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Development Aid and Employment

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Abstract

Globalization has led to a precarization of labour, which especially manifests in the unstable working conditions, a lower labour share in national income as well as in a growing income inequality, with the exception of some countries with high initial income inequality. The neglect of concern for employment and inequality in the formulation of the Millennium Development Goals (MDGs) in 2000 is noted; the addition of a goal for full employment in a reformulation of the MDGs in 2005 did not lead to a change in focus in official development assistance (ODA). If the growing concern for employment and inequality is taken seriously, a refocus of development efforts is necessary, combining a greater share of development assistance for employment and productivity enhancing activities with a change in national and international economic and financial policies, so as to make employment creation (together with poverty reduction) an overarching goal.

Keywords: employment, inequality, development assistance, development goals

JEL classification: J21, J38, O15, O19

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1 Introduction

Employment, especially decent and productive employment, has recently become more topical in the world of development and development co-operation. A recent indication of this are the events related to the 'Arab Spring' of 2011. In only a few months various Arab regimes have been toppled by a population, not only wanting more democracy, but perhaps even more importantly, especially by educated youth, wanting good jobs and the prospects of advancement in life. Yet this turmoil took place in countries which scored well on progress in the by aid donors much hailed Millennium Development Goals (MDGs) (see Table 1).

Table 1: MDG progress ranks and other indicators, selected countries

Country	MDG progress rank 2010	Youth unemployment 2009	GDP pc 2008	pc GDP growth 1970-2008	Inequality
Egypt	6	24.7 (2007)	1991	2.5	32.1
Tunisia	1	30.6 (2005)	3903	3.1	40.8
Jordan	6	26.9	3596	1.6	37.7
Brazil	5	15.5	8205	2.2	55.0
Vietnam	6	4.6 (2004)	1051	4.2	37.8

Source: CGD (2011), ILO (2011).

Tunisia and Egypt, as well as Jordan, are among the eight best performing countries with respect to progress in the MDGs. However despite this progress on Human development, youth unemployment was higher than in other countries, such as Brazil, and Vietnam, with different levels of development but similar achievement in MDG progress to these Mediterranean countries.

After the change in regimes in various Arab countries in the spring of 2011, the leaders of UNDP and other development agencies quickly retorted that something must be done about employment. Helen Clark, the administrator of the UNDP, declared in an article entitled 'Jobs, Equity and Voice: Why Both Economic and Political Inclusion matter in the Arab world' (*Huffington Post*, 7 April 2011) that:

> Inclusive growth in the middle income countries in the Arab States region must also include strategies to generate decent jobs in higher value-added sectors, for which revamped tertiary education and skills training can educate people. The mismatch between the supply of university graduates and the type of jobs available is deeply dispiriting for those who cannot find suitable work.

However it was not only in the context of the events unravelling in the Arab world that the view that employment had to become one of the major aims of development, if not the major aim, was increasingly expressed. The devastating earthquake in Haiti engendered a massive increase in aid. Yet in a review of developments in Haiti, Fukuda-Parr (2009) argues that in delivery of aid to Haiti all efforts were concentrated on humanitarian aid and longer-term provision of social services, but that the aid donors had little or no understanding of the need to stimulate jobs and growth as a means of advance for the population in general.

> While social investments are important, they are not sustainable without investment in the productive base of the economy. Social services are essential for the fulfillment of human rights to education, to healthcare, and social security and a massive investment in these sectors is still needed. But the current allocations are unbalanced; economic growth is needed for the fulfillment of the human rights to housing, to food, and productive work. The growth pillar of the national poverty reduction strategy (DSNCRP or PRSP) is only financed by 20 per cent and is not included in the programmes of major donors such as the UN system.

It should be recalled that employment issues were notably absent from the MDGs when these were formulated in 2000. In a recent volume on employment, and inequality,[1] Mkandawire (2011) and Amsden (2011) argue that the neglect of attention to employment issues resulted from too much focus on poverty alleviation.

Amsden (2011) remarks that:

> To slay the dragon of poverty, deliberate and determined investments in jobs above starvation wages must play a central role, whether for self-employment or paid-employment. The grass roots approach to solving poverty doesn't go far enough, because it aims only at improving the supply side of the labour market, making job seekers more capable, and not the demand side, making new jobs available for them. It acts as though new ways of earning a living emerge (at a positive wage) simply because the supply of job seekers is better clothed, housed, and fed, or enjoys more human rights—which is the same fallacious reasoning behind Say's Law… Employment generation is different from poverty alleviation because it has a concept behind it, 'capital'. This means that the labour market is influenced by, and influences, all flows through the savings-investment nexus, including accumulation, distribution and innovation. It is at the heart of political conflict. Multi-faceted policies, therefore, are required to promote employment growth, from fiscal and monetary, to industrial and trade. Poverty alleviation has its policy rages, too, but they're more confined, outside the capital accumulation process. Still, the co-ordination of policies to create employment in the Third World's most impoverished regions is not impossible even if it is multifaceted. Excellent work in the 1970s was produced on the subject, only to be shelved in the 1980s for political reasons.

Mkandawire (2011) concurs in observing that:

> Politically underpinning this has been the social differentiation since independence and the accompanying ideological shifts that have contributed to the shift in focus of state policies away from social and employment policies.

Amsden proposes therefore:

> … to revolutionize foreign aid by tying it to jobs. For every dollar spent on poverty alleviation, a dollar should be spent in the poorest regions on employment creation,

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1 van der Hoeven (2011).

following the lead in rural employment generation established by China and Taiwan. Some aid donors could concentrate on the investment part of the project and other donors, with hands on experience in business, could provide technical assistance on what is likely to work. Instead of buying a US$100 laptop computer, developing countries could start competing with a US$95 dollar one'

However, five years after the formulation of the Millennium Development Goals, the World Summit 2005 outcome document contains a reference (paragraph 47) to employment issues:

> We strongly support fair globalization and resolve to make the goals of full and productive employment and decent work for all, including for women and young people, a central objective of our relevant national and international policies as well as our national development strategies, including poverty reduction strategies, as part of our efforts to achieve the Millennium Development Goals. These measures should also encompass the elimination of the worst forms of child labour, as defined in International Labour Organization Convention No. 182, and forced labour. We also resolve to ensure full respect for the fundamental principles and rights at work.

This paragraph in the 2005 Summit Outcome document led to the inclusion of a new sub-goal in 2007 (under MDG1):

> Achieve full and productive employment and decent work for all, including women and young people, with four indicators:

i) Growth rate of GDP per person employed;

ii) Employment-to-population ratio;

iii) Proportion of employed people living below US$1 (PPP) per day; and

iv) Proportion of own-account and contributing family workers in total employment.

This addition has been welcomed by organizations like the ILO, NGOs, trade unions and various governments as it could give these organizations a handle to bring employment issues more forcefully into the discussion of development, development goals and aid delivery. However some criticize the inclusion of a goal for full employment, as it is not easy to measure and thus deviates from the intentions behind the original MDGs (Vandemoortele 2011).

Such criticism though reflects the somewhat ambivalent role the MDGs are playing, in the current development discourse, namely that originally the MDGs were designed to set, measure and monitor goals for some important aspects of development, without prescribing a concomitant development trajectory, so that all countries could agree with the goals without being obliged to adhere to the same policy prescriptions; something developing countries had become very wary of since the introduction of the structural adjustment policies in the 1980s and 1990s. Yet, despite the intention of not having an underlying prescribing development theory, the MDGs have paradoxically led to a situation where those issues that were not explicitly mentioned in the MDGs, like employment, consequently received less attention from the development aid community as a result.[2] So in that respect it is understandable and justifiable that full employment has been added as one of the (sub) goals of the MDGs.

But this leaves many questions open as to how to implement the goal. In recent discussions there has been a growing consensus that, although the goal of full employment has now been established, too little co-ordinated effort has been undertaken to achieve it. For example, a recent review of the MDGs (UNDG 2010), five years after the inclusion of the (sub) goal of employment in the MDGs, reports on the progress or regress in employment issues globally as well as in some countries by means of a number of employment indicators. It also gives 18 narratives of how particular development projects have contributed to more or better employment in individual countries. The examples include successes of employment schemes, training schemes for entrepreneurs, training schemes for unemployed youth, improved collective bargaining, social security etc. However looking at the different examples chosen in this review, it is not always clear how development aid in general has contributed to more and or better employment. Most of the examples do not make use of any counterfactual analysis or even mention whether other schemes *mutatis mutandis* were also contributing to employment creation.

Notably absent is any macro analysis of the effects of total volumes of aid on growth and its possible impact on employment. It thus remains difficult to distil from the 2010 outcome review how successful development and development aid efforts have been in respect to creating more and better employment. It remains equally difficult to distill from the DAC statistics how aid flows in general have contributed to employment creation.

What statistics[3] have made clear is that the share of ODA commitments for the social sector (3-year moving averages) has greatly and steadily increased: from 16 per cent in 1990 to 34 per cent at the time of the introduction of the MDGs in the year 2000 to over 40 per cent in 2008, mainly driven by substantial increases in the share of ODA commitments to government and civil society and to a lesser extent to health, education and population programmes (Figure 1). Commitments to economic, to production activities as well as to multi-sectoral activities all declined over the same period. In all major developing countries groupings ODA commitments to social sectors were 42 per cent or higher in 2009 (Figure 2).

These ODA statistics relate to the traditional ODA donors. New donors like China and India almost certainly have a higher share of their aid in infrastructure, transport, mining etc. (Figure 3) (see also *The Economist*, ‘Charity begins abroad, new sources of aid’, 13 August 2011). These aid flows and projects may in the long-run add to new capacity and to greater generation of jobs, although in the short-run the employment effects might be quite limited or even offset domestic employment creation, as projects are often undertaken by contractors and even by temporary imported workers from these donor countries. These flows are currently still considerably smaller than the flows from the traditional DAC countries, but are increasing faster than traditional ODA and therefore in the future may change the current trend of ODA, which is increasingly benefitting the social sectors.

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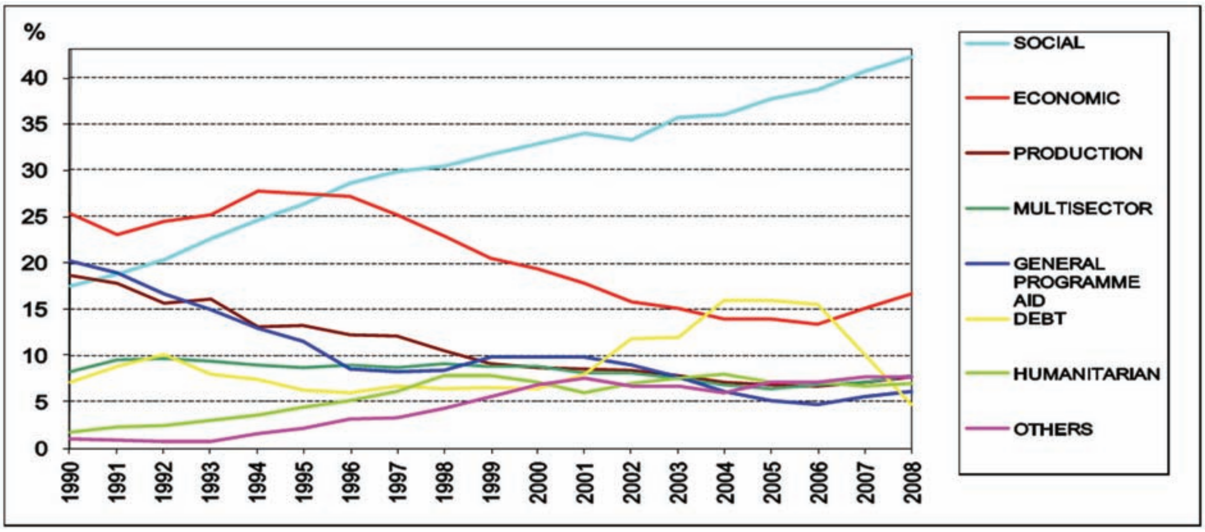
[2] A recent example, for instance is the way DFID has analysed the ‘effectiveness’ of different UN organizations.

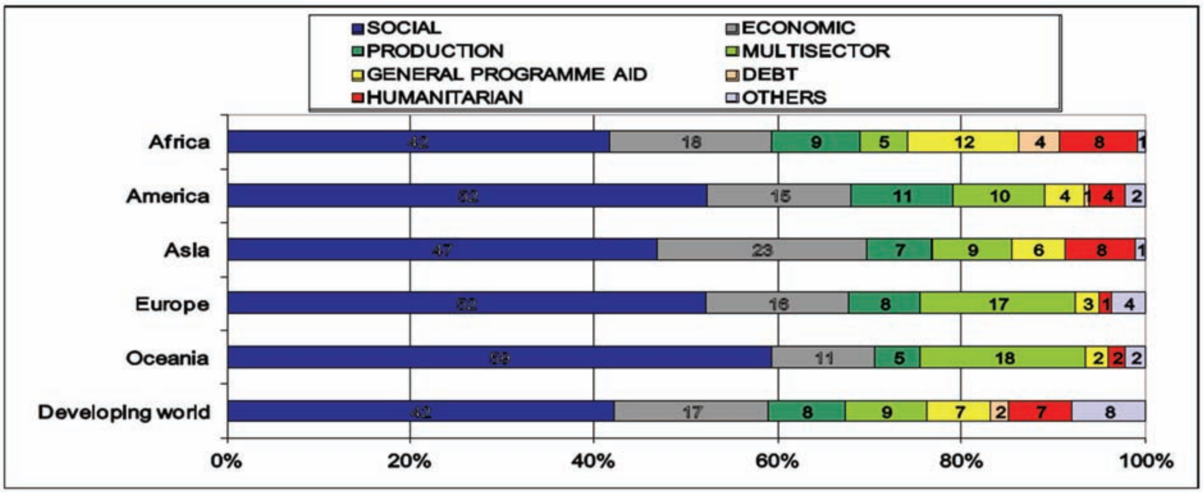
[3] (OECD DAC online, consulted 13-09-2011).

Figure 1: ODA to developing countries by sector: ODA by sector since 1990 (as a percentage of total ODA, 3–year average commitments



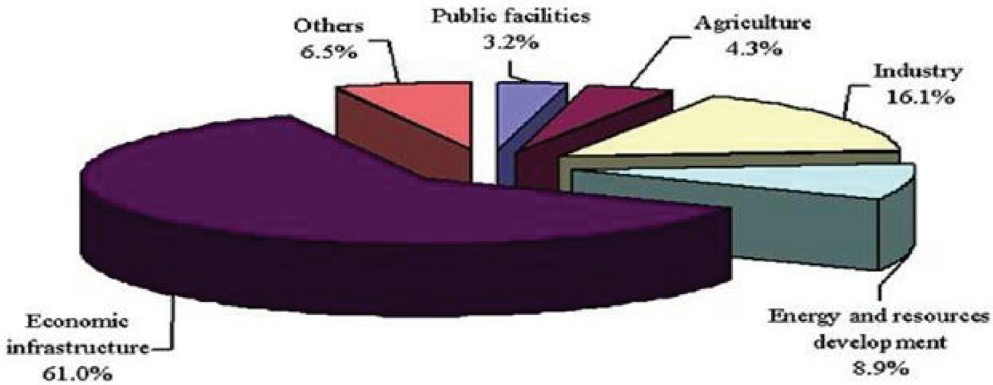
Source: OECD-DAC secretariat online database; © OECD.

Figure 2: ODA to developing countries by sector: ODA by region and by sector in 1990 (as a percentage of total ODA committed for each region



Source: OECD-DAC secretariat online database; © OECD.

Figure 3: Sectoral distribution of concessional loans from China (by end of 2009)



Source: Information Office of the State Council, The People's Republic of China, 2011. *China's Foreign Aid,* Figure 1 April 2011, Beijing.

These changes in sectoral allocation cannot prima facie be taken as an indication of whether more or less attention is paid to employment in development aid. Aid programmes to the social sectors could, on the one hand, by increasing human capital and governance, very well contribute indirectly to increases in the quality of employment and to increased employment creation, but, on the other hand, by shifting resources away from investment in infrastructure and capital they might well lead to reduced growth of production and thus lower employment.

Hence we have to decompose the question of development aid efforts for employment into the following string of questions. Does aid contribute to growth and poverty alleviation? Does growth contribute to employment creation? And can aid interventions, while contributing to growth, be made to contribute more specifically to employment creation? Related to the first question, there is currently a debate as to whether aid in general does contribute to growth (Arndt et al. 2010). Furthermore, in the current context of integrated markets and globalization, it is not helpful, to discuss the effectiveness of aid in the absence of considerations of related issues of international governance and coherence in development and other policies.[4]

This paper discusses therefore first, how globalization is leading to more precarious forms of work through an overview of some major employment trends over the last 20 years,[5] this is followed by a discussion of which (national and international) employment policies seem to be warranted in the light of these trends of precarization. A final section discusses how development aid can support these employment policies.

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4 The examples of the negative effects of cotton subsidies in the USA on cotton farmers and workers in Mali and of the deindustrializing effects in developing countries of the economic partnership programmes (EPA) proposed by the EU. See South Centre (2012) *The EPAs and Risk for Africa, Local Production and Regional trade,* SC/TDP/AN/EPA/30, Geneva.

5 We will therefore not look at the effects on employment of development aid in developed or donor themselves, although this may be an important issue in the political discourse on development aid.

2 Employment trends[6]

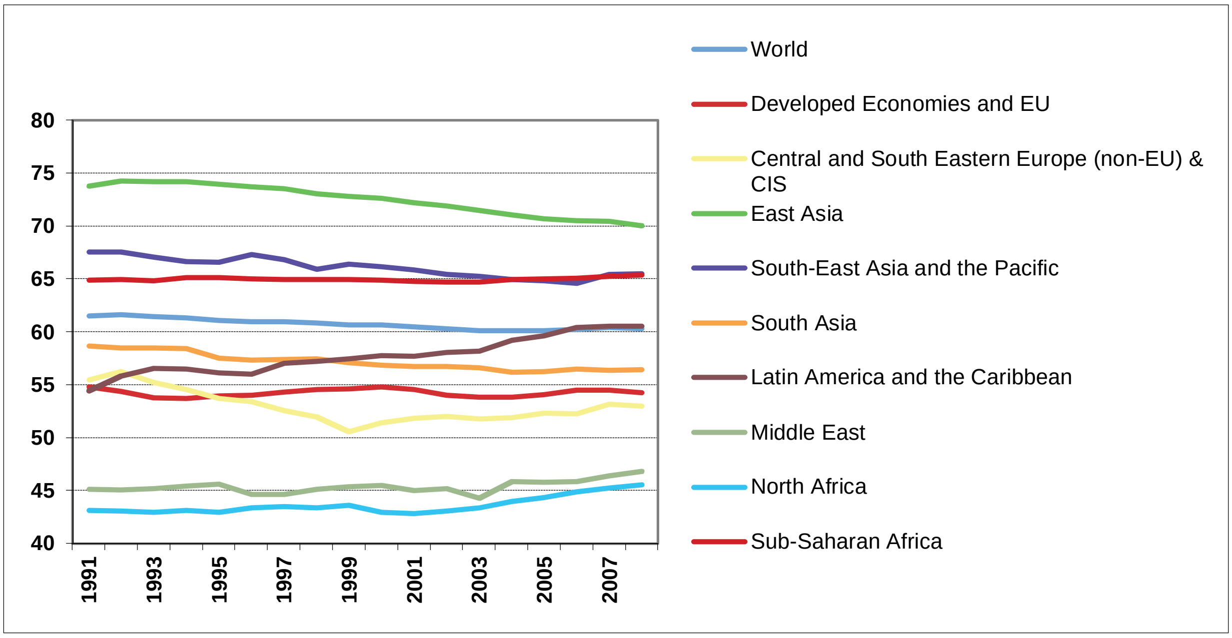
The ongoing process of globalization has resulted in many countries in a growing precarization of labour,[7] which we illustrate through six labour market trends:

1. declining employment population ratio,
2. the increase in service employment,
3. the continuing high share of workers in the informal economy,
4. the declining wage share and greater income inequality,
5. growing importance of multinational enterprises and
6. the growing number of migrant workers in industrialized countries.

2.1 A decline in the employment to population rate for most regions in the world

For the world as a whole, the employment-to-population ratio seems to have remained rather constant, but there are important regional differences. All three Asian regions (East, South-East, and South) (73.8, 67.5, 58.7 per cent, respectively) and sub-Saharan Africa (SSA) had the highest employment-to-population ratio at the beginning of the 1990s, but experienced declines by several percentage points between then and 2009 (Figure 4).

Figure 4: Employment to working age population ratio 1991-2008: various regions in the world



Source: ILO, Trends Econometric Models, July 2010.

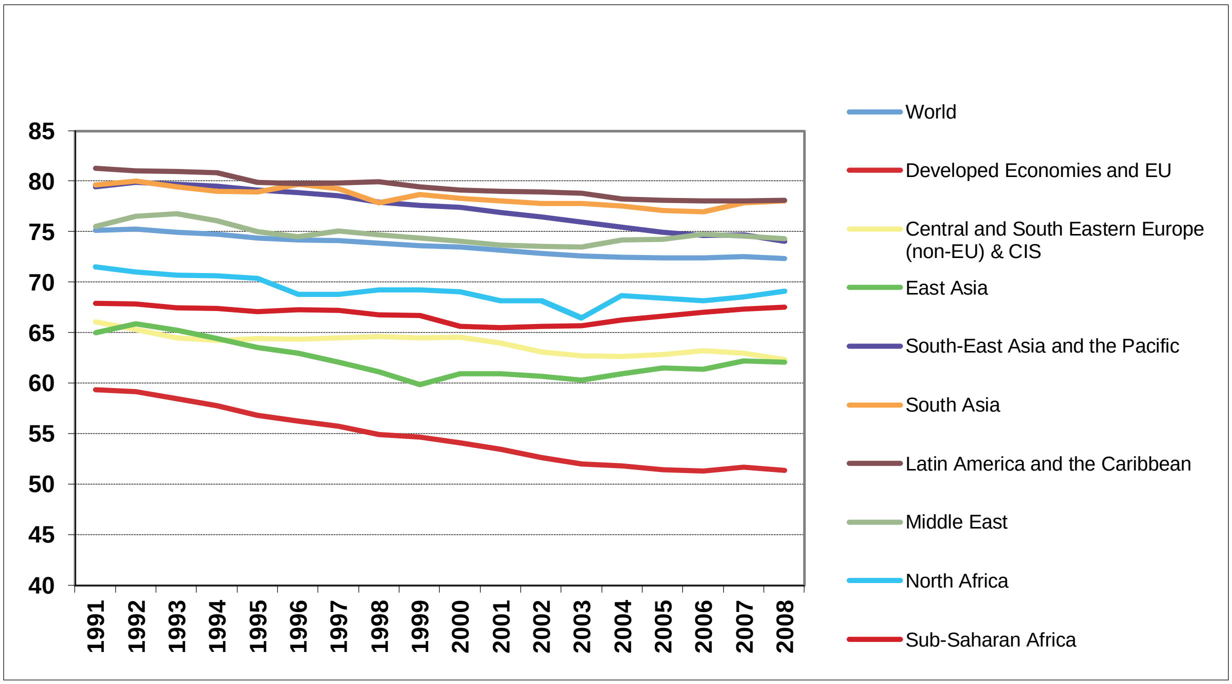
In contrast, the employment-to-population ratio increased slightly from much lower levels in the Middle East, North Africa and Latin America. The lower employment-to-population level in these regions at the beginning of the 1990s can be explained by (very) low female labour

6 This section draws on van der Hoeven (2010).

7 See for example recent issues of the *World of Work* report published annually by the ILO.

force participation. At the global level, we notice two opposing trends, namely an increased ratio for female labour force participation and a decline of male participation (Figure 5). The first trend can be ascribed to changes in customs and norms, and the second one more to deterioration in employment opportunities as consequence of globalization.

Figure 5: Male employment to working age population ratio 1991-2008: various regions in the world



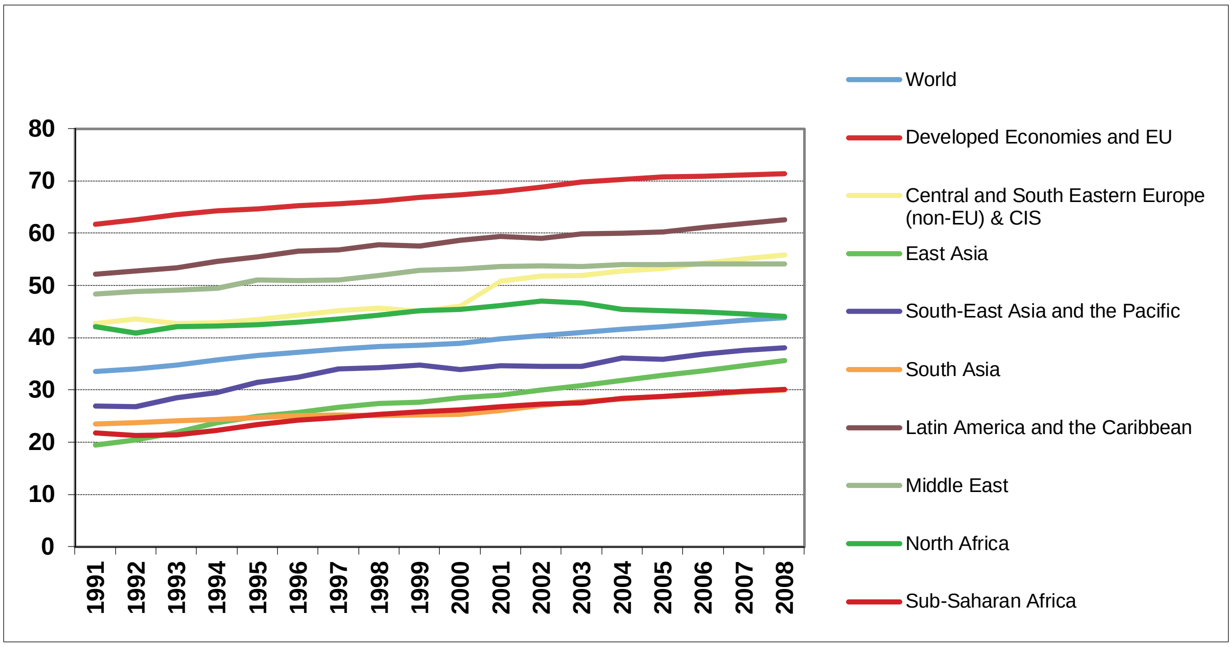
Source: See Figure 4.

2.2 Changing pattern in production

For the world as a whole, the percentage of employment in the service industry has risen from 33.6 per cent in 1991 to 43.8 per cent in 2008. A high service sector share in employment already prevailed in developed countries, the Middle East, and North Africa where we consequently see small increases of around 9.5, 2.5, and 2 percentage points, respectively. However a massive increase in this share took place in East Asia, where it almost doubled from 19.5 to 35.7 per cent, and in South Asia, where it increased from 23.6 to 30.1 per cent (Figure 6).

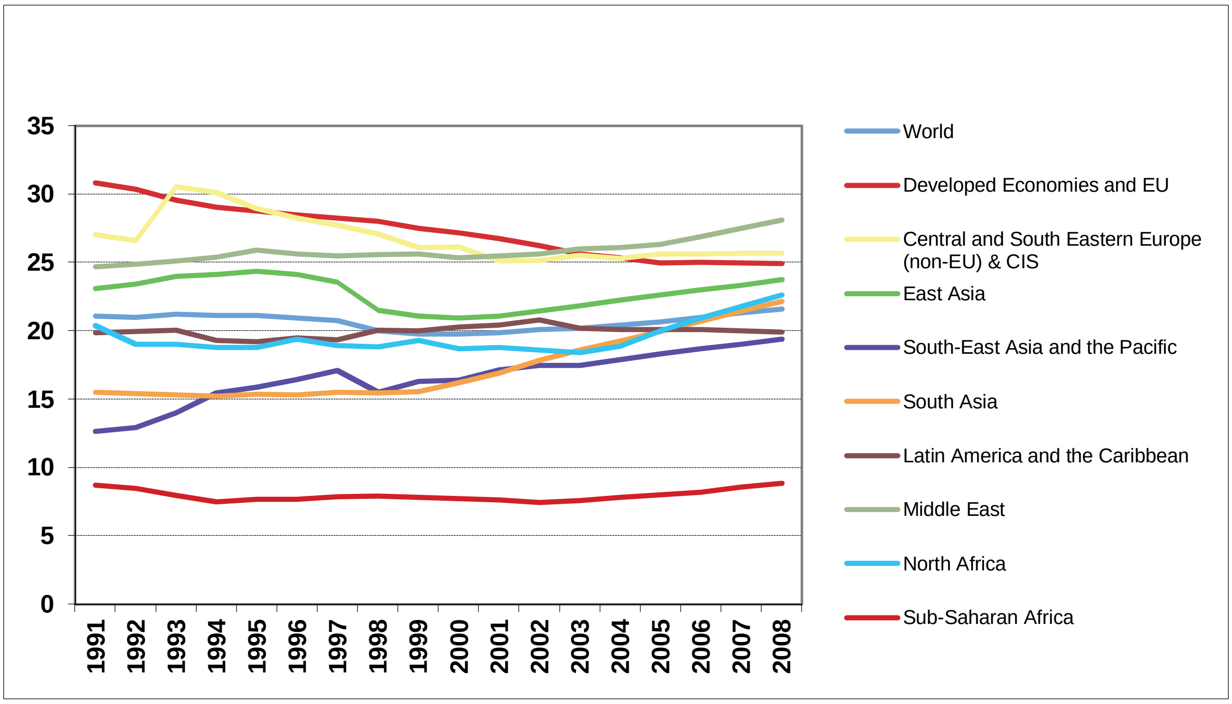
Some analysts interpret the increase in the employment in the service industry as an indication of post-industrial society and as such an important indicator of progress in development. This fails to recognize that the service industry encompasses a wide range of activities, from hawking and peddling in the street to sophisticated financial services. Therefore a better indicator of development for developing countries is the size of the manufacturing sector. Here we notice differing trends over the last two decades (Figure 7). At the world level, the share of employment in industry has hardly changed between 1991 and 2008, remaining at 21.5 per cent. But there are again important regional differences. The most dramatic increase is in South-East Asia and the Pacific, where the share increased from 12.7 per cent in 1991 to 19.4 per cent in 2000, and in South Asia where it increased, over the same period, from 15.4 to 22.4 per cent, thereby almost reaching the share in East Asia,

Figure 6: Percentage employment in services 1991-2008: various regions in the world



Source: See Figure 4.

Figure 7: Percentage employment in industry 1991-2008: various regions in the world



Source: See Figure 4.

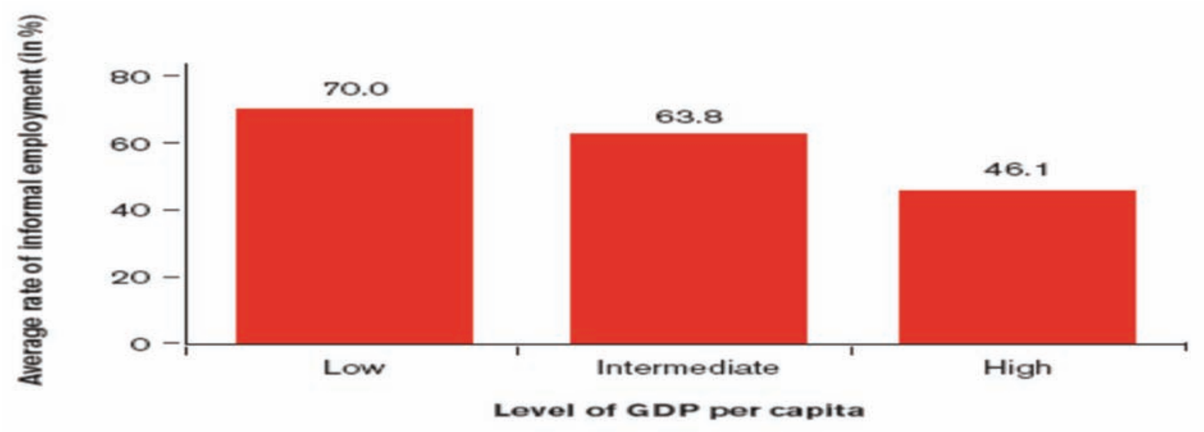
where the share has remained more or less constant over the period (around 23.5 per cent, with a dip of 3-4 percentage points around 1998 due to the Asian crisis). Noticeably are the very low and stagnant share in SSA (at around 8.5 per cent) and a declining share in North Africa.

It should be noted however that the share of employment in industry could even underestimate the level of progress in industry. As Rada and Taylor (2006) note, industry often has high productivity (or a low employment value-added elasticity). An important issue is therefore not only the size of employment in industry but also how the surplus generated in the industrial sector is used for reinvestment and how it is distributed in the rest of the economy.

2.3 The increases of non-standard forms of employment

In developing countries, the important element of precariousness is most clearly manifested in the existence of a pervasive 'informal sector' in the economy or the 'informal economy'.[8] This phenomenon is not restricted to poor developing countries, as Figure 8 shows.

Figure 8: Informality and economic development



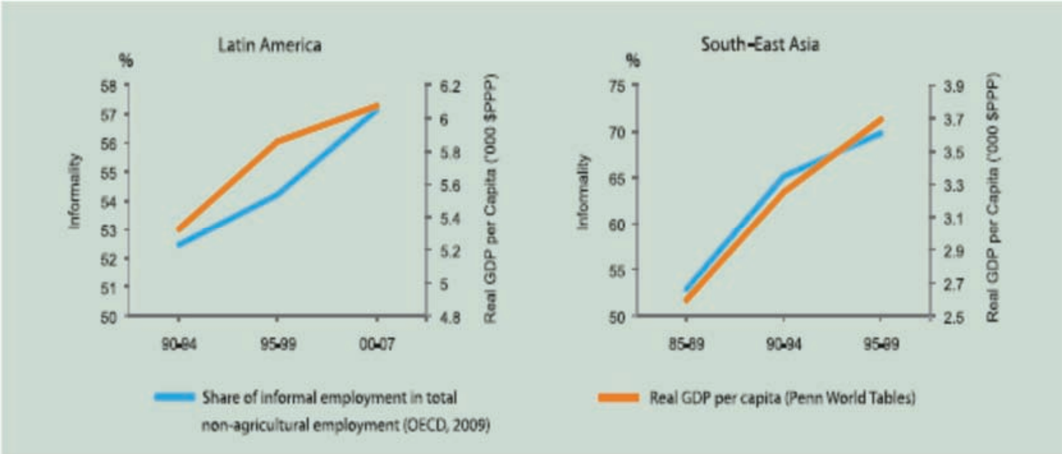
Note: The graph plots deciles of GDP per capita levels (in PPP) against the average size of the information sector in the informal employment database used in IILS informality database.

Source: ILO (2009).

The existence of the informal economy is partly related to the changes in the structure of employment: especially for the poorer regions, the increase of employment in the service sector reflects an increase in the share of workers engaged in informal activities. Figure 9 indicates clearly this pervasiveness of the informal sector in Latin America and Southeast Asia. Despite increases in per capita income in these regions, quite substantial in the case of Asia, the size of the informal sector has not declined, but rather increased.

8 It has become common to speak about the 'informal economy' rather than the 'informal sector', as increasingly informal activities take place within established enterprises. It would thus be a misnomer to continue to speak about the informal sector.

Figure 9: Informal employment and GDP in Latin America and South East Asia



Note: Graphs based on un-weighted averages of countries in OECD (2009).

Source: UNDP (2008: 8).

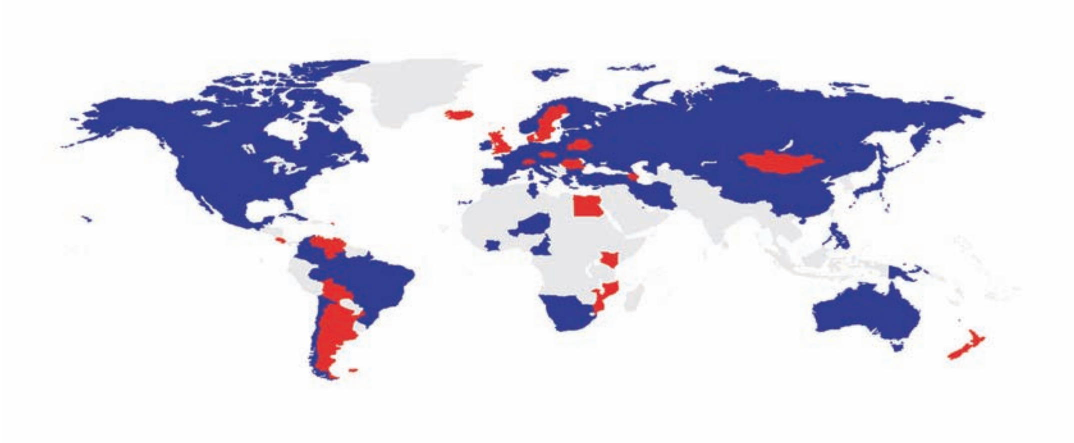
There are however contradictory explanations of the pervasiveness of the informal sector. Some (e.g. Maloney 2004) argue that the size of the informal sector is determined by the degree of labour market inflexibility. According to them, the more inflexible the labour market, the greater the preference of employers to avoid employing workers formally and the more an inclination to act informally. Others (e.g. Kucera and Roncolato 2008) argue that the major cause of the informal sector activities is the lack of formal jobs. This interpretation has gained ground in ILO, OECD, and other UN organizations.

There is evidence of a clear link between the increase in non-standard work and income inequality (Rani 2008), mainly due to widening wage differentials between standard and non-standard jobs. Some would explain this by the low education level of those engaged in the informal sector, as statistics show. But it is most likely the type of job rather than the educational attainment, which drives inequality. An increase in education levels will result in better educated workers in the informal economy without a major decline in wage inequality in the absence of newly created formal jobs.

2.4 A declining wage share and the growing wage inequality

ILO (2008) reports that the wage share declined over 1995-2007 in two thirds of the developing countries, including the major ones, as well as in the major developed countries (Figure 10). The only exception was the Latin American region, where some countries witnessed an increasing wage share. The ILO report attributes the declining wage share to increasing trade and globalization and confirms earlier research findings (see Diwan 2001 and Harrison 2002) that, contrary to the conventional wisdom that sees the labour share in GDP as relatively constant, the proportion of GDP that goes into wages and other labour income varies over time. Using a data set from 1960 to 1997, Harrison (2002) splits her sample (of over 100 countries) into two even groups (based on 1985 GDP per capita). Her data show that, in the group of poorer countries, labour's share in national income fell on

Figure 10: Increasing and declining (75% countries) wageshare 1995-2007



Source: ILO (2008).

average by 0.1 percentage point per year from 1960 to 1993. The decline in the labour share accelerated after 1993, to an average decline of 0.3 percentage points per year. In the richer sub-group, the labour share grew by 0.2 percentage points prior to 1993, but fell by 0.4 percentage points per year since then. Thus there was a trend reversal for richer countries post-1993, and an acceleration of an already downward trend for the poorer sub-group.

Harrison (2002) tested for factors that could explain changes in labour shares, combining detailed national accounts data from the United Nations with measures of trade openness, capital account restrictions, and capital flows. Overall, the results suggest that changes in factor shares are primarily linked to changes in capital/labour ratios. However, measures of globalization (such as capital controls or direct investment flows) also play a role. Harrison found that frequent exchange rate crises lead to declining labour shares,[9] suggesting that labour pays a disproportionately high price when there are large swings in exchange rates (i.e., wages are more severely affected than GDP). Capital controls are associated with an increase in the labour share, an effect that Harrison attributes to the weaker bargaining position of capital vis-à-vis labour, if the cost of relocating production increases with capital controls. Foreign investment inflows are also associated with a fall in the labour share. The weak bargaining position of labour in contexts of open capital accounts is also a causal mechanism explored by Lee and Jayadev (2005). They find that financial openness exerts a downward pressure on the labour share both in developed and developing countries for the period from 1973 to 1995. Harrison also finds that increasing trade is associated with a fall in the labour share. This result is robust across specifications. These results point to a systematic negative relationship between various measures of globalization and labour's share in GDP.

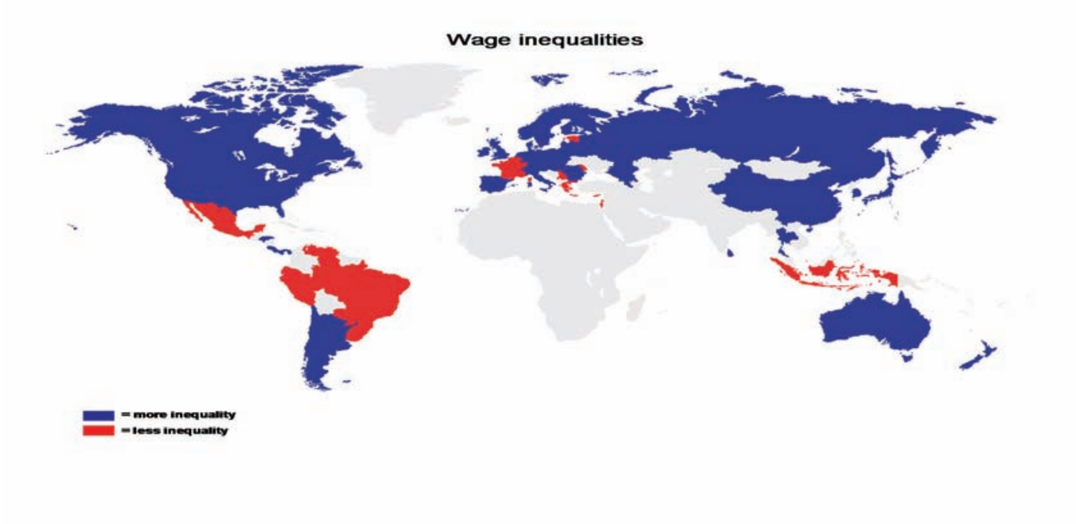
Diwan (2001) reports, based on a large sample of countries, an average drop in the labour share of GDP in each crisis of 5 percentage points, and a modest catch-up thereafter. In the three years after the crisis, labour shares were still 2.6 percentage points below their pre-crisis average. Given the fact that most countries have undergone more than one crisis, the cumulative drop in the wage share over the last 30 years is estimated at 4.1 per cent of GDP, and is especially large for Latin America, where the share dropped by 6.7 per cent between the 1970s and the 1990s. The overall decline in the labour share is partly explained by what

9 Labour shares decreased with a real devaluation but in the recovery did not return to pre-devaluation levels.

some call the ratchet effect: After an economic shock or a financial crisis, the labour share in gross national income decreases and does not recover when national income recovers (van der Hoeven and Saget 2004).

However not only has the inequality between wages and other components of gross domestic product increased, but the distribution among wage earners has also worsened. The ratio of the average wage of the top ten per cent wage earners in relation to the bottom ten per cent is found to have increased in seventy per cent of the countries (Figure 11). Here also, one notices similar regional differences, an almost uniform pattern for most regions, but a mixed pattern for Latin America.

Figure 11: Growing inequality in 70% of countries, inequality between top and bottom wage earners has increased since 1995

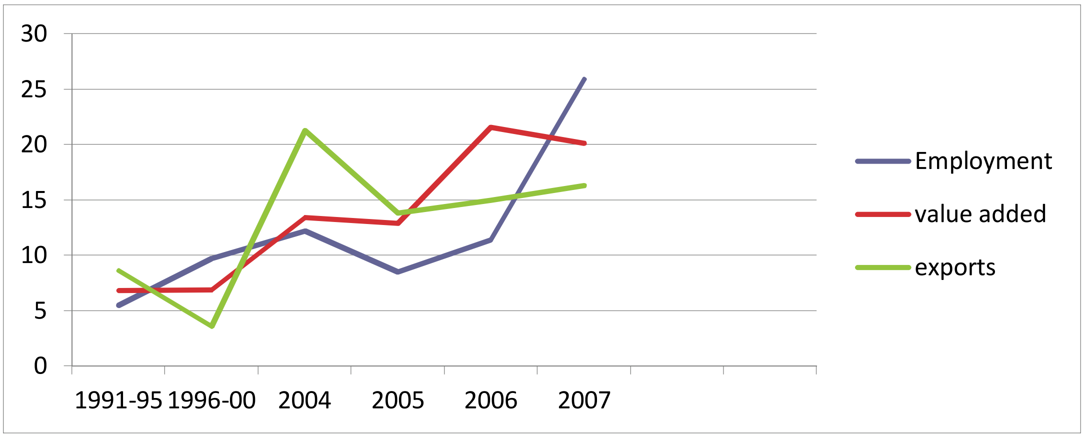


Source: ILO (2008).

2.5 The internationalization of the production process

Today there are some 82,000 transnational corporations (TNCs) with 810,000 affiliates in the world. These companies play a major role in the world economy. For instance, exports from foreign affiliates of TNCs are estimated to have grown from about a quarter of total world exports of goods and services in 1982 to one-third in 2007. And the number of people employed by these corporations has increased fourfold since 1982, standing at about 77 million in 2008, implying a much faster rate of growth than that of the labour force. These TNCs are dominated by a smaller number of large firms. The largest 100 TNCs account for 11 per cent of all employment in TNC and for about 4 per cent of world GDP. Over the last 15 years, the largest TNCs have undergone a rapid process of internationalization (Figure 12). There has also been a progressive increase in the proportion of companies operating in the service sector and of TNCs based in developing countries (UNCTAD 2009: 17-18).

Figure 12: Annual growth of employment, value added and exports, transnational enterprises, 1986-2007



Source: Figures based on UNCTAD (2009: Table 1.6).

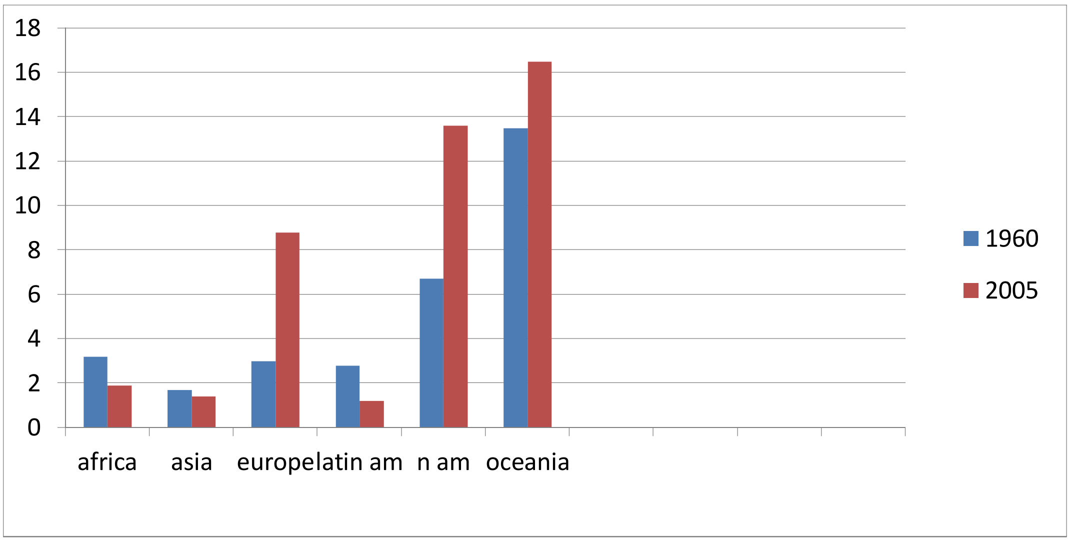
2.6 International migration

Global figures of migration do not show a substantial change: in 1960 the stock of total migrants in the world population was 2.7 per cent and in 2005 this percentage had not changed.[10] This has led some commentators to argue that globalization is characterized by increased capital flows and increased trade and service flows but not increased labour flows. However this characterization is misleading. If one looks at more disaggregated (by region) figures, one clearly sees a growing trend in some regions. In Europe, the stock of migrants as part of the population increased from 3 per cent in 1960 to 8.8 per cent in 2005. The same ratio increased from 6.7 to 13.6 per cent in Northern America, from 13.5 to 16.4 per cent in Oceania, and from 4.9 to 37.1 per cent in the Gulf States. By contrast, the ratio of the stock of migrants to the local population declined in Africa, Asia and Latin America as a whole (Figure 13). The increase in the share of migrants in the local population in developed countries is quite substantial; despite the severe restriction most of these countries have put on inward migration.

This increased level of migration is leading to tensions in receiving countries but is providing an increasing source of foreign exchange for the sending countries. Figure 14 indicates that for many developing countries remittances represent a much larger flow than development assistance. For example, in East Asia and the Pacific in 2007, in per capita terms, remittances stood at US$34 per capita compared with US$5 ODA flow. Analogous figures for Latin America and the Caribbean are US$114 and US$10, and for South Asia US$33 and US$6. Only in SSA, was the per capita inflow of remittances (US$26) lower than that of ODA (US$39).

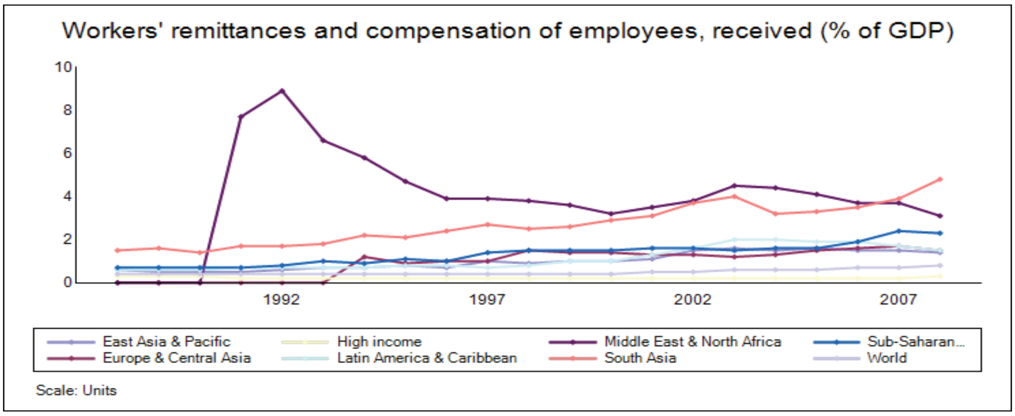
10 This figure excludes the former Soviet Union as after the independence of the former soviet republics remaining soviet citizens are counted as migrants.

Figure 13: Migrants as percentage of population



Source: UNDP (2009), Statistical Annex Table 1.

Figure 14: Workers remittances as % GDP, various regions, 1988-2007



Source: World Bank (2009).

Using a broad definition, the World Bank estimates that remittances to developing countries amounted to US$166.9 billion in 2005, compared to US$85.6 billion in 2000 and US$31.2 billion in 1990 (World Bank 2005: 88). Remittances are not only a rapidly growing source of external finance, but they are generally steady across years and not prone to sudden reversals of direction (Sirkeci et al. 2012). They tend to be counter-cyclical to crises in developing countries (i.e. migrants send more money home to support their families) and hence help to smooth consumption volatility.

2.7 Conclusion

The trends described above all point to a growing precarization of labour. This is especially the case for the decline in labour participation rates in many regions, the declining wage share and the growing wage inequality, as well as the continuing informalization of the labour force and the slow progress of structural change in many countries. Growing employment in multinational enterprises and their subsidiaries as well as growing in migration in some areas of the world and growing workers remittances have not been able to arrest the growing precarization.

3 Policies for employment creation

In the light of the trends just elucidated, particularly the 'precarization' of the labour market, we briefly discuss national policies as well as types of enabling international environment which are conducive to employment creation, in order to pave the way for the discussion on the nature of development aid interventions which might support such policies.

In discussing (national) policies for employment creation, it is important to distinguish between short-term (macroeconomic) policies and longer-term structural policies. The first basically should strive[11] for full capacity utilization, so that all productive forces, including labour, can be fully engaged in the production process, while the second should strive for the expansion of capacity and an increase in the employment content of growth, to the extent that increasing the employment content of growth does not jeopardize growth itself. (Or at least that it does not jeopardize growth to such an extent that the economy arrives at a declining growth and employment trajectory.)

It should be noted that this distinction between the short-term and long-term policies for growth and employment creation were very much on the mind of the original architects of the Bretton Woods system in 1945, to the extent that the IMF and emergency funds of the UN were responsible for assisting and guiding shorter term policies and the World Bank and the specialized agencies of the UN for longer-term policies. However since the debt crisis of the 1980s and the ensuing structural adjustment policies (now labelled Poverty Reduction Strategies), the picture has become more complex. However in order to get a clear picture how different elements of development aid could better contribute to employment creation it is better in the first instance to maintain the analytical distinction between the short term and long term.

Although the question of the relation between development aid and employment was posed in the terms of employment, it is also important to qualify the term employment.

In assessing outcomes of employment policy it is necessary to consider not only the quantity of employment but also the quality of employment, as in poorer countries most people cannot afford to be unemployed and have to be engaged in whatever survival mechanisms are possible. Statistics show that people in higher income classes have higher unemployment rates than people in poorer income classes (Ghose et al. 2008). Hence we have to introduce some quality considerations. Often quality of employment is measured either by whether incomes among the self-employed or wages among employees exceed a certain level, or by the existence of a minimum level of secondary benefits such as social security and access to legally binding employment contracts. A combination of these three measures is also often applied. Terms used to describe those with adequate quality of work then are 'good jobs', 'decent work' or whether a worker or self employed person belongs to the 'working poor' or not. So it is necessary to consider both employment creation and the quality of employment when assessing how development aid contributes to employment creation.

[11] It may not be possible to get full use of all productive forces given fixed factor proportions in the short run.

3.1 Shorter-term policies for employment creation: some illustrative examples

In developed countries policy debates on employment over the last 30 years have been dominated by the so-called NAIRU, the Non-Accelerating Inflation Rate of Unemployment.[12] Given that many governments put the control of inflation as the most important instrument of short-term macroeconomic policy, the NAIRU becomes the target unemployment rate. A major problem with the NAIRU, however, was and is that it varies substantially, between 3 and 7 per cent in the USA, and another is that the NAIRU is subjected to hysteresis: after a period of (financial) crisis the NAIRU is estimated to be higher than before the crisis (Ball 2009). This has led to too slow and too limited macro-policy reactions to increasing unemployment in many developed countries. The influence of the NAIRU, and the dominance of inflation corrections rather than employment creation as the principle aim of macroeconomic policy, has also taken hold in policy prescriptions for many developing countries (Freeman 2007). In this section we will therefore argue, through three examples, that such a policy stance is not appropriate and that greater concern for employment creation is good macroeconomic policy.

The first example of short-term policies for employment creation is in the realm of macroeconomic policy. The World Bank has over the last years become more concerned with growing inequality and has devoted various research publications to this. One example is a study on monetary and exchange rate reforms (Conway 2005). It opens with a reference to the so-called ‘policy trilemma’ of international economic policies (see Mundell 1963; Cohen 1993; Obstfeld et al. 2004). This states that national economic policy space is circumscribed by the impossibility of pursuing the following three policies simultaneously: open capital account, fixed exchange rates, and independent monetary policy. The trilemma posits that only two out of these three policies can be combined. For example, under a system of an open capital account and fixed exchange rates, countries cannot pursue an independent monetary policy, for example to stimulate employment growth, since interest rates are determined by world interest levels. Conversely, if countries need to undertake an independent monetary policy, they have either to revert to flexible exchange rates or opt for a closed capital account.

The policy restrictions posed by this trilemma do hamper policies for full employment. But the policy trilemma, which has guided policy makers for several decades, and is still guiding a majority of macroeconomists, can be relaxed by avoiding the rigid two-corner solutions referred to above, for example by looking beyond the traditional opposing alternatives of fixed versus flexible exchange rates, or open versus closed capital accounts, to adopt intermediate options in these three policy domains—like a capital account management through the selective application of capital controls, or a managed real exchange rate (see Bradford 2004).[13]

Although, much like any other policy instrument, capital controls have, much like any other policy instrument, not always been fully effective in reaching their stated objectives (see Ariyoshi et al. 2000), they have contributed to regaining greater policy autonomy in several

12 See for example, Ball (2009).

13 For example, in the case of China, research from the IMF argues that making the quasi-fixed exchange rate more flexible would allow the country to pursue a more independent monetary policy. The same paper also argues for a cautious approach to capital account liberalization, given the institutional weaknesses of China’s financial system (see Prasad et al. 2005). The argument could be extended to many other developing countries. Rather than abandoning capital controls altogether, they should remain a policy tool that can be used selectively.

cases. In Chile, for example, controls imposed on inflows have helped to reduce their level and to change the composition of inflows towards longer maturities, hence increasing the autonomy of monetary policy (Gallego et al. 1999; see also de Gregorio et al. 2000). The more controversial issue is controls on outflows, but Edison and Reinhart (2001) argue that such controls enabled Malaysia to stabilize exchange rates and interest rates during the East Asian crisis and to gain more policy autonomy. Kaplan and Rodrik (2001) conclude that the Malaysian approach has led to a faster economic recovery and to a smaller decline in real wages and employment than IMF policies would have done.

How could a system of a managed real exchange rate, the second element mentioned earlier, stimulate employment? Rodrik (2003) and Frenkel (2004) provide three channels. Active management of the real exchange rate would allow for higher capacity utilization in times of unemployment, if applied in combination with the appropriate mix of macroeconomic and fiscal policies. It would also stimulate output growth and hence employment, if combined with appropriate industrial policies, as the experience in various Asian countries has shown. It could shift the sectoral composition of exports towards more labour intensive goods, and hence increase the employment elasticity of the economy as a whole.

Employing a policy mix with intermediate options such as a managed capital account or a managed real exchange rate requires more fine-tuning and coherence in policies than relying on rule-of-thumb policy interventions. To achieve this requires national institutions, which have explicit mandates for employment and decent work to achieve this.

Another possible, supplementary, element to relax the policy trilemma is to include one or two additional policy instruments to complement the fiscal and monetary tools (see also Tinbergen 1970 [1952]). Bradford (2004) suggests, for example, social pacts or co-ordinated wage bargaining to hold down inflation and so to ‘free up’ other policies aimed at growth and employment creation. Also, a greater concern for inequity and a reduction of national inequalities could contribute to reducing inflationary pressure and could be added either as part of a social pact or as a stand-alone policy instrument (see van der Hoeven and Saget 2004). It is thus very important to have employment creation and equitable distribution as explicit policy objectives for macroeconomic policies.

A second example of employment conscious short-term policies is that of considering central banks as agents of development as suggested by Epstein (2007). He argues that an employment-targeting approach to central bank policy may seem quite alien to those schooled in the orthodox tradition of inflation targeting and financial liberalization, but that in fact this has been quite common historically in both currently developed and developing countries. Over the years, central banks have been seen as agents of economic development, not just agents of economic stabilization. And while sometimes central banks have failed quite spectacularly in this mission, there have been other important success stories, including important periods in the US, UK, France, Germany, Japan, South Korea and India, to name just a few examples.

As for developing countries, Amsden (2001, 2007) describes the key role that investment banks, in co-ordination with central banks, played in the industrialization success stories countries such as South Korea, Taiwan, Malaysia, Brazil, Argentina and others, in mobilizing and directing savings to key industrial sectors, and in particular to those specializing in exports. Epstein (2007) recalls that in many of these cases, central banks were a key part of the government apparatus that played a supporting role by maintaining low interest rates, maintaining capital controls to help stabilize exchange rates at competitive levels, and sometimes engaging in direct lending for preferred purposes. Engaging in these developmental roles, using a wide variety of instruments was widely seen as a key part of the central bank's mission. After the Second World War, there was a major transformation of central banking in the developing world. In many respects, these changes paralleled those in the developed world. Epstein deplores the resilience of inflation targeting and argues that inflation targeting is far from benign as it creates in central banks a *culture* of inflation focus, or even inflation obsession.[14] An explicit employment target as well as an inflation target could change the mind-set of traditional economists.

A third example of shorter-term policies stimulating employment and decent work is that of setting minimum wages. Several ILO studies (Saget 2001, 2008) have observed that, as a consequence of structural adjustment and liberalization policies and a breaking down of trade unions and labour market institutions, the minimum wage in a sizeable number of countries is so low that it is does not contribute to reducing inequalities or poverty reduction and has in effect become meaningless. In a second set of countries, the minimum wages appears to fulfill its objective of reducing poverty without hampering employment creation.[15] But there is also a set of countries where the minimum wage is very high: too high in fact to be considered as a genuine minimum wage, with the risk of hampering economic growth and thus longer-term employment creation. This is the so-called 'maxi minimum wage' (Saget 2008). In this situation minimum wage policies amount more to average wage fixation than to fixing minimum wages. Poorly developed collective bargaining is often a driving factor behind the emergence of such 'maxi minimum wages'; minimum wage consultations are the only forum where trade unions can make their demands known, with the danger that the resulting minimum wage is not a genuine threshold, but rather the actual wage earned by most formal workers. As is known from macroeconomic policy, one can only have as many policy instruments as policy goals: the minimum wage-setting machinery is expected to respond to too many policy goals (Saget 2008) and becomes an obstacle rather than an instrument for employment creation and decent work. The interesting conclusion is that both too low and too high minimum wages are an indication of malfunctioning employment and labour market policies.

Misconceived (short-term) macroeconomic policies can prevent economies from achieving sustained growth and employment. Taylor (2009), gives various examples how stability in interest rates and foreign exchange can contribute to steady growth, but that, with increasing financial openness, pro-cyclical macroeconomic policies, especially for medium-sized and smaller economies, have become the rule rather than the exception affecting sustained growth.

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14 As Epstein (2007) notes: 'Millions of dollars are spent studying every aspect of inflation, but few aspects of unemployment; thousands of hours of the time of highly scarce, skilled economists are spent pouring over complex models designed to show how to get inflation down from 8 to 4 per cent, but not on how to create more and better jobs; and if other government officials or those in civil society ask the central bank to do something about employment creation, the central banks can respond, 'that's not our job'. More than anything else, the cost of inflation-focused monetary regimes is to divert the attention of the some of the most highly trained and skilled economists and policy makers in developing countries away from the tasks that previous generations of central bankers took for granted as being their main job: to help their countries develop, to create jobs, and to foster socially productive economic growth'.

15 It has been argued that the existence of minimum wages results in greater informal employment. ILO (1977) shows however that minimum wages up to 2/3 of the level of wages of unskilled workers will not produce substantial increases in informality.

3.2 Longer term policies for employment creation

Having reviewed some of the short-term policies for employment creation we now turn to the long-term policies for employment creation.

Although economic growth depends on many factors, one factor contributing to growth is structural change, a process where economic activity increasingly takes place in sectors with high value added, with diversification and sophistication of production. Although this process of structural change necessitates labour reallocation and can thus generate (frictional) unemployment, the higher value added created in the growth process results in higher incomes from wages and capital, which, together with increased demand from abroad, will lead to higher growth and employment. This virtuous picture can however be disturbed when structural change and expanded production and productivity increases in some sectors do not lead to higher national productivity. McMillan and Rodrik (2011), for example, argue that structural change in Asia has led to higher national productivity and growth, but that in Africa and Latin America, until recently, policies were based on capturing comparative advantage in primary products leading to lower labour productivity and lower growth, with negative consequences for employment and wages. Asian countries had, and have, an industrialization process in which industrial policies have been applied successfully, in contrast to Africa where industrial policies were mainly absent and in Latin America where, at least until recently, these policies, constrained by the legacy of the Washington Consensus, were not robust enough to be effective. The current debate is therefore not whether public policies for industrialization are useful or not, but which type of public policies will best work under which circumstances (Lin 2011).

It is thus important to consider appropriate policies for structural change and well thought out industrial policies in a meaningful debate on employment creation.

Melamed et al. (2011), based on the work of Khan (2007) and others, surveyed the literature on findings on the relation between growth, poverty and sectoral employment. In 24 growth episodes detailed information on growth and employment was available, and out of these in 18 episodes, poverty decreased with rising employment in services and in manufacturing in most of them (see Table 2). The six cases where poverty increased or remained stable were mostly characterized by an absence of increases in employment in every sector. This analysis thus gives support for a link between growth and employment. However the link is far from robust and needs further research.

Table 2: Growth, employment and poverty, a summary of evidence

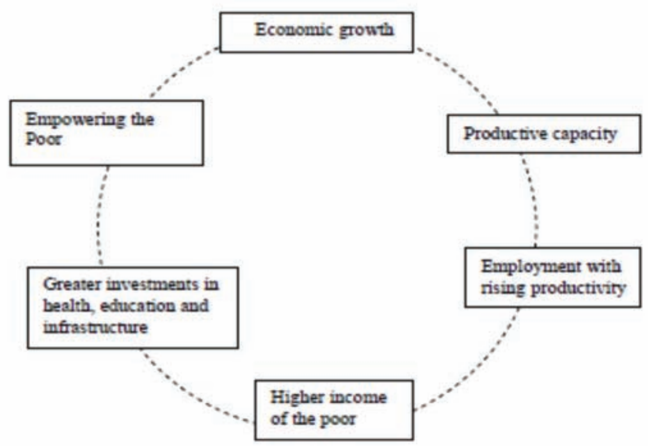
Number of episodes	Rising agricultural employment	Rising industrial employment	Rising services employment
Growth episodes associated with falling poverty rates			
18	6	10	15
Growth episodes associated with no fall in poverty rates			
6	2	3	1

Source: Melamed et al. (2011); reproduced here by permission of ODI.

As argued above, policies for employment need to take into account both the quantity of employment and the quality of employment, or as Khan (2006), has put it: ‘policies for employment need to be concerned with the quantity of employment, the factor productivity of employment, the factor remuneration of employment and the terms of employment’.

Ernst and Berg (2009) have conceptualized these policy concerns in what they call the virtuous circle of links between growth, employment and poverty reduction, namely economic growth, productive capacity, employment with rising productivity, higher incomes of the poor, greater investments in health, education and infrastructure leading to an empowering of the poor, all contributing again to economic growth (see Figure 15). However there are many obstacles for such a virtuous circle to become effective in practice. Policy interventions are needed to overcome these obstacles and to stimulate employment creation.

Figure 15: Virtuous circle of links among growth, employment and poverty reduction



Source: Ernst and Berg (2009); © OECD.

Khan (2007) gives a useful overview of such policies. He distinguishes between the following six policy areas.

The poor can escape working poverty when policies achieve a combination of the following:

(a) an increase in wage employment;
(b) an increase in the real wage;
(c) an increase in self-employment;
(d) an increase in productivity in self-employment;
(e) an increase in the terms of exchange of the output of self-employment.

However the poor face various constraints. One of the major constraints in the current context of globalization is a low output elasticity of demand for labour. Furthermore economic growth, often in combination with exports to advanced markets, often leads to a rate of growth in employment for which the poor do not possess the necessary skills. Also often in the context of structural adjustment programmes the employment impact of high growth is offset by a countervailing contraction of employment induced by economic reform. Another important factor is that growth might also fail to reduce poverty if the distribution of scarce productive resources is, and remains, highly concentrated.

In order to deal with these challenges various longer-term employment policies are suggested: first, rapid labour absorbing growth providing the poor with productive and reasonably well-remunerated employment; second, conversion of the poor in self-employment into productive entrepreneurs; third an increase of productivity of poor workers both in wage and self-employment; fourth, labour market policies that improve and adjust the skill composition of the poor; fifth, macroeconomic policies that result in appropriate terms of exchange of the produce of the poor; sixth in some countries an orderly dismantling of past systems of inefficient excess employment in the public or semi-public sector, with appropriate compensation, rather than a disorderly and sudden dismantling; and seventh a set of economic and social policies which incorporate special programmes designed for households, which cannot cover their basic needs from proceeds of labour.

The effect of growth on employment is sometimes measured by the concept of the employment elasticity of growth; that is say the percentage increase of employment that occurs with a one per cent increase in growth. Although various international reports use this concept, it is not without problems. First in many developing countries since people cannot afford to be unemployed or to withdraw from the labour force, the employment elasticity of growth measures labour force participation and does not give an indication of the quality of employment as all activities performed by the poor are generally included in the measurement of employment. Second, high employment elasticity in itself does not convey success of an employment policy. For example, a country with a high employment elasticity (close to one), whose GDP grows slowly say at e.g. 1 per cent a year clearly does worse than a country with an employment elasticity of 0.5 but whose GDP grows at 7 per cent per annum. So when the concept of employment elasticity is used it should be in conjunction with figures on growth and on the quality of the jobs created in different sectors and never as a single macroeconomic figure in itself.

4 Aid and employment

4.1 Introduction

Putting together the trends in employment and in decent work and the required national and international policies to promote good outcomes, the question is to what extent can development aid and development aid policies contribute to such policies?

However, it may be useful to note that according to earlier observers, aid often has actually had a negative impact on employment of the poor. The analysis of the path-breaking employment missions of the UN system in the 1970s pointed to a bias of aid against employment creation—e.g. 1972 Mission Report to Kenya for the International Labour Organization, see also Jolly (1973). Major conclusions of these missions were that development aid often financed imports, which made capital cheaper vis-à-vis labour. Imported technologies were often also labour replacing and big industries profited more than small industries from support and subsidies. Emphasis of aid was on urban areas to the detriment of rural areas, where most of the poor and underemployed lived. Some of these conclusions still hold true today, but in other cases aid donors have indeed shifted focus. But even this change in focus often has not dealt with some of the root problems of employment creation, in particular: first the need for investment to generate output and demand for employment; and second the distribution of profits emanating from productivity increases so that they can contribute to investment or increased wages to stimulate demand. Aid donors often instead supported social expenditure and programmes for small enterprises, rather than dealing with the necessary structural changes needed for increased productive employment. Thus a clearer conceptualization of the link between the necessary policies on the one hand, to create employment and, on the other, the aid projects and policies to achieve this, is clearly needed.

Table 3 summarizes potential policies directed towards the short-term objective of increased capacity utilization, and the longer-term objective of an increase in capacity, which might be supported by aid.

This Table includes a number of policies that are favoured by current aid donors, but it also emphasizes policies for structural change and policies, which affect the demand side of the economy. This follows our analysis above and is in line with a recent observation by Taylor (2009) that orthodox economists in short-term macroanalysis place a great deal of emphasis on the supply side ignoring the demand side, and that in relation to longer-term development, conventional economic analysis favours letting markets work rather than supporting the policies for structural change and industrial capacity building.

Table 3: Employment policies, which might be supported by development aid

	Capacity utilization	Capacity increase
Policies which might be supported by aid programmes and policies	• Fiscal policies • Monetary policies • Exchange rate • Trade barriers • Unemployment benefits • Cash transfers	• Public investment • Infrastructure • Industry policy • Education • Vocational and management training • Small enterprises • Health • Social security

Source: Author.

As one can observe the policies that influence employment creation and potentially interact with aid policies span a rather wide spectrum. As various analysts of structural patterns of development of successful countries have observed, a single general framework of development policy, like the Washington Consensus, does not exist in relation to policies to promote structural change. Policies need to be time and context specific, and calls for ‘best practice’ are often a sign of intellectual laziness.

Therefore, in order to get a better appreciation of the possible and desirable interaction between employment policies and development aid, a more detailed analysis of some the aid-employment relationships seems to be necessary, taking into account context specific situations (including stage of development) specific, as listed below:

- The effects of aid in increasing demand in situations of under capacity and thus increasing employment.

- The effects of aid and the Dutch Disease in changing the balance between tradeables and nontradeables and the consequences for employment.

- The effects of aid in increasing infrastructure and thus removing bottlenecks of production in order to create more employment.

- The effects of aid in making capital more productive, with an ambivalent effect on quality and quantity of employment;

- The effects of aid in supporting structural change towards economic activity in sectors with high value added, with diversification and sophistication of production, which has a positive effect on employment and on the remuneration of unskilled and skilled workers in the long run.

- The role of aid in increasing education and hence human capital.

- The effect of aid on health issues so as to make work more productive.

- The effects of aid on social security to make workers more productive and willing to adjust etc.

5 Conclusions

This paper has argued that in many countries the process of globalization has led to a precarization of labour, which is especially manifest in the unstable working conditions of many workers, in growing inequality between the labour share and the capital share in national income in more than 75 per cent of the countries in the world as well as in a growing income inequality and wage inequality in many regions in the world, with, however, the exception of some Latin American countries where inequality declined from very high initial levels at the beginning of the century and some countries in SSA and South-East Asia. The neglect of concern for employment and inequality in the formulation of the MDGs in 2000 and their consequent is noted; moreover, the addition of a goal for full employment in a reformulation of the MDGs in 2005 did not lead to a change in focus in Official Development Assistance. This paper argues that if the growing concern for employment and inequality is taken seriously, a refocus of development efforts is necessary, combining a greater share of development aid for employment and productivity enhancing activities with a change in national and international economic and financial policies, so as to make employment creation (together with poverty reduction) an overarching goal.

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