Informal Preparatory Meeting on the Theme of the 2006 High-Level Segment of ECOSOC

Roundtable 1: Growth and Employment

Mr. Peter Fallon
Deputy Division Chief, Policy Development and Review Department
IMF

Growth and Labor Market Outcomes

Sustaining poverty reduction and progress towards the Millennium Development Goals (MDGs) entails an improvement in labor market outcomes. Improvements must include not only increases in employment generation in the formal sector but also higher wages in agriculture and the informal sector. Higher incomes for rural and urban informal workers are particularly important, as such workers may constitute the bulk of the national labor force and usually earn less than their counterparts in the formal sector.

It is by now widely agreed that economic growth, especially broad-based, labor-using growth, is the only sustainable way of improving labor outcomes. In low-income countries where underemployment may persist in the subsistence agricultural and informal sectors, growth can raise labor income in these sectors while permitting the transfer of workers to higher-paid, higher-productivity jobs in the formal sector. Such a transfer should reduce inequality in labor incomes. The importance of growth for labor outcomes is borne out by empirical evidence for low- and middle-income countries— in countries where data are available, higher long-term growth is normally associated with rising real wages in agriculture and manufacturing. I would like to sketch out the key elements of an agenda geared to achieving these aims.

There are a number of elements in any sensible agenda aiming to lay the basis for sustained growth with employment generation and other desirable labor outcomes. Maintaining a stable macroeconomic environment must be at the top of the agenda. Otherwise, it is very difficult to attract both domestic and foreign direct investors and to sustain efforts at boosting the physical capital accumulation required for long-term growth, with the result that fewer jobs will be created. Although they may seem attractive as a way of stimulating the economy and possibly even directly creating jobs through increased government expenditure, expansionary monetary and fiscal policies that lead to macroeconomic instability eventually do more harm than good. Evidence for this link between instability, and adverse labor market outcomes comes, for example, from the East Asian crisis of the late 1990s, in which real wages fell significantly and poverty rose.

A second agenda item is to improve the environment for a stronger private sector. A better business environment not only leads to more and higher-productivity investment, but it also facilitates the entry of small businesses and an associated shift from the informal to the formal economy. To strengthen the private sector environment, policies should focus on simplifying the regulatory system, securing property rights and strengthening contract enforcement. Investment in physical infrastructure should also be increased, particularly in Sub-Saharan Africa where deficiencies in infrastructure are particularly severe. An objective of fiscal policy in many developing countries should therefore be to reorient government expenditure away from unproductive areas and towards growth-supporting infrastructure.

A third item is to accelerate human capital formation through better provision of health and education services. Raising the skill levels of workers and improving their health will contribute to growth, ease shortages of skilled workers in the modern sector, raise labor incomes and reduce inequality. Low-income countries now allocate higher proportions of government expenditure to health and education than in 1990, but spending still falls short of what is needed to achieve the MDGs.

Improving governance in developing countries is a fourth and overarching part of the agenda, as it is crucial to the business environment and to ensuring high quality public investment and service delivery. In the macroeconomic sphere, the governance of the central bank and the safeguards built in to the public expenditure management system are critical to the conduct of macroeconomic management. Although governance is improving in some countries, reforms still need to be accelerated in many.

The remaining two items require actions on the part of the international community and developing country governments:

- First, a substantial increase in aid could help to support efforts to raise growth rates. Project aid can have direct employment effects as well as leading to higher long-term growth, but other types of aid are helpful as well. Aid volumes are rising, but more is still needed to accelerate growth with favorable labor outcomes. It is also vital that aid have more developmental impact than in the past. This means aligning aid more with country needs and ensuring that higher aid volumes are consistent with the absorptive capacity of recipient countries. It also means that developing countries need to manage aid efficiently.

- Second, trade liberalization can have tremendous benefits for growth and consequently for labor outcomes. For example, a joint World Bank-IMF study found that 27 million jobs are foregone in developing countries because of quotas and tariffs on textiles and clothing in importing countries. Improving market access for agricultural exports from developing countries would also provide a major boost to growth and labor incomes. To take advantage of trade liberalization, developing countries will need to improve their investment climates and relevant infrastructure.

In conclusion, let me note that it is important that efforts to achieve better labor outcomes in low-income countries be based on country-owned and –led poverty reduction strategies linked to medium-term frameworks. Equivalent national development strategies should perform this role in middle-income countries. Donors should use these strategies as the basis for aligning and harmonizing assistance.