for reducing poverty. Most labour force entrants do not access the small

number of new wage and salary jobs on offer—because they are not qualified and because there are not enough jobs for those who are. Women often can not access the jobs because they can't combine them with their burdensome household tasks—the wage and salary sector is overwhelmingly male. So men and women end up in casual labour, self-employment, or small family businesses.

For many, these activities have sufficed to raise their income above the poverty line, but their productivity is low and they remain vulnerable. For African governments, a major goal is to achieve the kind of economic growth that can create new urban jobs at least as fast as the urban labour force is growing.

Government policy can improve the quality of growth by offering a better environment for firms, especially large labour-intensive ones; this could increase demand for labour, creating private wage and salary employment. In particular, export-oriented growth in industrial and service sectors has the potential to greatly expand formal employment. To create such jobs, African economies need to become more competitive in the global economy. Often, African labour markets are blamed for competitiveness problems, but our analysis found that labour markets in Africa are flexible, and wages and employment are responsive to market forces.

The most important issues for formal sector job creation are currently outside the narrow area of labour regulation, and are in the broader category of the investment climate. Many African countries have taken measures to improve this area, but more remains to be done in areas such as improving economic infrastructure and financial services, and institutional and organizational

reforms to reduce red tape and the risk of doing business.

However, labour market regulations may become important as other constraints are addressed. In the one country where this happened, Mozambique, the problem is being tackled through new legislation, which shows that this issue can be addressed when it is the binding constraint. Governments can also take measures to increase the quality of the labour supplied, by expanding effective policies and programmes to upgrade the education and health of workers, focusing on skill gaps critical to growth. Incentives to stay in school, combined with stricter enforcement of legislation to combat child labour, would provide youth with better opportunities for the future.

The demographic factors greatly increase the challenge of job creation in Africa. Even under the best of scenarios the expansion of wage and salary jobs will not absorb the majority of the future urban labour force. The good news is that in most countries the high growth of the non-farm informal sector—which appears to be at least partly a supply response to the weak demand from the medium and large enterprise sector and the poor prospects in agriculture—has been a major route out of poverty. Given the projected pace of urban labour market growth, this sector will continue to absorb a large share of the growing labour force over the next 10-20 years. Hence, government policy needs to focus on how to improve the productivity of the informal sector as well. How to do

this effectively needs to be further analysed, including by *ex post* impact evaluations of programmes with this aim.

Looking forward, what are the lessons for countries wanting to realise the aspirations of their growing, mostly urban, non-farm labour forces?

- *Recognise the dimensions of the problem caused by the projected rapid labour force growth.* Improving access to reliable means of birth spacing and family planning is an urgent issue for growth and poverty reduction in many African countries, and will have positive benefits in the long term.
- *Lower the costs of doing business and of creating jobs in urban areas for large, labour-intensive firms.* Most empirical analysis suggests that the main obstacles are not labour market policies but other regulations; also, poor infrastructure raises the costs of food and transportation, pushing up African wages relative to competitors.
- *Reduce the skill deficit across the board, not just for boys and not just for the wealthier populations in urban areas.* Governments need to make sure that (i) public and private education systems turn out graduates that meet the skill needs of private sector firms and (ii) all children have access to a quality primary education, which clearly pays off through higher consumption and better health and nutrition outcomes.

- *Ensure that informal sector, including the rural non-farm sector, remains a route out of poverty.* Job creation and income growth in the formal and informal non-farm sectors need to be linked and thus support sustainable shared growth. Most studies find the links are on the consumption side because this small sector is dominated by the production and retail sale of consumption goods. Africa is rife with pilot and small-scale projects targeted at this sector. Analysis is needed to identify policies and programmes that have the potential to achieve this goal on a larger scale.
- *Collect reliable data on labour activities, outcomes, and welfare at the household level, and on labour demand at the firm level.* The current stock of data is inadequate for monitoring trends in these variables, and even worse for identifying the underlying dynamics and analysing the results of policies and programmes. At a minimum, African countries should be collecting integrated household survey data at regular intervals that cover both economic activities of household members and consumption—as a way of measuring earnings and poverty status. Firm surveys are needed to analyse changes in labour demand and wages in the formal sector. ■

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Growth of the Labour Force, Wage and Salary Employment, and GDP per Capita in Selected African Countries

Country	Years	Average annual growth			Percentage of formal sector workers who are female
		GDP per capita (%)	Labour force (%)	Wage and salary employment (%)	
Burkina Faso	1998–2003	1.9	1.8	3.6	24.2
Cameroon	1996–2001	2.6	2.1	8.7	23.0
Ghana	1991–98	1.6	3.3	2.5	25.4
Mozambique	1996–2002	6.5	1.8	5.7	18.5
Senegal	1994–2001	2.0	2.8	4.9	36.6
Uganda	1992–2002	3.7	2.9	3.1	26.5

Source: Authors' calculations using World Bank data.
Note: Data are for last year of each range.

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The Employment-MDGs Linkages

What linkages exist between employment and the three relevant types of MDGs?

The key is the extent to which MDGs are affected by household income and/or involve externality and public goods elements.

Multidimensional action for accelerated attainment of MDGs is urgently needed.

It should include job-intensive growth, public investment and policy interventions.

How does employment feature in the nexus of growth, poverty reduction and the MDGs? Though employment is not an explicit component of the MDGs, its central role is well established. This article explores the linkages between employment and different types of MDGs with focus on the extent to which MDGs are affected by household income and/or involve externality and public goods elements.

The nature of the employment-MDGs linkage is quite different for MDG1—halving income poverty and hunger—than for the other, non-income MDGs. Employment impacts the MDGs by enhancing the income of individuals; hence the effect of employment on any MDG is higher the more private expenditures determine its level and the less externalities there are. The first MDG entails **the least externality** and hence the employment elasticity of this MDG is high. Employment-intensive growth reduces poverty most effectively because labour is the most plentiful resource that poor people are endowed with and labour income is an overwhelming determinant of the living standard of the poor.

The direction of causation between employment growth and poverty reduction may also run the other way: getting out of poverty may both enhance the ability to work and reduce the incentive to work. Another possibility is that the spending of the poor—on basic consumption and small-scale investment—is likely to be more concentrated among labour-intensive goods and services than is the spending by the non-poor.

Next in order of the strength of linkage with employment are the three MDGs for which individual income is a

major determinant though the **significant externality** that they entail makes public action necessary to supplement private expenditure to ensure their achievement. These concern universal primary education (UPE), and child and maternal mortality rates. The relationship between employment and UPE is strong both ways: access to employment and wages enable private investment in education. Access to education sooner or later improves the productivity of employment and thus increases the demand for labour.

The linkage between employment and child mortality should be similar to that between employment and UPE. Employment growth enhances the capacity of the poor to invest in ensuring better nutrition and health care for children and thus contributes to a more rapid reduction in child mortality. An autonomous decline in child mortality would reduce birth rates which would contribute both to reduced dependency ratio and a reduction in the excess supply of labour.

Similarly, maternal mortality can be reduced by employment growth through augmenting the capacity of households to invest in maternal health. The reverse causal link between a fall in maternal mortality and employment growth appears more tenuous although one is tempted to argue that the effect must be positive in so far as maternal mortality causes disruption in family life which is likely to create difficulty for the members of the household in pursuing employment. Reduced maternal mortality can also have externalities in the form of improved health and education status of children thereby strengthening the effect of the latter on employment.

In the case of these three MDGs a combination of enhanced personal income and increased public investment in education and health would be needed to achieve the targets.

Augmenting personal income, while a sufficient instrument for the reduction of income poverty, would not be enough for the acquisition of adequate levels of education and health; it must be supplemented by public investment.

Three MDGs should be considered as **public goods**. They concern gender equality and empowering of women; combating HIV/AIDS, malaria and other diseases; and environmental sustainability. If their contents are appropriately broadly interpreted, then the effect of employment growth on them would at best be small.

Employment growth would have little effect on the overall status of women. Very rapid employment growth may tighten the labour market to the point of improving the access of women to wage employment. But the status of women depends on many more things—institutional, social and legal—on which employment growth per se will have little effect.

Similarly the effect of employment growth on the reduction of HIV/AIDS and other diseases is likely to be modest and the same goes for environmental sustainability: the outcome depends on the kind of employment growth that takes place. Employment growth for survival could be at the cost of environmental degradation and environment-hostile industrialization can promote employment growth. While in the long run environmental sustainability and employment growth need not be in conflict, in the short run a poor society may not be able to avoid a trade-off. Thus employment growth per se would be a weak instrument to achieve these MDGs.

The reverse linkage between each of the three public-good MDGs and employment is likely to be much stronger. Enhanced gender equality is favourable for employment growth. Empowerment of women leads to a reduction in birth rate and should promote better health and education for children, thereby reducing

the excess supply of labour, reducing the dependency ratio and improving labour productivity. All these are conducive to an improved intensity of employment.

The reverse linkage between combating HIV/AIDS and other diseases on the one hand and employment growth on the other is likely to be strong: a reduction in the incidence of AIDS and other disease should have a strongly positive effect on employment and productivity growth since AIDS strikes workers in their prime and disease adversely affects productivity. Better environment, especially when encompassing improved access to sanitation, drinking water and slum improvement, should make strong contribution to employment productivity.

Employment-intensive growth would need to be supplemented by a broad range of public action in the achievement of the MDG package.

Finally, the linkage between greater global partnership (MDG8) and employment growth would appear to consist largely of a unidirectional effect. The specific targets for this MDG—larger aid inflow, a non-discriminatory trading and financial system, comprehensive debt relief, making essential drugs affordable, and developing and implementing strategies for youth employment—should be of much help for employment growth in the developing countries.

The effect of a better employment performance in a developing country by itself is unlikely to have much effect on any of these elements which are essentially beyond the scope of country development policy and are matters for international negotiation on development cooperation. This latter attribute rules this MDG out of the realm of policy making by individual countries.

For the attainment of the MDGs entailing externalities and public goods it is not

enough to augment personal income. Compared to the earlier development goal of promoting growth with equity, the endorsement of MDGs as the principal development strategy by the world community thus represents a substantial widening of the role of public action in development, a point that should be adequately recognized. Employment-intensive growth would need to be supplemented by a broad range of public action in the achievement of the MDG package.

An in-depth analysis of the range of policies related to employment-intensive growth and other public actions needed to attain the three categories of MDGs in four countries—Armenia, Cambodia, Ethiopia and Mongolia—as well as a more limited set of aspects of performance in attaining MDGs for a larger set of poor countries was recently done. The analysis and evidence suggest that action for accelerated attainment of MDGs is urgently needed. Such action needs to be multidimensional. It should consist of the following components:

1. Rapid employment-intensive growth must be an essential element of the strategy. It not only contributes directly to the attainment of most of the first MDG and good parts of the second, fourth and fifth MDG targets; it is also essential for the generation of resources for public investment in MDGs.
2. But it needs to be supplemented by public investment and intervention for the promotion of those MDG elements that embody externalities.
3. The attainment of the MDGs that are public goods must be the matter for public investment and intervention partly because the contribution of private expenditure to their attainment is likely to be small and partly because these MDGs would facilitate the implementation of the employment-intensive growth strategy. ■

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Structural Policies for Poverty-Reducing Employment

An effective economic agenda on poverty-reducing employment requires a clear conception of structural as well as equity-focused and macroeconomic policies.

However, even progressive economists have difficulty in formulating structural policies that are conducive to enhancing both equity and productivity.

Various policy instruments are available for making growth “employment-intensive”—a major objective of structural policies.

How can the employment

nexus between economic growth and poverty reduction be strengthened? Poverty reduction could be enhanced by economic growth that is faster or more pro-poor, or both. But each of these routes would necessarily involve generating more productive employment, namely, employment that provides income, per household, that is above the poverty level.

S.R. Osmani has provided a conceptual framework that is a useful starting point for analysing this issue. He identified three underlying factors that influence the employment and incomes of poor workers: 1) the growth factor 2) the elasticity factor and 3) the “integrability factor”.

The first refers to the rate at which an economy grows. The second refers to the extent to which growth improves the quantity and quality of employment. And the third adds the proviso that poor worker should be “integrated” with the income and employment opportunities offered by the first two factors.

There is little debate that faster growth should generally provide more employment opportunities. But the relationship between the two can be variable. This would depend on, among other factors, the initial structure of an economy and the sectors in which growth is concentrated.

If the growth sectors are employment-intensive and their growth rapid, increases in economy-wide productive employment could follow. This would depend also on whether the growth sectors are large and/or closely linked to the rest of the economy.

However, there would still be no guarantee that poor workers would

benefit greatly from such rapid and employment-intensive growth. They would need to have, for example, the health, the nutrition, the education and the skills to gain access to such expanded opportunities. They would also need access to productive resources, such as land, water and energy, if they were small farmers or entrepreneurs.

This analytical framework implies the need to combine Macroeconomic, Structural and Equity-Focused Policies in order to achieve the objective of the rapid generation of poverty-reducing employment.

Macroeconomic policies can be used to stimulate investment and growth. Structural policies can be used to influence the intensity of growth with respect to productive employment. And equity-focused policies can be used to improve the access of poor workers to expanding economic opportunities.

Macroeconomic policies and equity-focused policies—commonly associated with national poverty-reduction programmes—have received a lot of attention in discussions of poverty. But the same cannot be said of structural policies. Yet a clear conception of such policies is necessary for formulating an effective progressive economic agenda on poverty-reducing employment.

While macroeconomic policies are broad, blunt instruments having mostly an economy-wide impact, structural policies are qualitatively different. They help “structure” the access to economic opportunities, including decent employment.

However, there is little consensus on the desirability or applicability of such policies. And even progressive economists have difficulty in formulating

structural policies that are conducive to enhancing both equity and productivity.

Making growth more “employment-intensive” should be a major objective of structural policies. Various instruments are available. Fiscal policies are an obvious choice. Their impact can be differentiated by economic sector or employment category, such as focusing public investment in economic or social infrastructure where employment-intensive sectors are located.

Financial policies could be used for a similar purpose—such as providing banks with incentives to direct credit to small and medium enterprises. Industrial policies represent another option. They could differentially channel resources to various economic sectors or subsectors—such as to sectors with both growth and employment potential. Trade policies, such as adjusting tariffs by sectors or subsectors, could promote a similar objective. An example would be maintaining tariffs to protect domestic food security.

An IPC Country Study of South Africa illustrates the advocacy of structural policies. The study finds not only that recent economic growth has been too slow to generate much employment but also that average labour intensity has been falling sharply. Thus, it proposes both more expansionary fiscal and monetary policies to accelerate growth and structural policies to improve the employment intensity of growth.

The study takes note of the importance of the government’s Expanded Public Works Program (EPWP), which provides temporary employment in labour-intensive public works schemes. However, the programme remains too small and the jobs too temporary to make a dent in South Africa’s high unemployment, which affects over one quarter of the workforce.

If EPWP were expanded and designed to have a large impact on sectors that are directly employment-intensive and/or have a multiplier impact on employment in other sectors, then it might make a great deal of sense. But ultimately, the government would face a budget constraint if it relied solely on public works to create employment. Public

Employment in South Africa in 2014 under Alternative Scenarios

Three scenarios	Total employment 2014	New employment created by 2014
1. Current Economic Trends	9.8 million	0.9 million
2. Accelerated Growth But No Credit Subsidies	10.8 million	1.9 million
3. Accelerated Growth with Credit Subsidies	12.4 million	3.5 million

investment needs to be complemented by private investment to provide enough new employment.

Hence, the IPC study proposes a large-scale programme of loan guarantees directed at sectors of the economy that can provide more formal-sector jobs. Examples of such sectors are agro-processing, apparels and textiles, and tourism.

The study proposes that such sectors receive credit on subsidised terms through the private banking system. In return for directing one quarter of their credit to these employment-intensive sectors, private banks would receive a government guarantee against default on three-quarters of the principal of their loans.

Such a loan-guarantee scheme need not be expensive. Assuming a reasonable default rate, the study predicts that the total yearly cost to the government would be about 1-2 per cent of its fiscal budget. The pay-off from increased growth and employment—and boosted revenue—would far exceed this amount.

The goal of such a programme is to stimulate investment in employment-intensive sectors that accounts for about 25 per cent of all private investment in the economy. The study expects that this investment would lead to much faster growth in these sectors in the rest of the economy, and considerably more formal-sector employment.

In making its case, the IPC country study compares the employment impact of three different scenarios until 2014, which is the year that the government expects to have halved unemployment (see Table). The first scenario is the projection of the “status quo”, namely, current economic trends projected

until 2014. The second assumes only accelerated growth, which results from the more expansionary fiscal and monetary policies that the study advocates.

The third, and the most desirable, scenario projects both accelerated growth across the whole economy and credit subsidies directed towards employment-intensive sectors. This scenario is projected to create 3.5 million new formal-sector jobs by 2014. This would be about 84 per cent more than the total jobs (namely, 1.9 million) that would be created by accelerated growth alone. It would also be about four times more than the jobs created by the extension of current policies.

In the third scenario, the unemployment rate would fall to about 15 per cent, from the level of about 26 per cent when the IPC study was written. The lesson is that while more expansionary macroeconomic policies could accelerate growth in South Africa, structural policies, such as sector-targeted credit subsidies, could substantially enhance the impact of this growth on employment.

If such macroeconomic and structural policies were supplemented by equity-focused policies, such as providing poorer households with greater access to quality education and training or to land and extension services, significant progress could be achieved in expanding poverty-reducing employment.

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Reintroducing Employment into Macroeconomic Policy

The narrow focus on price dynamics as the primary indicators of economic and social stability raises numerous concerns.

The evidence seems to suggest that when inflation rises above 12-15 per cent, it begins to have a negative impact on growth.

An alternative approach to macroeconomic stability is more cognizant of the performance of the real economy.

A coherent employment policy requires a rethink of standard approaches and traditional boundaries.

Improved access to quality employment will raise living standards and expand the choices individuals have. Thus, employment-centred growth facilitates poverty reduction and the realization of the MDGs.

Macroeconomic policies currently focus on maintaining economic stability, often restricted to price stability. Few would argue that macroeconomic instability is desirable. However, the narrow focus on price dynamics as the primary indicators of economic and social stability raises numerous concerns. It is not clear that maintaining very low rates of inflation guarantees stability in the quality and accessibility of employment opportunities. Real economic performance has increasingly become subordinated to monetary and inflation targets.

Monetary policy has a direct impact on the real interest rate, the average price level, and the exchange rate. Inappropriate monetary policy will constrain economic growth, lower investment, and hinder efforts to create better employment opportunities. In most countries around the world, the dominant goal of monetary policy currently is to reduce inflation to the low single digits.

Research studies have not provided an unequivocal answer to the question of when inflation reduction is consistent with higher rates of growth and when trade-offs may kick in. The evidence seems to suggest that when inflation rates rise above 12-15 per cent they begin to have a negative impact on growth. However, struggling to maintain inflation well below this threshold may not be beneficial and could hurt the real economy if it means dramatically raising interest rates or enduring over-valued exchange rates.

When monetary policy is assigned the role of lowering inflation, fiscal policy is often relied on as the instrument for managing interest rates. Higher levels of government spending, it is often argued, will bid up interest rates and slow growth. However, the budget is perhaps the single most important tool for targeted development spending. If fiscal policy must first and foremost keep interest rates low in the face of restrictive monetary policies, then the ability of budgets to support other social and economic objectives is curtailed.

Although the management of the fiscus and the sustainability of the debt are of paramount importance, the ability of fiscal policy to fully exploit its developmental potential is limited in the context of a narrow interpretation of macroeconomic stability.

The approach to macroeconomic management currently in vogue eschews development goals and favours financial and monetary targets. Moreover, it limits the number of instruments available for managing the economy. For example, interventions into foreign exchange markets are discouraged and market-determined exchange rates are promoted. However, managed exchange rates, properly applied, can be a powerful tool for shaping the macroeconomic environment.

An alternative approach to macroeconomic stability is more cognizant of the performance of the real economy. Monetary policy could target real (inflation-adjusted) interest rates, keeping them positive and low; fiscal policy could prioritize public investment, education, and health for a productive economy; and managed exchange rates could be used to maintain a desirable external balance. If necessary,

precautionary controls on short term capital flows could be enacted to limit the negative effects of more speculative outflows. Such an approach would not marginalize the real economy, nor would it belittle the central importance of macroeconomic stability.

Macroeconomic policies are blunt instruments, capable of affecting the environment in which employment dynamics play out, but not sufficiently fine-tuned to constitute an employment strategy in themselves. Other complementary interventions are needed to support productive activities and employment creation—such as trade policy, industrial policies, and development financing. Nevertheless, we can discuss macroeconomic policies that are employment-friendly or employment-oriented, such as the alternative approached sketched out above.

Typical stabilization policies do not explicitly target real economic performance. The contribution of macroeconomic policies to achieving desirable employment outcomes is frequently restricted to the maintenance of stable prices, assumed to be conducive to improving growth and employment. In this framework, lack of decent employment is often blamed on labour market distortions and rigidities—microeconomic misalignments, not inappropriate macroeconomic priorities.

The strategy most closely associated with the standard stabilization packages is the pursuit of “labour market flexibility”, which is a catch-all term for a withdrawal of state regulation, a shift away from “distorting” social protections, and a reduced role for collective action, specifically on the part of worker organizations. The rationale for this strategy rests on the ideal of the perfectly competitive labour market—in which employers and employees are free to voluntarily establish optimal employment relationships. Any movement away from this ideal distorts the functioning of labour markets and will lead to a misallocation of productive resources.

The idea that, in the absence of regulation, perfectly competitive labour

markets would prevail is hard to justify. Non-regulatory market failures are endemic in developing countries. For example, labour market participation involves real costs in terms of time, effort, and financial resources. Imperfect information and the costly enforcement of contracts cause outcomes to deviate from the perfectly competitive ideal. Labour markets are often characterized by asymmetries of power—between employers and employees and between the self-employed and stronger economic players.

Perhaps most importantly, a large fraction of total employment in developing countries is not governed by formal labour market institutions at all. Self-employment, particularly in the informal sector, is often not subject to labour market regulations. Informal wage employment, by definition, lies outside the formal regulatory sphere.

These forms of employment have been shown to be characterized by low and volatile earnings, limited or no social protection, and high risks of poverty. The argument that these substandard employment conditions are caused by excessive regulation lacks credibility—as does the assertion that labour market flexibility alone promises a solution to the employment problems of developing countries.

The low quality of employment in many developing countries, at least for the majority of workers, should not be seen as a labour market problem but rather as a developmental challenge. Meeting this challenge requires coordination across a range of different policy areas—macroeconomic policy, financial sector reform, productive sector support, and, of course, appropriate labour market regulation.

Most growth models treat labour (apart from human capital) as a “given” endowment, not something which is actually produced in the economy. However, recognizing labour as a produced factor of production allows social policy to contribute to the macroeconomics of long-run growth. Many of the institutions responsible for producing labour are the objects of

Integrating social policies in growth strategies requires a change of mindset in which production of human resources is recognized as part of the functioning of the economy.

social policies—including educational and health services. Childcare programs help resolve conflicts between labour force participation and unpaid work. Social insurance for both formal and informal workers sustains households facing unexpected shocks.

Causality runs in both directions. Growth generates resources needed to supply social programmes and social policies contribute to long-run macroeconomic performance. Treating social policies as a component of a growth strategy requires a change of mindset in which the production of human resources is recognized as integral to the functioning of the economy.

A coherent employment policy requires a rethink of standard approaches and traditional boundaries. Macroeconomic stability should be redefined to include real economic outcomes. Moreover, the sharp conceptual divisions often made between macroeconomics, labour markets, and social policies are often counter-productive. Appropriate labour market institutions are not necessarily a drag on employment and economic performance, but can improve efficiency. Only by recognizing these policy interactions can a coherent employment strategy be developed, one that improves standards of living and moves the world closer to attaining the MDGs.

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by Janine Berg and
David Kucera,
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Labour Market Institutions and Employment

Institutions protecting freedom of association and collective bargaining are major achievements of modern times.

Yet, nowadays they are often blamed as causes of unemployment and informality.

Labour laws and labour market policies are needed for preventing abuse and improving working conditions.

The scope and enforcement of these laws need to be broadened, not chipped away.

Policy makers need to take on re-regulation as opposed to de-regulation.

When unemployment insurance was first adopted in Europe in the early part of the 20th century, it was seen as a response to the destitution brought about by job loss. Legal statutes on maximum hours, minimum wages, and health and safety regulations were adopted with the purpose of improving working conditions and the standard of living of workers. And laws protecting freedom of association and collective bargaining were adopted to remedy the bargaining power disadvantage of workers. Such laws and the related institutions are major achievements of modern times.

These institutions have been widely adopted in many parts of the developing world, but now they are often considered to cause unemployment and informality. One influential example of this thinking is the Doing Business report from the International Finance Corporation of the World Bank Group. It ranks countries according to their “ease of doing business”; regulations concerning hiring and firing of workers, working hours and social security are seen as barriers to private investment, thus causing poverty. What explains this change in thinking?

Since the early 1980s, neoclassical economics has come to dominate policy debates. Unemployment is no longer attributed to a lack of demand in the economy; rather, it is believed to be the result of market impediments. In this view, the labour market is a fair exchange between two equal parties with wages being determined by supply and demand. The theory assumes full employment and any attempt to regulate labour relations is believed to impede the workings of the market by artificially raising the wage, leading to unemployment or informality. If “rigidities” are removed, then the theory

postulates that the market will return to full employment, thereby resolving the labour market problems of any economy.

Empirical evidence is cited to support the theoretical model, yet closer inspection reveals that the results are not as straightforward as is often claimed. For instance, in 2003, the IMF published a chapter in its *World Economic Outlook* titled “Unemployment and Labor Market Institutions: Why Reforms Pay Off.” Contrary to the title of the paper, however, the most definitive evidence indicated that labour market institutions “hardly account for the growing trend [in unemployment] observed in most European countries and the dramatic fall in US unemployment in the 1990s”.

Similarly, the introduction to an often-cited volume on *Law and Employment: Lessons from Latin America and the Caribbean* by Heckman and Pagés (2004) states that “the microstudies assembled here find a large and negative effect of job security on employment” (p. 85). Yet in five of the eight countries studied in the volume—Barbados, Brazil, Chile, Jamaica, and Trinidad and Tobago—there was no statistically significant relationship found between “job security provisions” and employment.

Further complicating the debate is the issue of what to measure and how to gauge performance. There are a multitude of labour institutions that affect the labour market, in contrasting ways, both good and bad, depending on the criteria at hand. These institutions relate to the labour market both directly—e.g. employment protection legislation, hiring halls, and collective bargaining—and indirectly, e.g. trade unions and employers’ organisations and the work ethic. Some labour institutions are clearly market institutions, but others

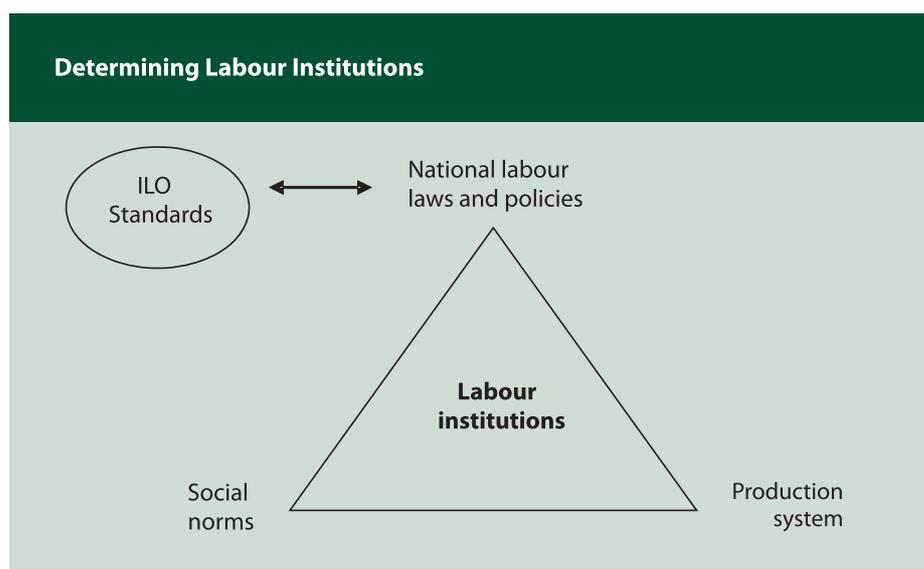
are not, or are a combination of the two. For example, social security can be provided by the State, the enterprise or through institutionalised private networks, but can also be based on family and communal obligations. Sorting out the competing effects of these institutions in econometric studies is difficult.

There is also the question of how to gauge success. For example, Tzannatos (2008) identifies indicators, at both the microeconomic and macroeconomic levels, that have been used to evaluate performance. These include wages, productivity, research and development, accident rates, turnover, unemployment, inflation, economic growth, inequality and poverty. The conclusion is that “theory is often ambiguous and the indicators, even when measured without errors, may exhibit different behaviour in different periods or at different times or even within the same country in different periods” (p. 179).

But while there are technical challenges to empirical work, the greatest problem has been referred to as the “priors” that have guided participants in the debate. As the examples given above show, in many instances the participants have selectively presented empirical evidence that accords with what they wish to believe. Given the simplicity of the neoclassical model, it is understandable why some researchers exhibit such unfettering devotion. And though Ockham’s razor would perhaps suggest that the simple neoclassical model is best, policy conclusions based on this model are likely to be wrong.

This is because the labour market, unlike those for land, machinery or raw materials, is not used or exchanged according to the same rules. Thus the statement that “labour is not a commodity,” which appeared in the ILO’s Declaration of Philadelphia of 1948, is not just a social aspiration, but an accurate description of the world of work.

Labour institutions guide the labour market. They comprise rules, practices and policies—whether formal or informal, written or unwritten—all of which affect how the labour market works. They are as explicit and long-standing as certain labour laws that



we have come to consider as universal rights, but also span the scope of informal practices that reflect the views of society, as well as short-term laws and policies that fade and resurge depending on the policy mood.

All countries, irrespective of their level of economic development, have labour institutions. The distinction between countries lies in the degree to which they are embedded in law, whether the law is applied in practice, and the extent that government policies are used to pursue certain objectives.

Labour institutions are determined by—and comprised of—social norms, national labour laws and policies as well as the system of production (see Figure). The three axes of the triangle affect—also form part of—labour institutions. For example, trade unions and employers’ associations are labour institutions. These institutions bargain over national labour laws and policies. How they bargain and what they bargain over will depend on underlying social norms as well as on the constraints or demands of the production system, as well as national labour laws on freedom of association and collective bargaining. Similarly, the organisation of jobs within the firm is a labour institution that is determined by the production system and perhaps national laws, but that can also reflect underlying social norms, such as occupational sex segregation.

The rules, practices and policies that are inherent in labour institutions influence

almost every aspect of our working lives: how we enter a job, the training we receive to qualify for the job and while on the job, the conditions under which the job is performed—the employment contract including the hours, pay, benefits and safety measures associated with the work—as well as what happens when the job ends. Although labour institutions are pervasive, not all are desirable or defensible. After all, forced labour is a labour institution and discrimination in employment is sustained by various labour institutions. Labour laws and labour market policies are needed for preventing against abuse and for improving working conditions. The concerns that prompted the enactment of laws to regulate working conditions nearly a century ago are as valid today as they were then.

It is for this reason that in most developing countries the scope and enforcement of the law needs to be broadened, not chipped away. And new laws and policies should be designed and advanced to address new trends in the world of work, brought about by shifting social norms, technological advancements and economic integration. In short, policy makers need to take on re-regulation as opposed to de-regulation. ■

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Labour Migration for Pro-Poor Growth: More than a Quick Fix?

In several countries labour migration has reached such proportions that it has a dominant influence on economic and social development.

In the case of Moldova, poverty fell rapidly from very high levels thanks to the dual impact of remittances and improved domestic job and income opportunities.

However, only a minor share of the migrants' contribution to the host economies ends up in the migrants' own pockets.

In the wake of the fall of the Soviet Union and its satellite regimes in Eastern Europe, many of the successor states suffered severe economic contraction as the old economic structures collapsed. A severe mismatch emerged between the countries' human resources and the capacity of the economies to provide productive employment opportunities, which in turn triggered a mass exodus of labour in search of income opportunities abroad. In several countries labour migration reached such proportions that it came to exercise a dominant influence on economic and social development. Traditional economic analysis, focusing on the economic activities inside a country captured this dramatic development quite poorly.

A more conducive approach would arguably be to focus on the economic actors, the labour force and the population of the country, irrespective of whether the economic activities they pursue take place within or outside the country. This article adopts such an approach, using Moldova as a case study, to examine the role of migration for work abroad from the perspective of economic development and poverty reduction.

Investments abroad are commonly thought of as investments of capital rather than of human resources, even though the latter is arguably an important form of foreign investment. The parallels between the two are obvious. From a national perspective, it is in both cases a question of investing productive resources in the economy of another country, thus diverting them from the domestic economy, in the hope of getting higher returns than could be obtained at home. From the perspective of the individual economic actor or household, a decision to migrate abroad for work can be seen as an

investment and can be compared with regular investments in the home country.

In both cases economic actors invest their money and time in the hope of getting higher returns and incomes than they would have had without the investment. In both cases the investment involves risks and uncertainties. In both cases, the investment can be expected to result in enhanced economic growth in the country of destination and in a return flow of capital to the source country. Seen from this perspective, Moldova stands out as a major foreign investor in Europe.

The Table indicates that financial investments in labour migration abroad were almost as large as the total private investments in the domestic Moldovan economy in 2006. An estimated \$453 million, equivalent to 15 per cent of GDP, were invested by Moldovans in migration abroad, as against \$516 million invested in the domestic economy. A very approximate, but conservative, estimation suggests that, as a result of investments in labour migration, Moldovan labour contributed some \$3,500 million to the GDP of other countries, by their labour abroad, in 2006. Thus, Moldovan labour contributed as much to the GDP of other countries—mainly Russia and Italy—as to that of Moldova.

For sure, Moldova benefited too, from these investments in migration. Remittances back to Moldova of income earned by Moldovan labour abroad amounted to \$1,119 million in 2006, according to official data, equivalent to about one third of Moldova's GDP. Indeed, income from "export of labour" was larger than the total income of exports of goods from Moldova. Remittances had also become a major source of income for Moldovans living in Moldova, increasing

their purchasing power and permitting a higher standard of living.

In a situation of severe imbalance between the human resource endowment and the employment and income generating capacity of the economy, migration for work abroad can provide a powerful vehicle for reducing poverty and for putting a depressed economy back on a path of economic growth, as seen e.g. in Albania, Moldova and Tajikistan. Here, large scale migration abroad in the wake of an economic collapse at home triggered economic recovery through a powerful injection of remittance-based demand into the domestic economies and poverty fell rapidly from very high levels thanks to the dual impact of remittances and improved domestic income opportunities.

In Moldova, the result was a dramatic fall in headcount poverty from 73 per cent in 1999 to 27 per cent in 2004. Three years later, by 2007, remittances accounted for 23 per cent of the personal disposable income in rural areas, while real average wages had increased by 46 per cent since 2004.

Still, impressive as they are, the gains from migration for work abroad could be larger. In contrast to the situation with regard to financial overseas investments, those who invest their labour abroad do not benefit from any free movement

across borders or from legal and regulatory framework protecting their interests and rights. Hence, migration, not least to the EU, entails high costs and risks. Only a minor share of the migrants' contribution to the economies at their destination ends up in the migrants' own pockets.

There is a discrepancy between the supply and demand prices for migrant labour, which, combined with the absence of an adequate regulatory framework, results in a large scope for rent-seeking. A Moldovan who desires to migrate to an EU country spends on average some 3,600 Euro for her (more rarely his) first departure; money that ends up in the pockets of middlemen and the agents who arrange the transport and visa.

Once within the EU the migrants are forced to accept working conditions and wages that are far worse and lower than the domestic workers would accept. Indeed, the lack of legal rights makes them an easy prey for all manners of exploitation and most of them live under a constant threat of expulsion. While migration for work has made possible escape from poverty for many, it is inevitably a second-best solution compared to having job opportunities at home, not least because the social costs are very high. Large-scale labour migration increases notably the stakes

for achieving pro-poor growth at home. On the one hand, the impact of migration undermines the international competitiveness of the economy of the source country through three main channels: (i) an appreciation pressure on the domestic currency resulting from large inflows of remittances; (ii) an upward pressure on domestic wages; (iii) the appearance of shortages of critical skills.

Thus, it makes the need to increase labour productivity particularly acute, which in its turn highlights the need for well-functioning markets and a generally conducive business climate, access to technology and know-how and, not least, a high rate of investment. It also implies particular demands on the educational system. On the other hand, the migrants make up a potentially extremely valuable asset for the domestic economy. Return migrants bring with them not only human resources (skills, knowledge etc.) and large amounts of capital, but also social capital in the form of contacts, knowledge and visions acquired while abroad.

Indeed, while a static picture may suggest that investments in migration abroad are tantamount to investments foregone to the domestic economy, a more dynamic perspective yields a different picture. Demand-led growth triggered by remittances has resulted in improved investment opportunities as well as increasing availability of capital in the domestic economy.

Migration, especially when circular, also generates valuable cross-border networks and information channels. Investments in the Moldovan economy have increased threefold in real terms within the span of only four years (2003-2007), albeit from a low level. The investments come from various sources, but there is ample anecdotal evidence of the role of return migrants as entrepreneurs, investors and carriers of information and knowhow, who thus contribute to creating a future for themselves and their fellow countrymen at home. ■

Eskola, E. (2007). "Investing in a Brighter Future Abroad: The Need for a Domestic Alternative in Moldova", *Country Economic Report, Vol. 6* (Stockholm: Sida).

Investments in Domestic Economy and in Migration GDP Produced in Moldova and by Moldovan Labour in 2006

	Million USD	% of GDP
Domestic private investments	516.2	17.9
Migration to CIS	19.3	0.6
Migration to EU	397.4	13.3
Other migration	36.4	1.2
Total investment in migration	453.2	15.2
Total private investments	969.4	33.1
GDP	Million USD	Per capita USD
- produced in Moldova	3,356	935
- produced by Moldovans abroad	≈3,500	≈ 975
- produced by Moldovan labour, total	≈ 6,850	≈1,909
- of which accruing to Moldova	4,475	1,247

Source: Author's own calculations and E. Eskola, Sida 2007.

by Erik Jonasson,
Lund University

Rural Non-farm Jobs— A Pathway out of Poverty?

For the majority of peasants, assets and incomes are insufficient for getting households out of poverty.

Develop rural centres, towns and small cities as attractive alternatives to the urban economy.

Agriculture continues to be the dominant source of employment and income for rural households in the majority of less-developed countries. In many areas, however, the rural population grows faster than employment in agriculture, causing the gap between the number of rural workers and the number of agricultural jobs to widen. The World Bank's *World Development Report 2008* calls rural employment creation a "daunting challenge".

In Latin America, one of the reasons that employment in agriculture stagnates is that a large part of agriculture is large-scale and concentrated in less labour-intensive production such as cereals and beef production. Even though wage labour as a share of agricultural employment is on the rise in many regions, the majority of the agricultural

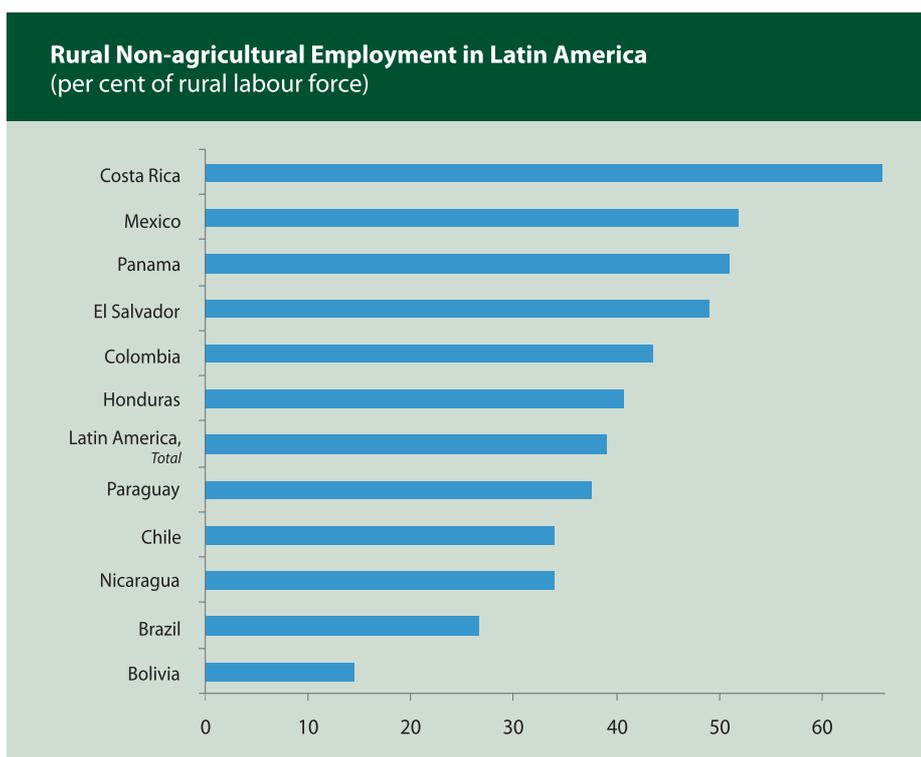
labour force are still family subsistence farmers. Some rural households possess enough land and productive equipment to be viable farmers, who are able both to earn a living in agriculture and to re-invest some of their surplus in productivity-enhancing technology. For the majority of peasants, however, productive assets are scant and incomes are usually insufficient for raising households above the poverty line. For these low-productive peasant households, and for landless households, complementary income sources are needed—besides farming on their own.

In the rural development research literature, rural non-agricultural employment (RNAE) has received increased attention since the 1990s. Empirical studies show that RNAE is increasing and accounts for 35-45 per cent of income among rural households, worldwide. RNAE has been considered a means of creating new employment opportunities for an underemployed rural labour force, increasing and smoothing household income flows, and slowing down rural-to-urban migration flows in regions where such migration have adverse effects.

But for whom, and under which circumstances, is RNAE a potential income source and a possible pathway out of rural poverty?

The rural non-agricultural sector is a residual concept, including all forms of production other than raw agri-food production, livestock husbandry, hunting, fishing, and forestry. RNAE is any job held by a rural resident in the non-agricultural sector, whether this job is done in a rural or urban setting.

The character of RNAE differs across regions, depending on local economic



Source: M. Dirven: *Rural non-farm employment and rural diversity in Latin America*, CEPAL Review, 83, 2004.

conditions. Yet, a few stylized facts can be observed: i) on average, RNAE pays better than agriculture; ii) RNAE tends to be dominated by small-scale manufacturing (mainly processing of food and other agricultural products), commerce, and various forms of services; iii) RNAE intensifies the closer to population centres one gets, and iv) RNAE is more prevalent among women than men (e.g. in Brazil where RNAE is the principal occupation for 42 per cent of the rural female labour force, compared to only 25 per cent of the male rural labour force).

Even though workers involved in RNAE are found to earn a higher income, on average, than workers engaged in agriculture, there are plenty of “low-productivity” non-agricultural jobs. Using the local wage rate among agricultural labourers as a benchmark, only about half of the non-agricultural labour force has earnings above that local agricultural wage rate in Brazil. In fact, domestic services—which employ almost 30 per cent of the women in RNAE in Brazil—pay below the agricultural wage rate in 4 out of 5 cases. Thus, holding a non-agricultural job is not a guaranteed route out of rural poverty.

The access to RNAE and its potential for a rural worker are determined largely by two factors: the human capital endowment of the worker and the proximity to markets in which non-agricultural goods and services are demanded. Even if education has an important role to play for the productivity in agriculture, studies show that returns to education are even more important in non-agricultural activities. Without a minimum set of skills, a job in the non-agricultural sectors is unlikely to provide any higher income than agriculture, and education is the key determinant for access to high-productivity RNAE.

Local economic conditions are also important. While farm products can be consumed by the own household, this is not the case with non-agricultural production. Therefore, the potential of RNAE for improving livelihoods depends to a greater extent than farming on the

proximity to buyers of non-agricultural goods and services. Proximity can mean physical distance, transportation costs, as well as the quality of marketing channels through which the producer reaches the consumer.

A traditional view of the rural non-agricultural sector is that it depends to a large extent on agricultural production, either through forward and backward linkages in the value chain—such as food production or service and repair of agricultural equipment—or through demand of non-agricultural consumption goods induced by local agricultural income.

This view has two implications: one is that the non-agricultural sector is viable only where agriculture is well-developed. Another is that, if RNAE depends mainly on very local demand, improved connections with the urban economy might actually have adverse effects on the rural non-agricultural sector. With competition from the urban economy, the demand for locally produced non-agricultural goods and services might wither away, as buyers shift to superior goods from the urban market.

There are two reasons to oppose this view. Firstly, if there is little cost advantage in having agricultural food processing and other processes in the agricultural value chain done locally, or if these processes are highly mechanized, the local linkages of RNAE to agriculture are likely to be very weak; local demand induced by agricultural income will be low as well, if land owners do not live locally. Secondly, if rural infrastructure allows mobility of workers and goods, the principal source of demand for RNAE need not be the local rural economy.

For workers within commuting distance to an urban area or to a rural town, RNAE could imply residing in a rural area and working in the town or city, while benefiting from lower housing costs and other possible amenities associated with rural residence. Moreover, to the extent that production costs are lower in rural areas—through the relative abundance of labour and land—non-agricultural

The key to better non-agricultural job prospects for the rural population is investment in education and infrastructure.

production could be localized to rural areas but be distributed primarily on an urban market.

To improve employment and income prospects in the non-agricultural sector for the rural population, investment in infrastructure and education stand out as the foremost policy measures. Rural infrastructure development could be aimed at improving the connection to the urban economy and hence facilitate the mobility of workers and goods from the rural to the urban economy. Also, and maybe more importantly, it could be aimed at developing rural centres, towns and small cities to become attractive alternatives to the urban economy—with the agglomeration economies of urban areas but still the comparative advantages of the rural economy.

Rather than attempting to reach the most remote settlements in the hinterlands by improved infrastructure, which can seldom be motivated by cost-benefit analysis, investing in such rural “nodes” could induce people in disadvantaged areas to relocate to more dynamic areas that allows both vibrant agricultural and non-agricultural sectors.

To avoid merely shifting low-productive agriculture employment into low-productive non-agricultural employment, however, any attempts at promoting the growth of RNAE needs also to be accompanied by education of the rural population.

■
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by Christoph Ernst,
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Promoting Youth Employment

Are special youth employment programmes called for, besides general growth and investment climate policies?

Underutilisation of young people on the labour market can trigger a vicious circle of intergenerational poverty and social exclusion.

Youth unemployment often results in social conflicts, violence and juvenile delinquency.

An integrated strategy for growth and job creation needs to cover both labour demand and supply, combined with well-targeted and structured interventions.

Youth employment is an important part of the MDG agenda as developing countries struggle with the challenge of offering decent jobs for the large number of young men and women entering the labour market every year.

What are the recent global labour market trends with regard to the youth?

- Around 1.2 billion people—18 per cent of the world's population—are aged between 15 and 24 years. About 87 per cent of them live in developing economies.
- Youth unemployment is high with a global average of 14 per cent in 2005, i.e. three times higher than the adult unemployment rate. Moreover, young people made up 44 per cent of the total unemployed people in the world despite accounting for only 25 per cent of the working population.
- More than one third of the young people in the world are either unemployed or have completely given up looking for a job or are working but still living below the \$2 a day poverty line. There are an estimated 125 million young working poor at the \$1 threshold, which corresponds to 20 per cent of employed young people in 2005.

In view of this challenge, many governments are investing considerable amounts in youth employment programmes, which complement general poverty reduction and employment policies. The question arises as to what justifies these youth-specific interventions and why is it not sufficient to focus on promoting a favourable investment and business climate?

- Young people face specific challenges in accessing the labour market and

this lowers their chances of finding decent employment. The main difficulties are: (i) a higher chance of losing their jobs during economic downturns, (ii) specific barriers to entry, often stemming from lack of experience, and (iii) path dependence: early unemployment increases likelihood of subsequent unemployment. At the same time, these constraints can be amplified by discrimination based on gender, ethnicity, race, health, or family status.

- Under-utilised young people incur significant economic costs, as the national workforce has not been used to its full potential. Moreover, young people are often more dynamic, more highly skilled and more likely to acquire new skills for new activities in the labour market. It is also mainly young people who opt for migration if they cannot find adequate employment in their own country. Under-utilisation of young people in the labour market can trigger a vicious circle of intergenerational poverty and social exclusion.
- Unemployment causes psychological problems such as reduced self-esteem, discouragement and related illness.
- Employment difficulties of young people often result in social conflicts, such as violence and juvenile delinquency, which, in turn, incur high social costs. Moreover, post-conflict countries have predominantly young populations without a decent job, many of them deprived of education, having grown up in violent societies and have often been combatants themselves.

So what can governments do to promote youth employment? On the **supply side**, a well-linked educational and training

system and closer cooperation between this system and the private sector facilitate a smoother transition from school to work. Often, the educational system does not provide the appropriate labour force needed by the domestic market. As a result of the labour market mismatch, young people's employment opportunities are often limited to the informal economy, which may lead to frustration, or even make them opt for migration, while there are unfilled vacancies in other technical jobs in the country.

Skill development should also include the informal economy. Often, vocational training has to be complemented by remedial education, as many young workers in the informal economy may have dropped out of the educational system at an early stage. Nevertheless, these young informal workers acquire technical skills also in informal activities but, as these skills are often not recognized officially, they face difficulties to have access to better jobs. Recognition and certification of skills acquired through informal channels are key elements in this regard. In addition, young people often do not know which profession to join and where to look for a job. Special youth labour market information and employment services, as well as early career guidance, may facilitate their entry into the labour market and help avoid a mismatch between youth labour supply and demand.

It has been argued that labour market institutions, in particular employment protection legislation (EPL) and minimum wages, increase youth unemployment by making labour too expensive. Yet, recent evaluations and other studies challenge this and do not find a clear impact on young workers. Many young people work in the informal economy, where EPL and minimum wages have a rather limited impact. The question is not whether or not to regulate, but what kind and what level of regulations are appropriate to get the best forms of protection for young people without inhibiting firms from hiring.

With regard to the **demand side**, resolving the problem of youth

unemployment and under-employment requires, on the one hand, growth of salaried employment in the formal economy. This would lead to more jobs for young people and encourage the transition from the informal to the formal economy. On the other hand, the quality of employment—such as productivity, working conditions—in the informal economy should be improved.

Job creation depends primarily on economic growth, which itself depends on investment. A stable macroeconomic environment which boosts investment, private and public, and thus growth, is fundamental for employment creation in general, but it would be of particular benefit to the young people, who suffer most from economic downturns because of their short job tenure and lack of experience.

Sectoral policies can promote job creation in the medium to long-term, promoting private initiatives to create or improve employment in sectors traditionally dominated by the youth or with a high potential for them, e.g. in agriculture, catering and tourism, information and communications technology (ICT), basic and social services, as well as sports. The public sector can also influence youth employment directly through public spending. Employment-intensive investments, such as in infrastructure or construction, will create employment opportunities in sectors dominated by young people.

Entrepreneurship is another way of unleashing the economic potential of young people. The promise of youth entrepreneurship can be maximised through programmes that address the barriers to doing business. Young people face particular challenges because they lack appropriate skills and experience, are less credit-worthy, and have more difficulty in accessing business networks and sources of information. They often struggle with the complex policy and regulatory environment.

Higher volatility and lack of work experience are strong reasons why entrepreneurs often abstain from hiring young people. Wage subsidies and/or reduction in payroll taxes for enterprises

that hire inexperienced young workers seem to be the best options to counter-balance these concerns of the employers and, therefore, increase the demand for young workers.

Youth employment programmes and policies aimed at refining the labour markets dynamics often result in interventions that are fragmented, too narrow or isolated and do not fully take into account the general economic, institutional and social framework.

Inconsistencies may arise in terms of the content of the interventions, their level, the geographical location and the target beneficiaries. Moreover, supply side measures tend to outweigh demand side measures.

Hence, an integrated strategy for growth and job creation is called for that covers labour demand—job opportunities—and supply—employability—as well as the mediation or matching process, combined with well-targeted and structured interventions. There is also need for improved programme monitoring and evaluation as a basis for enhancing effectiveness.

Youth employment policies must be embraced by the broader context of a country's employment and development framework, considering possible crowding-out effects on other age groups.

Decent work for young people requires sustained and concerted action by a wide number of actors. Coherence and coordination between relevant government agencies and other national and international stakeholders is crucial. While not necessarily the only mechanism, the use of national action plans for youth employment can be useful.

These plans need to have a strong and sustained political commitment and be based on broad participation. The participation of the youth in national policy-making processes is key, as they know best what they want and what they can offer. The energy, skills and aspirations of young people are invaluable assets that no country can afford to squander. ■



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