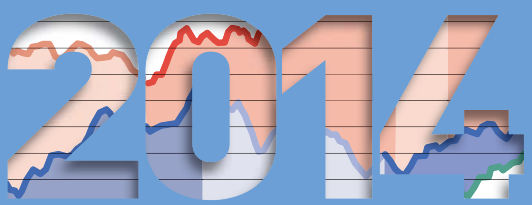
International Labour Organization

World of Work Report



2014 Developing with Jobs

World of Work Report 2014

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Developing with jobs

INTERNATIONAL LABOUR ORGANIZATION
RESEARCH DEPARTMENT

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Preface

Guy Ryder
ILO Director-General

Since the eruption of the financial crisis in 2008 much of the global policy debate has focused on advanced economies and their ability to cope with the impacts of the crisis. During this period, a major policy shift has taken place in developing countries that has often gone unnoticed. Notably, in the face of the slowdown of their exports to advanced economies, developing countries have been confronted with the need to rebalance their economies and find new sources of economic growth and job creation.

This report draws out the many lessons that can be learned from this policy shift. First and foremost, it shows the considerable policy innovation among the over 140 emerging economies and low-income countries which are examined. The measures range from employment guarantee schemes to cash benefits for vulnerable groups and policies to promote formal enterprises. Some of these are being replicated throughout the developing world and have even had some attraction for a number of the advanced economies most affected by the financial crisis.

Second, a key finding emerging from the report is that good quality jobs matter for development. While it has long been argued that developing countries should concentrate efforts on trade and investment liberalisation and infrastructure spending, supported by external aid if needed, evidence presented in the report shows that such policies will not yield development unless accompanied by dedicated efforts to boost employment and decent work opportunities and tackle working poverty. In countries where it was implemented, such a policy shift not only helped development but also played a counter-cyclical role that helped attenuate the impacts of the financial crisis.

Third, governments in developing countries have gained confidence and therefore policy space. They have realised that there is no one size fits all solution to their problems and that remedies that used to be advocated (though not always applied) in industrialised countries are not necessarily what is required in a developing country context. Renewed interest among developing countries in well-designed employment regulation, minimum wages and social protection illustrate the point.

At the same time, huge challenges persist. Rising youth unemployment, including among new graduates, stubbornly high employment informality and significant income inequalities require urgent policy attention. In too many developing countries, including some emerging economies that have significant institutional capacity, core labour standards are not properly enforced. There are no independent trade unions in some countries, and employer organisations cannot operate effectively in other parts of the world.

In sum, "Developing with Jobs" highlights the relevance of the ILO's mandate, values and policy tools. It also demonstrates clearly why decent work and social protection should be central goals in the post-2015 development agenda.

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Executive Summary

Developing countries are catching up with advanced economies …

The process of economic convergence between developing countries and advanced economies has gathered momentum. Between 1980 and 2011, per capita income in developing countries grew, on average, by 3.3 per cent per year – much faster than the 1.8 per cent per capita income growth recorded in advanced economies. This process of convergence has accelerated since the early 2000s, especially since the start of the global crisis in 2007–08 (Chapter 1).

There are, however, significant cross-country differences. The report identifies a group of emerging economies which have grown particularly fast (Chapter 2). In recent years, most low- and medium-income countries and least developed countries have also made significant progress in terms of economic growth.

… with those countries that are investing in quality jobs making most progress

The extent to which countries have made efforts to improve job quality plays a part in explaining the observed growth patterns (Chapter 3). This is particularly the case over the past decade. In countries that have made the greatest investment in quality jobs from the early 2000s, living standards (as measured by the growth in average annual per capita income) improved more than in developing and emerging economies that paid less attention to quality jobs.

Among those countries where working poverty – including workers earning less than US$2 a day – declined most steeply from the early 2000s, overall per capita income grew by 3.5 per cent, on average, over the 2007–12 period. For those countries that made least progress in cutting working poverty since the early 2000s the figure is only 2.4 per cent.

Likewise, countries that were particularly successful in reducing the incidence of vulnerable employment during the early 2000s enjoyed significant economic growth after 2007. In these countries, per capita growth was almost 3 per cent per

year between 2007 and 2012, practically 1 percentage point higher than in countries making least progress in reducing the incidence of vulnerable employment – which includes own-account employment as well as unpaid family work.

However, the disparity in quality jobs remains significant …

Despite these positive trends, employment and social challenges remain acute in most emerging and developing countries. More than half of the developing world's workers (i.e., nearly 1.5 billion people) are in vulnerable employment. These workers are less likely than wage earners to have formal working arrangements, be covered by social protection such as pensions and health care or have regular earnings. They tend to be trapped in a vicious circle of low-productivity occupations, poor remuneration and limited ability to invest in their families' health and education, which in turn dampens overall development and growth prospects – not only for themselves but for generations to follow. In South Asia and sub-Saharan Africa, more than three out of four workers are in vulnerable forms of employment, with women disproportionately affected compared to men.

… levels of working poverty remain elevated despite the considerable progress already made …

The reduction in the incidence of working poverty in many countries of the developing world has been impressive. Still, 839 million workers in developing countries are unable to earn enough to lift themselves and their families above the US$2 a day poverty threshold. This represents around one-third of total employment, compared with over half in the early 2000s.

… and around 200 million new jobs are needed over the next five years to keep pace with the growing working-age population in emerging and developing countries …

Over the next five years there will be an estimated 213 million new labour market entrants – 200 million in developing countries alone. This raises the issue of youth unemployment. Already, the youth unemployment rate exceeds 12 per cent in developing countries – more than three times the unemployment rate for adults. Regionally, the highest youth unemployment rates are found in the Middle East and North Africa regions, where nearly one in three young people in the labour force are unable to find work. Young women, in particular, are struggling to find work in these regions, with unemployment rates approaching 45 per cent.

The job challenge is also qualitative. Indeed, educational attainment is improving fast in most developing countries (Chapter 4). There is therefore a growing gap between the skills acquired in education and the nature of jobs available.

… pushing many educated youth to emigrate

The lack of quality jobs is a central determinant of emigration, especially among educated youth in developing countries (Chapter 9). The gap in wages between receiving and sending countries tends to be as high as 10 to 1. In 2013, over 230 million people were living in a country other than the one in which they were born – a rise of some 57 million since 2000 – with South Asia accounting for roughly half of this increase.

To meet these challenges, it is essential, first and foremost, to boost a diversified productive capacity rather than just liberalizing trade …

The evidence presented in Chapter 5, including the case studies of countries that have successfully upgraded their productive capacity, shows that development requires a strategy to diversify the economic base and enhance the ability of sustainable enterprises to create quality jobs.

While manufacturing tends to be associated with faster economic growth and quality job creation, the report highlights successful experiences based on agricultural and rural development, efficient and equitable use of natural resources and services that connect with the rest of the economy. There is no single development path and the report documents success stories for countries at all levels of development. The natural resource constraints and environmental limits faced by all countries can be turned into an advantage by developing and emerging economies which seize the opportunity for technological "leapfrogging". In this respect, the green economy offers new prospects for developing countries, which face fewer adjustment challenges than advanced economies with mature, carbon-intensive production structures.

In all cases, however, it is crucial to avoid a concentration of economic growth in a few export-oriented sectors with limited links to the rest of the economy. Economic diversification policies, measures to facilitate formalization and expansion of enterprises, and the enforcement of labour standards can all contribute to broad-based development and promotion of decent work.

Productive transformation needs to be underpinned by an enabling environment for enterprises, including supportive macroeconomic policies. The experiences of several Asian and Latin American countries underline the potential of development strategies to foster production diversification in collaboration with the private sector and strengthen the environment for enterprises, while at the same time ensuring that there is sufficient aggregate demand, notably through countercyclical macroeconomic policies. They have also demonstrated success with well-calibrated capital controls to manage volatile capital flows and keep exchange rates both predictable and competitive.

These findings shed new light on the role of government in developing countries. According to conventional wisdom, selective interventions and targeted support would be a source of distortions and economic inefficiency. In reality, success depends on careful diversification strategies in the context of gradual trade liberalization consistent with multilateral commitments.

… second, strengthen labour market institutions rather than neglecting labour standards …

Labour and social protection institutions are important ingredients of economic growth, quality jobs and human development (Chapter 6). It is not possible to achieve economic diversification without active measures to tackle low productivity in agriculture and small and medium-sized enterprise, poor working condition traps and high rates of informality. Sustained, strong growth is at risk if social inequality grows, or rent-seeking behaviour by owners of natural resources or land is allowed to continue unchecked.

Making such institutions more effective remains a serious challenge for many developing countries. Wage-setting mechanisms and labour regulations need to be properly designed and attention must be given to implementation capacity.

Despite these difficulties, there are many interesting recent innovations in this area. There is growing awareness of the role of minimum wages in fighting working poverty and inequalities, while promoting labour market participation. The report gives examples of how some developing countries have found innovative ways of setting and implementing minimum wages, including through social dialogue. Likewise, well-designed collective bargaining can have positive impacts on income distribution while also tackling informality and low-productivity traps. One major challenge is the decline in the coverage of collective bargaining – a trend also evident in advanced economies.

The issue of employment protection, which has been the subject of lively debate but often without a systematic review of current practices, is carefully examined in the report. Contrary to predictions, weaker regulations on employment have not facilitated transitions to formal employment. Instead, the report provides examples of countries, such as Argentina, that have tackled informality through pragmatic approaches, combining tax reform, social protection, faster registration processes for enterprises and better enforcement.

… third, extend well-designed social protection floors as drivers of inclusive development, not just as a narrowly targeted safety net for the poor …

There is evidence that social protection helps to reduce the incidence of poverty, inequalities and vulnerable employment (Chapter 7). Well-designed social protection enhances individual capabilities to access better jobs. For instance, Bolsa Família in Brazil, the Mahatma Gandhi National Rural Employment Guarantee Act in India and similar programmes in Cabo Verde have been successful in providing supplementary incomes to households, allowing families to invest in productive activities as well as to improve their health and educational outcomes.

In addition, social protection can boost economic growth and quality job creation. Much depends on the responsiveness of social protection to changing economic conditions. Countercyclical programmes in China and South Africa are interesting cases in point in this respect. In some countries, such as Ethiopia and Namibia, employment is an explicit target of social protection schemes.

Establishing an efficient funding base for social protection is crucial. The creation of a tax on oil and gas exports in Bolivia was instrumental in ensuring sustainable financing of the non-contributory old-age pension.

Finally, it is important to combine social protection with a set of policies that promote a supportive environment for enterprises and job creation. This includes simplifying administrative procedures for the self-employed in order to facilitate formal entrepreneurship. Another successful measure has been the provision of additional incentives for benefits recipients, including jobseekers, to receive training and take on work, as illustrated by Brazil's vocational training programmes offered to beneficiaries of income transfer programmes.

… and, finally, ensure balanced income developments to avoid harmful inequalities

The widening of income inequalities within countries is now a well-established fact. Analysis suggests that this trend is associated with a change in the distribution of income, to the detriment of labour.

Developing countries have not been immune to these patterns (Chapter 8). Evidence suggests widening inequalities can be detrimental to economic growth, to the extent that the negative consumption effect associated with growing inequalities outweighs any positive impacts in terms of higher returns from investment and improved cost-competitiveness. Such a negative outcome is all the more likely because the competitiveness effects are dampened by the fact that the share of labour incomes falls in many countries – leading to a deficit of global aggregate demand and a race to the bottom in wages and standards. In addition to impacts on the economy, widening income inequalities may erode social cohesion and intensify social unrest, as has happened in some Arab and Asian countries.

The ability of developing countries to offset falling labour income shares through progressive taxation is more limited than in the case of advanced economies. It is therefore essential to reinforce labour market institutions, which can improve the market distribution of incomes between labour and capital. This can be done by facilitating dialogue between employers and workers, enforcing labour laws and standards as well as implementing well-designed social protection in order to ensure more balanced income distribution in developing countries. There are important experiences in this area, such as in Argentina, Brazil and – recently – Tunisia.

Finally, decent work should be a central goal in the post-2015 development agenda

The findings of the Report suggest that sustained development is not possible without making progress on the employment and decent work agenda. By putting in place policies and institutions that help create more and better jobs, the process of development will be facilitated. Conversely, economic growth is not sustainable when it is based on poor and unsafe working conditions, suppressed wages and rising working poverty and inequalities. In addition to their impact on economic growth, jobs, rights, social protection and dialogue are integral components of development.

Employment and decent work should therefore be a central goal in the post-2015 development agenda. The ILO has adopted a range of important initiatives which, as part of a new development agenda carried out under the aegis of the UN, could provide a significant contribution to improving the living standards of all women and men around the world.

Introduction and structure of the report

1 Global context and employment and social trends in the developing world

A global economic slowdown in 2013, but expectations of faster growth ahead

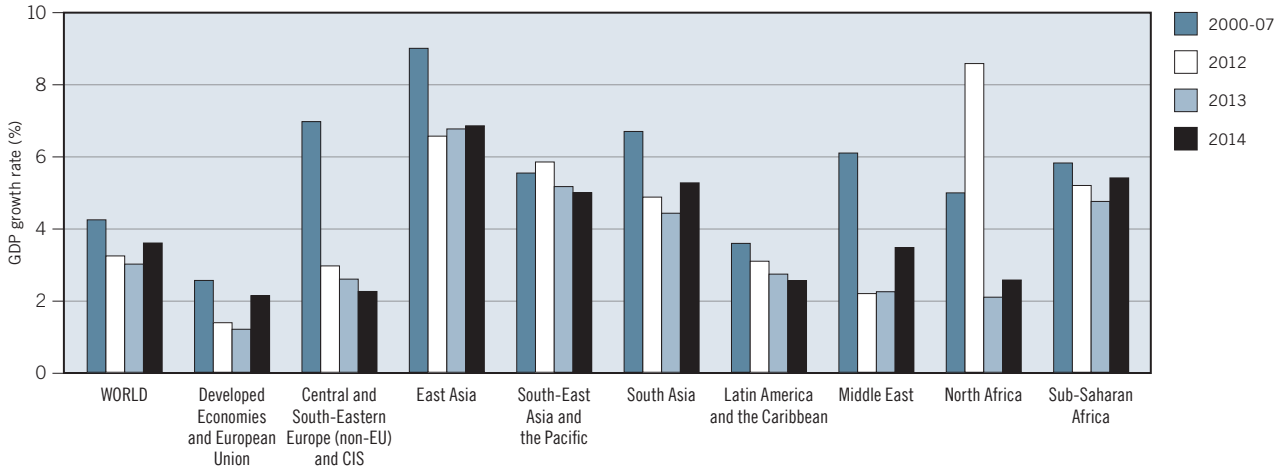
Global economic growth decelerated in 2013 to 3 per cent, down from 3.2 per cent in 2012 and well below the average annual growth of 4.2 per cent achieved during the period between 2000 and 2007, prior to the onset of the global economic crisis (figure 1.1). A driving factor behind this sluggish performance was the continued weakness in the developed economies (in particular in Europe), where growth slowed to just 1.2 per cent, compared with 1.4 per cent in the previous year, although the economic slowdown was widespread, also affecting much of the developing world. The regions of Central and South-Eastern Europe, South-East Asia and the Pacific, South Asia, Latin America and the Caribbean, North Africa and sub-Saharan Africa all registered slower growth rates in 2013 than in the previous year.

The main causes of the economic slowdown in emerging and developing countries include ongoing macroeconomic adjustments in certain large countries, such as China, as they move to more domestic-led growth; some periods of financial instability, which saw capital outflows from emerging markets in expectation of a less accommodative monetary policy stance in the United States; and diminished demand for exports from the advanced economies. Many developing countries are also struggling with the consequences of inadequate infrastructure and limited human capital – factors which are likely to have a negative impact on growth in the coming years.[1] Furthermore, while many developing countries are gradually shifting towards greater reliance on domestic sources of growth, this rebalancing process has been insufficient to offset the weak demand for exports in the advanced economies.

According to the latest IMF projections, global economic growth is expected to accelerate in 2014, reaching 3.6 per cent, and to accelerate further in 2015.

1. ILO, *Global employment trends 2014: Risk of a jobless recovery?* (Geneva).

Figure 1.1 Global and regional GDP growth estimates and projections, 2000–07, 2012–14 (%)



Source: IMF, *World Economic Outlook*, April 2014.

Central and South-Eastern Europe, South-East Asia and the Pacific and Latin America and the Caribbean are expected to see a modest slowdown in 2014. Growth in East Asia is projected to remain unchanged at 6.8 per cent. All other regions are expected to register faster growth in 2014 than in 2013. Much of the anticipated improvement in global growth in 2014 is due to better prospects in advanced economies, with the Developed Economies and European Union projected to grow by 2.1 per cent in 2014 and by 2.2 per cent in 2015 – the fastest growth since 2010.

At the same time, downside risks to growth continue to predominate at the global level. Concerns regarding a hard landing in some emerging economies have grown and uncertainty surrounding potential adverse effects of unwinding extraordinary measures put in place by central banks is weighing on the outlook.

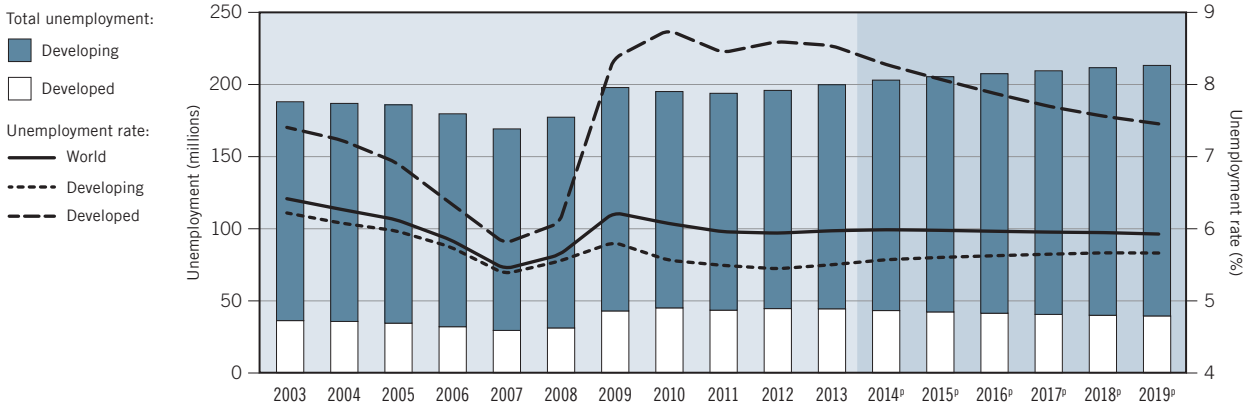
Unemployment remains elevated globally, though with notable differences between advanced and developing regions

Global unemployment rose by nearly 4 million in 2013, reaching 199.8 million, with the global unemployment rate remaining broadly unchanged at 6 per cent (figure 1.2).[2] Unemployment rose as employment growth failed to keep pace with growth in the labour force, which includes both the employed and those seeking work. The number of unemployed worldwide is now 30.6 million higher than before the onset of the global crisis – a reflection of the persistent weakness in labour markets during the global economy's fragile and uneven recovery over recent years.

Notable differences between advanced and developing economies have emerged with respect to unemployment trends (figure 1.2). The developed economies saw a large spike in the number of unemployed and the corresponding unemployment rate beginning in 2009, and the group's unemployment rate remains stuck at 8.5 per cent, substantially higher than the pre-crisis rate of 5.8 per cent registered in 2007. In contrast, in the developing world, there was only a modest increase in the unemployment rate at the height of the global crisis, rising from

2. To provide the most recent ILO estimates of key labour market indicators, unless otherwise noted, labour market data in Chapter 1 are based on ILO, *Trends Econometric Models*, April 2014.

Figure 1.2 Unemployment trends and projections, developed and developing economies, 2003–19



Source: ILO, *Trends Econometric Models*, April 2014.

5.4 per cent in 2007 to 5.8 per cent in 2009. It has since fallen back and is roughly in line with pre-crisis levels.

These trends reflect an important dichotomy between advanced and developing countries in terms of the ways in which economic distress affects labour markets. In developed economies, which tend to have relatively robust social insurance systems for jobseekers, unemployment typically increases as economic fundamentals deteriorate. On the other hand, in many developing economies, in particular in those with only limited social protection systems, there tends to be a far weaker relationship between economic growth and unemployment (see Chapter 3 in this volume). This, in turn, implies that, while unemployment rates are an important indicator in gauging the overall health of labour markets, additional indicators are necessary, particularly in developing economies, to form a comprehensive picture of ongoing labour market dynamics.

Global employment prospects are unlikely to be significantly improved even if economic growth is slightly faster than projected (box 1.1). This suggests that fundamental changes in the growth–employment relationship are needed in order to improve the labour market situation.

Key labour market challenges in emerging and developing countries include, first, boosting productivity levels, which are still far below those in the advanced economies …

With few exceptions, labour productivity growth rates in developing regions have been considerably higher than those in the advanced economies since the turn of the century, and this trend is projected to persist over the medium term. As productivity growth is an essential ingredient for sustainable improvements in living standards and poverty reduction in the long term, faster growth that could result in a "catch up" in productivity levels is a welcome development.

But how quickly are developing regions converging with the industrialized world with respect to this important indicator? Unfortunately, the answer is "fairly slowly". In East Asia, the region that has seen the most dramatic improvements in productivity levels over the past 20 years, output per worker in 2014 is still less than one-quarter of the corresponding level in the developed economies and European Union (figure 1.4). Substantial progress has been made, as the corresponding figure in 1994 was only 7.6 per cent; however, even assuming that the East Asia region managed to continue to grow labour productivity at the very rapid 8 per

Box 1.1 Scenarios for future employment growth in advanced and developing G20 economies

This box provides the results of ILO scenarios for employment in advanced and developing G20 economies to the year 2018, which were produced on the basis of observed country-level trends and patterns in employment elasticities. The scenarios are intended to show potential paths for future employment growth and to illustrate the scale of the challenge involved in closing the global jobs gap, as well as the relatively wide range of potential outcomes in pursuing this goal.

Data used and construction of the scenarios

G20 aggregate employment projections for the period 2014–18 are based on projections of employment at the country level. Specifically, nominal employment for G20 countries (including European Union members) is extrapolated using projected country-level elasticities of employment to GDP growth together with IMF GDP growth projections. These are then aggregated to produce employment projections between 2014 and 2018 for the G20 economies as a whole.

The **baseline scenario** (blue line) uses the projected employment elasticities for the period 2014–18 together with the baseline IMF GDP growth projections. The resulting employment projections are consistent with the central projections from the ILO's *Trends Econometric Models*, April 2014 database.

The **augmented growth scenario** (grey large-dotted line) uses the projected employment elasticities together with augmented GDP growth projections. For each G20 country, the baseline average IMF growth projection for the period 2014–18 is increased by 0.5 percentage points per year (as targeted by the G20 Finance Ministers). For countries with negative employment elasticities, it is assumed that the growth boost has neither a positive nor a negative impact on employment growth.

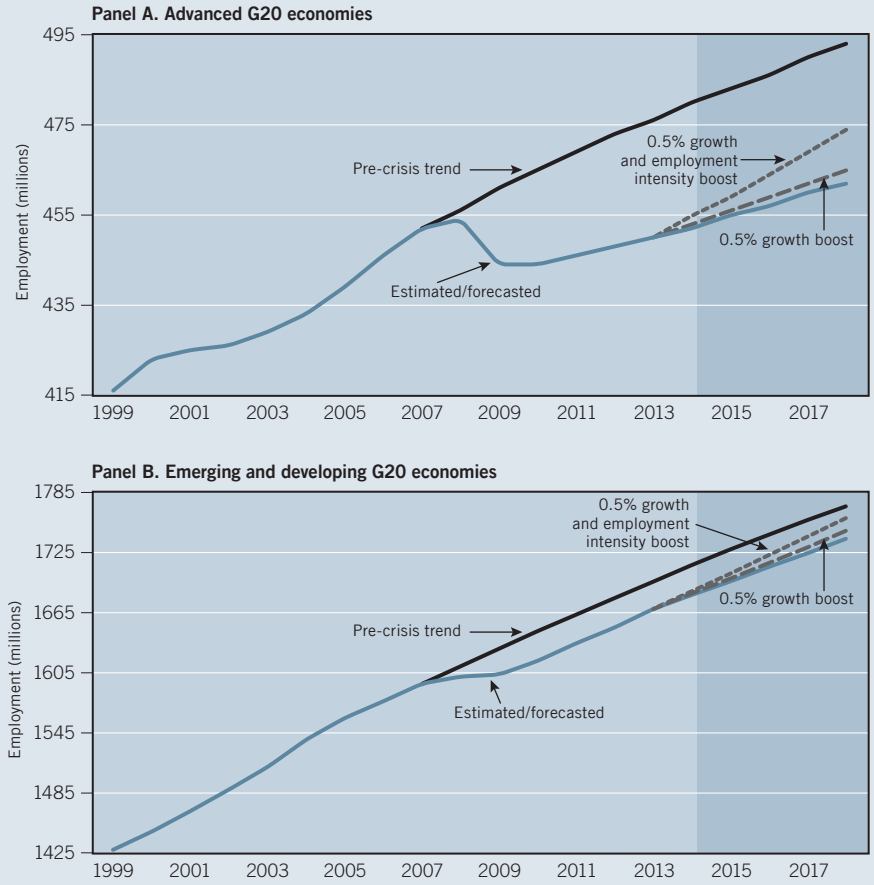
The **augmented growth and employment-intensity boost scenario** (grey small-dotted line) uses the augmented GDP growth projections together with augmented projected employment elasticities. The employment elasticities are increased by 50 per cent for developed G20 countries (for example, increasing Canada's projected employment elasticity from 0.28 to 0.41) and by 25 per cent for emerging and developing G20 countries (for example, increasing Indonesia's projected employment elasticity from 0.38 to 0.47). This scenario therefore assumes that GDP growth over the projection period will be more employment-intensive (and less driven by productivity growth). For countries with negative employment elasticities, the elasticity is increased by half (that is, a country with a –0.2 elasticity would have a –0.1 elasticity in the employment-intensive scenario).

Results in advanced and in emerging and developing G20 economies

In the baseline scenario, which is equivalent to the current ILO baseline employment projection based on current trends and growth prospects, the total jobs gap in the G20 economies (equal to the difference between actual G20 employment and the level of employment that would have resulted had pre-crisis trends continued) stood at 54 million in 2013 and is projected to reach 64 million by 2018. In the advanced G20 economies, the jobs gap equalled 26 million in 2013, or slightly less than half of the total G20 jobs gap. As the current jobs gap in the advanced G20 economies is equal to 5.8 per cent of their total employment, closing the gap presents a formidable challenge. In the baseline scenario, the gap is projected to widen further in the advanced G20 economies, to 31 million in 2018, equal to 6.6 per cent of total employment. In the emerging and developing G20 economies, the jobs gap is larger in nominal terms, at 28 million in 2013; however, this represents less than 2 per cent of total employment in these economies and thus narrowing the nominal employment gap in emerging and developing economies poses a significantly smaller challenge. In the baseline scenario, the gap is projected to grow to 33 million by 2018, or to 1.9 per cent of employment.

A scenario based on an additional increase in G20 countries' average GDP growth rates of 0.5 per cent per year makes only a modest impact on the jobs gap in the advanced G20 economies, resulting in 3 million additional jobs in 2018 in comparison to the baseline scenario. In this scenario, the jobs gap would still widen, from 26 million in 2013 to 28 million in 2018. In the emerging and developing G20 economies, a growth boost alone is projected to result in an additional 8 million jobs by 2018, which would narrow

Figure 1.3 Scenarios for future employment growth



Sources: Calculations based on ILO, *Trends Econometric Models*, April 2014 and IMF, World Economic Outlook projections.

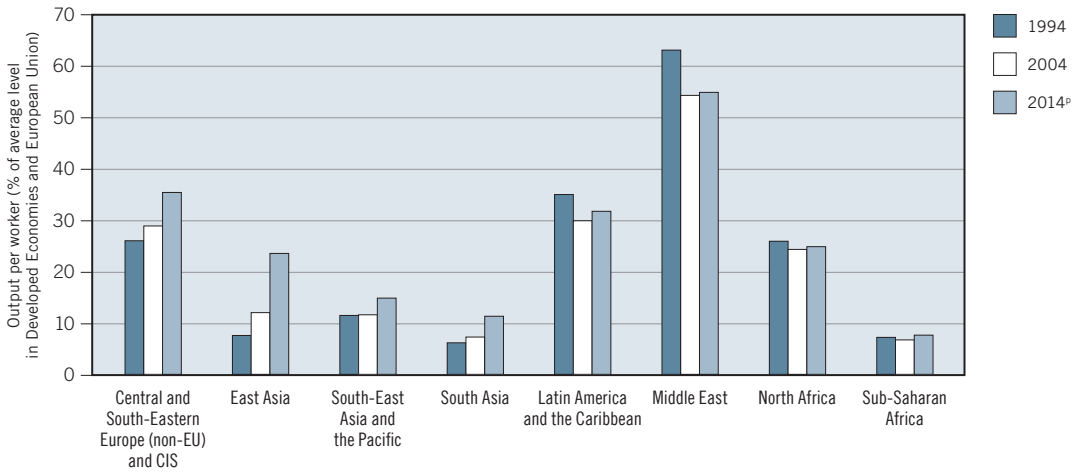
the gap to 25 million. Thus, according to ILO simulations, a total of 11 million additional jobs would be created through a growth boost alone. Related analysis conducted by the IMF, OECD and World Bank* projected a more optimistic jobs outcome, with a GDP boost of the same magnitude increasing G20 employment by 18 million by 2018. Yet, even with this more optimistic scenario, it is clear that faster growth alone is unlikely to make a significant contribution to closing the jobs gap that has opened up, particularly in advanced economies.

On the other hand, a scenario of increased growth along with a more employment-intensive growth pattern could have a major, positive impact in terms of reducing the gap. In the advanced economies, this is projected to result in the creation of 11 million additional jobs by 2018, reducing the overall jobs gap to 19 million, or to 4.2 per cent of total employment. In the emerging and developing G20 economies, this scenario would close much of the gap by 2018. These findings indicate that faster growth together with a more employment-intensive growth pattern could indeed make a significant dent in the jobs gap that has emerged as a result of the global economic crisis. However, increasing the employment intensity of growth would require an appropriate set of labour market policies, tailored to national circumstances.

It should be noted, however, that for a given rate of economic growth, shifting towards more employment-intensive growth implies a shift to lower-productivity growth. Particularly in developing economies, given the benefits of productivity growth to broader economic development objectives, such as poverty reduction, the focus should be on achieving growth that is balanced between creating more jobs and more productive jobs.

* Remarks by Angel Gurría, OECD Secretary-General, delivered at the G20 Finance Ministers and Central Bank Governors' Meeting; Washington, DC, 10 April 2014.

Figure 1.4 Labour productivity (output per worker as % of level in developed economies and EU), 1994, 2004 and 2014



Source: ILO, *Trends Econometric Models*, April 2014; World Bank, World Development Indicators.

cent average annual rate achieved over the past decade (an optimistic projection given the region's current productivity growth rate of around 6 per cent), East Asia would not reach the present level of productivity in the developed economies until the year 2033.

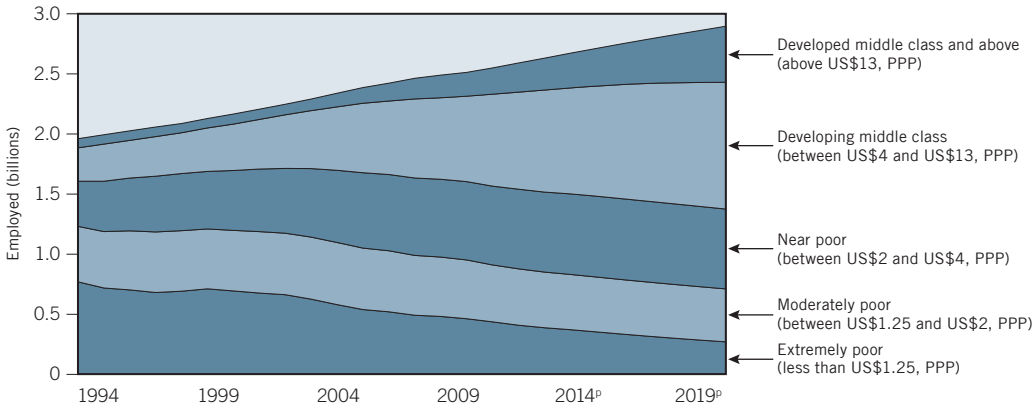
It would take South Asia until the year 2055 and South-East Asia until 2071 to achieve the current level of productivity in the developed economies. Looking ahead as far as the year 2100, without a substantial acceleration in productivity growth rates, average productivity levels in sub-Saharan Africa and North Africa would remain well below current levels in the developed economies. Thus, accelerating productivity growth poses a crucial challenge for many developing countries in the years ahead – while they simultaneously face the challenge of creating sufficient numbers of jobs.

… second, fighting working poverty and improving income distribution …

Rapid economic growth, together with improvements in labour productivity over the past two decades in much of the developing world, has resulted in marked reductions in the incidence of working poverty. In 1994, 39 per cent of the developing world's workers were living with their families in extreme poverty (on less than US$1.25 in consumption per household member per day). By 2004, this figure had fallen to around 25 per cent and, by 2014, it is estimated to have fallen to 13 per cent. As a result, there are 417 million fewer workers living in extreme poverty now than there were two decades ago (figure 1.5).

The number of workers living in moderate poverty in the developing world (on between US$1.25 and US$2), which stands at 457 million in 2014, is little changed since 1994. However, the share of these workers in total employment has declined – from 23.6 per cent down to 16.9 per cent – a far more modest reduction than the corresponding reduction in extreme working poverty. Taking these two groups together, 30 per cent of the developing world's workers remain poor today, down from nearly 63 per cent in 1994. While this clearly represents a tremendous achievement in the broader development agenda, more work needs to be done in terms of boosting the employability and productivity of the poor, as three in ten workers in the developing world are still trapped in poverty.

Figure 1.5 Employment by economic class in the developing world, 1994–2019



Note: PPP = purchasing power parity.

Source: S. Kapsos and E. Bourmpoula: *Employment and economic class in the developing world*, ILO Research Paper No. 6 (Geneva, 2013); ILO, *Trends Econometric Models*, April 2014.

A favourable trend that has coincided with the sharp reduction in poverty in the developing world has been the emergence of a "developing middle class" workforce (those workers living with their families on between US$4 and US$13 per household member per day), and a "developed middle class" workforce (those living on more than US$13 per day).[3] In 2014, the ILO estimates that nearly 34 per cent of workers in the developing world are in the "developing middle class", with a further 11.5 per cent in the "developed middle class". Thus, more than four out of ten workers in developing regions are either in the developing middle class or above, whereas fewer than two out of ten workers were considered to be in the middle class two decades ago.

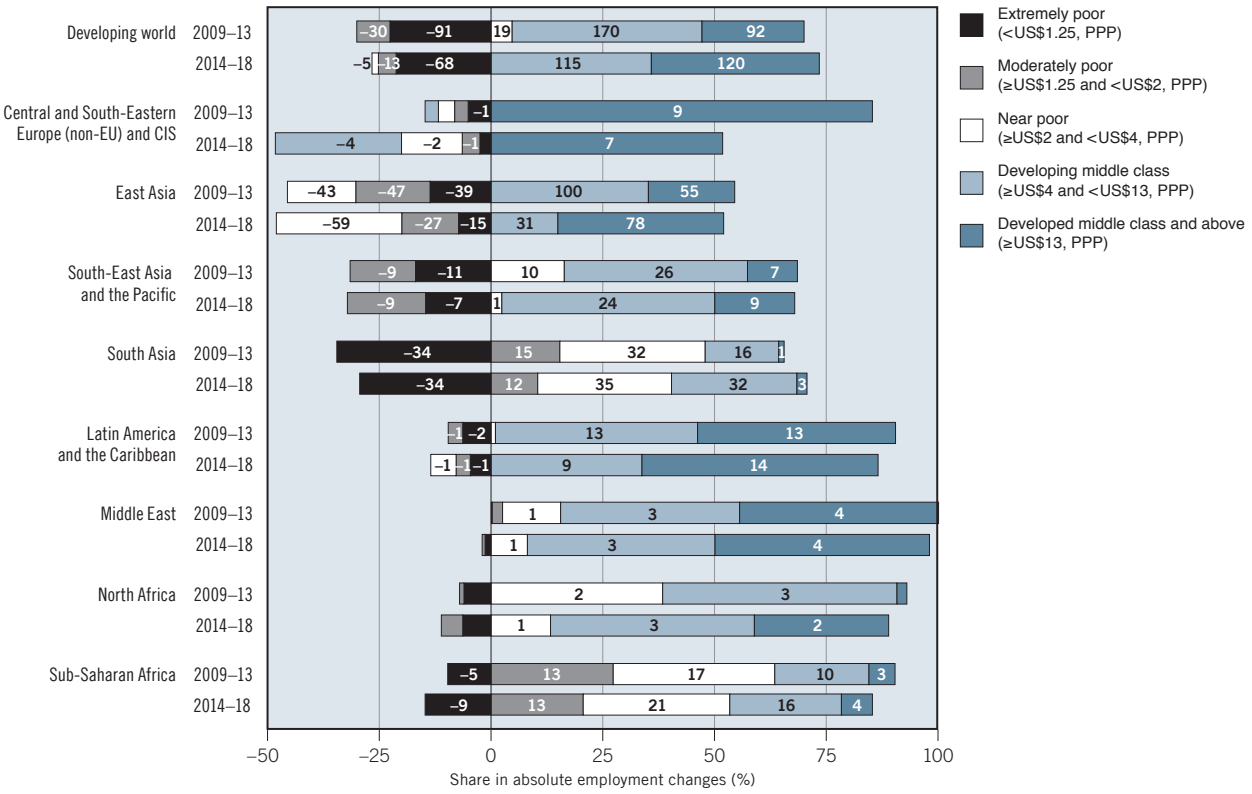
The remaining economic class category encompasses workers who are classified as "near poor" (between US$2 and US$4 per day) – those workers who are managing to eke out a living that enables them to escape poverty, but with insufficient income to be considered as falling within the middle class. Around one-quarter of all workers in developing regions are in this category, up from around 19 per cent in 1994 and roughly unchanged compared with 2004.

Looking ahead to 2018, the ILO projects a further reduction in working poverty in the developing world as a whole. As shown in figure 1.5, which indicates the historical growth in employment by economic class between 2009 and 2013 and projected growth between 2014 and 2018, the number of workers in extreme poverty is expected to fall by 68 million and the number of workers in moderate poverty is expected to decline by 13 million. The number of near-poor workers is unlikely to change significantly, although the share of near-poor workers in total employment will fall as the overall number of employed grows.

The number of workers in the developing and developed middle classes and above is projected to increase by nearly 235 million between 2014 and 2018, compared with growth in these two groups of 262 million over the period from 2009 to 2013. Most notably, growth in the number of workers in the developed middle class and above (living on more than US$13 per family member per day) is projected to accelerate substantially, with this segment set to grow by 120 million

3. These definitions are set forth in Kapsos and Bourmpoula (2013). The US$13 poverty line expressed in 2005 international dollars is equivalent to the 2005 poverty line in the United States.

Figure 1.6 Employment growth by economic class, 2009–13 and 2014–18



Note: PPP = purchasing power parity. The length of the columns sums to 100 per cent. Numbers in brackets indicate changes in employment by class in millions

Source: S. Kapsos and E. Bourmpoula: *Employment and economic class in the developing world*, ILO Research Paper No. 6 (Geneva, 2013); ILO, *Trends Econometric Models*, April 2014.

between 2014 and 2018 compared with an increase of 92 million between 2009 and 2013. The implications of this shift in employment quality are stark: for the first time in history, over the next several years, most new jobs in the developing world are likely to be of sufficient quality to allow workers and their families to live above the equivalent of the poverty line in the United States. Yet, even given this optimistic outlook, it is likely that around 85 per cent of the developing world's workforce will be living below the US-equivalent poverty line in 2018 (down from more than 88 per cent in 2014).

However, a closer examination of regional trends within the developing world reveals substantial differences across the developing regions (figure 1.6). In three regions, Central and South-Eastern Europe, East Asia, and Latin America and the Caribbean, growth in middle class employment is expected to account for all of the employment growth between 2014 and 2018, while the number of workers living with their families in poverty or near poverty is projected to decline. In each of these regions, the developed middle class group is expected to see the greatest employment growth. Indeed, these three regions, which are home to 47 per cent of the developing world's workforce, are projected to account for 82 per cent of the total growth in employment in the developed middle class throughout the developing world. This is suggestive of continued robust improvements in average living standards and favourable prospects for increased consumption and higher domestic demand. However, it also indicates a mixed employment picture in the remaining developing regions.

Indeed, in South Asia and sub-Saharan Africa, while extreme poverty is projected to continue to decline, many of the new jobs created over the next several years

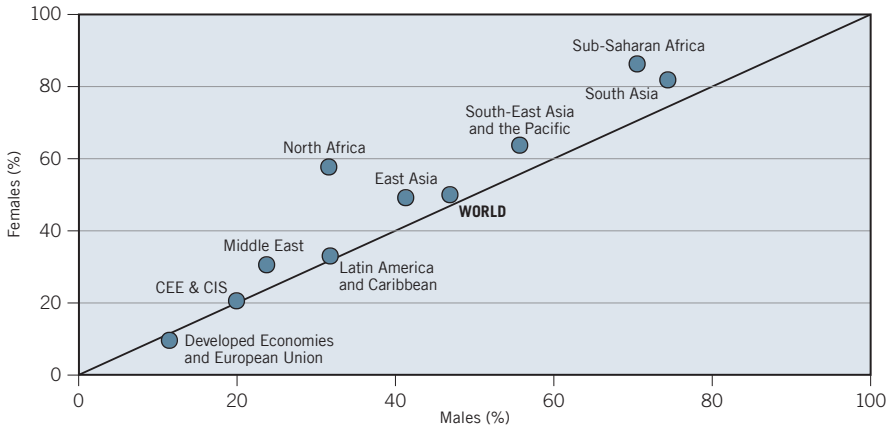
are unlikely to be sufficiently productive to allow workers to escape poverty or near poverty. In both regions, the "near poor" segment of the workforce is projected to see the most growth between 2014 and 2018 and both regions are also expected to see a continued increase in the number of workers in moderate poverty. In both cases, the two middle class segments are projected to see substantial gains, indicating that new, productive employment opportunities are being created. However, the challenge of generating broad-based productivity growth that can accelerate the reduction in poverty and growth in the middle classes in these regions remains formidable.

… third, improving the quality of jobs and working conditions …

More than half of the developing world's workers, a total of 1.45 billion, work either on their own account or as contributing (unpaid) family workers in a family enterprise. Together, these two employment statuses comprise so-called "vulnerable employment", an acknowledgement that these two groups are less likely than wage workers (employees) to have formal working arrangements, be covered by social protection systems or to have regular earnings. Workers in vulnerable employment are more likely than workers in formal wage employment to be trapped in a vicious circle of low-productivity employment, poor remuneration and limited ability to invest in their families' health and education, which, in turn, reduces the likelihood that current and subsequent generations will be able to move up the productivity and income ladders. Accordingly, the vulnerable employment indicator is one of the key labour market indicators used to measure progress towards the achievement of the Millennium Development Goals (MDGs).[4]

What is the extent of vulnerable employment across the different regions of the world? Among the developing regions, as figure 1.7 shows, vulnerable employment rates are highest in South Asia and sub-Saharan Africa (where more than three out of four workers are in vulnerable forms of employment) and considerably lower in Central and South-Eastern Europe and CIS, Latin America and the Caribbean, and the Middle East (where between two and three out of ten workers are in vulnerable employment statuses).

Figure 1.7 Vulnerable employment by gender, world and regions, 2014



Source: ILO, *Trends Econometric Models*, April 2014.

4. See: ILO: Guide to the Millennium Development Goals employment indicators, second edition (Geneva, 2013). Available at http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_elm/documents/publication/wcms_208796.pdf.

Box 1.2 The relationship between type of employment and family income

Based on a sample of household surveys from 39 developing countries, Kapsos and Bourmpoula (2013) find that 83.7 per cent of the extreme working poor (employed population living with their families on less than US$1.25 per person per day at PPP) in these countries are either engaged in own-account work or unpaid family work (the two categories that comprise vulnerable employment), while only 12.7 per cent of the extreme working poor are in wage employment (figure 1.8). Among the moderate working poor, 77 per cent are found in the vulnerable employment statuses, with a somewhat higher share (19 per cent) in wage employment. A higher share of the near poor class of workers is in wage employment (35.3 per cent), indicating that wage employment is not a guaranteed route out of poverty. However, wage employment is far more likely than vulnerable employment to lead to higher earnings that can result in improved living standards for workers and their families: more than six out of ten workers in the developing middle class and above in these countries are in wage employment.

A similar pattern is found in the sectoral employment distribution (figure 1.9), with a declining share of workers in agricultural employment observed as households move up the economic ladder. Three out of four workers in the developing middle class in these countries are employed in the services sector. There is only a slight difference in the share of workers in the industrial sector across the economic classes, which reflects the heterogeneity of industrial jobs, with low-productivity activities typically available to poorer workers and higher value added industrial employment among middle class workers.

Taken together, these findings imply that efforts to expand formal wage employment opportunities and to promote structural transformation, out of lower productivity, subsistence agricultural activities into higher value added employment in the services and industrial sectors is a potentially powerful mechanism for raising living standards and growing the middle class.

Source: S. Kapsos and E. Bourmpoula: *Employment and economic class in the developing world*, ILO Research Paper No. 6 (Geneva, 2013).

Figure 1.8 Employment by economic class and status in employment category

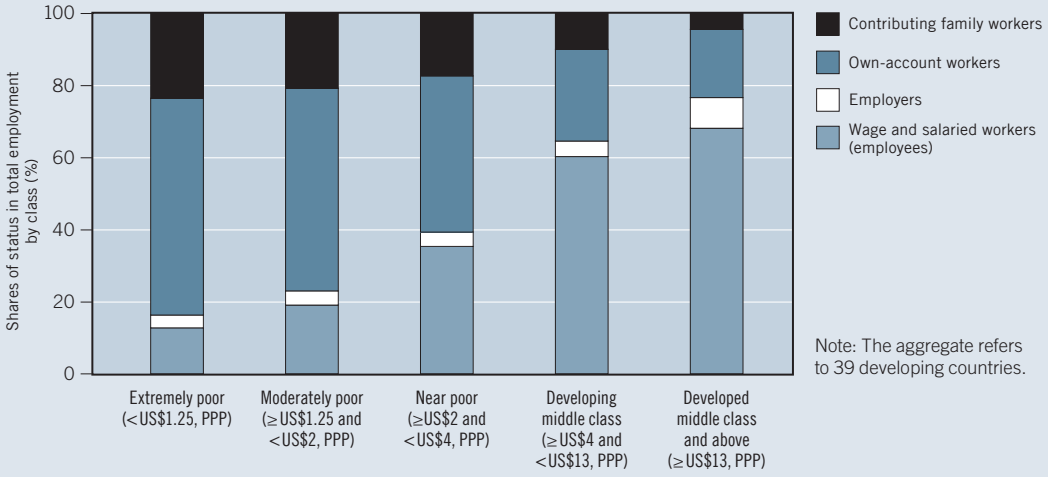
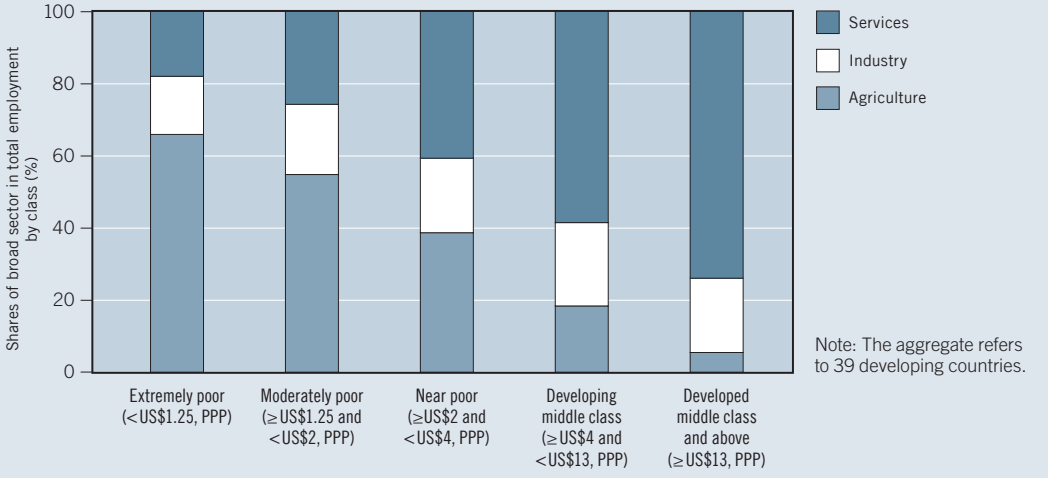


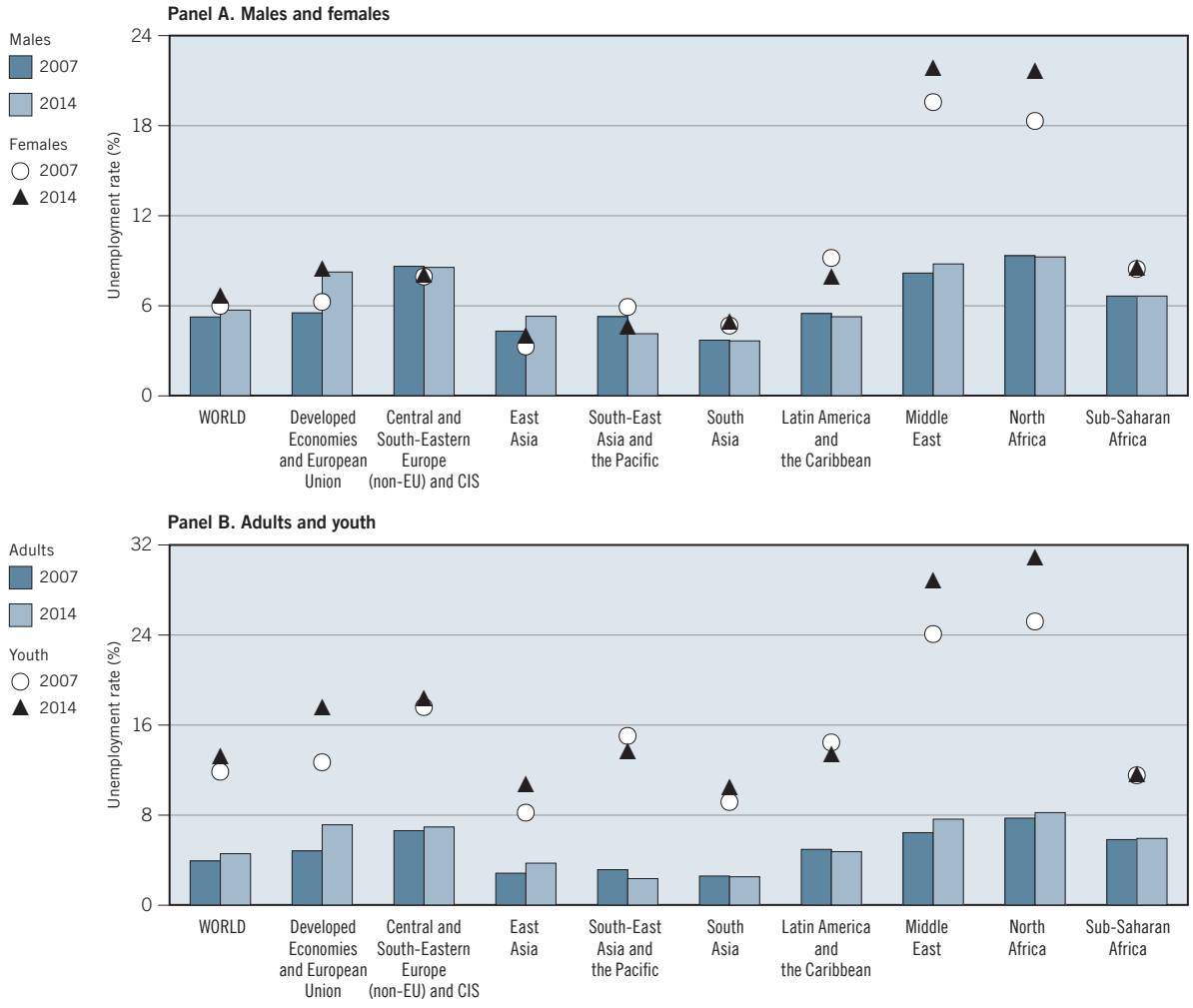
Figure 1.9 Employment by economic class and economic sector



In some regions, there is a notable gender difference with respect to the likelihood of being in vulnerable employment. In the world as a whole, women are only slightly more likely than men to be in vulnerable employment (48.7 per cent of female workers globally versus 46.9 per cent of male workers). However, in North Africa, the gap between women and men is nearly 25 percentage points, with women much more likely than men to be in vulnerable forms of employment. In sub-Saharan Africa, this gender gap is 14.8 percentage points and in the Middle East it is 5.9 percentage points. In contrast, in Central and South-Eastern Europe and CIS and in Latin America and the Caribbean, there is no difference between women and men in terms of the likelihood of being in vulnerable employment.

As workers in vulnerable employment are less likely than formal wage employees to have access to social protection coverage and more likely to live in poverty, expanding wage employment and reducing the incidence of vulnerable employment is a desirable goal from a social equity perspective. At the same time, given the strong, positive relationship between wage employment and higher levels of household consumption (and therefore higher levels of labour productivity), reducing vulnerable employment should also be viewed as a key objective in achieving the broader goals of increasing productivity, raising economic growth and promoting sustainable improvements in living standards (see box 1.2). Policies that take into account the particular constraints facing women in securing wage employment could also help to address gender imbalances.

Figure 1.10 Unemployment by age and gender, world and regions, 2007 and 2014



Source: ILO, *Trends Econometric Models*, April 2014.

… fourth, tackling youth unemployment …

Despite the weak overall relationship between growth and unemployment in the developing world as a whole, a closer look at age- and gender-disaggregated unemployment rates provides important insights into the state of the labour market, particularly with regard to identifying disadvantaged groups. Across all regions of the world, young people face higher unemployment rates than adults, often by a wide margin (figure 1.10). The global youth unemployment rate stands at an estimated 13.0 per cent in 2014, up from 12.8 per cent in 2012 and a notable increase from 11.5 per cent in 2007. This translates into 73.6 million unemployed young people around the world in 2014, an increase of 4.1 million since 2007.

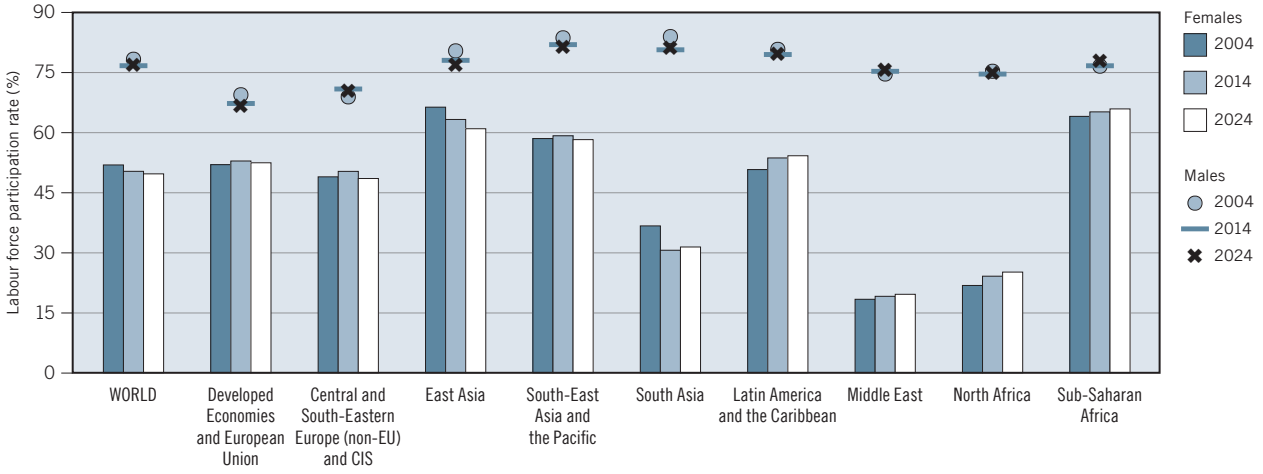
Regionally, the highest youth unemployment rates are found in the Middle East and North Africa regions, where nearly one in three young people in the labour force are unable to find work. Young women, in particular, are confronted by dire labour market prospects in these regions, facing unemployment rates of more than 46 per cent. Women experience higher unemployment rates globally, with the female unemployment rate estimated at 6.4 per cent in 2014, in contrast to a 5.7 per cent rate for men. Female unemployment rates are higher than corresponding male rates in every region except East Asia and Central and South-Eastern Europe and CIS.

… and finally, boosting female labour force participation

In some developing regions, women face substantial barriers to entering the labour market. The overall global female labour force participation rate stands at 50.3 per cent in 2014, meaning that half of all women of working age are either in employment or looking for work, while the other half are economically inactive – neither in work nor seeking work (figure 1.11). The corresponding participation rate for men is 76.7 per cent globally, representing a "gender participation gap" of around 26 percentage points.

However, there is wide variation – both between the advanced economies and the developing world and across the developing regions – in terms of this gender gap. In the developed economies and European Union, the gap is 14.2 percentage

Figure 1.11 Labour force participation by gender, world and regions, 2004, 2014 and 2024



Source: ILO, *Trends Econometric Models*, April 2014.

points, which is roughly the same as the gap observed in East Asia. In sub-Saharan Africa, the gap is only 11.5 per cent, as a large share of both women and men in the region remain poor and have no choice but to take up any form of work available. At the other extreme, in South Asia and North Africa, the gender participation gap is around 50 percentage points and, based on current projections, the gap in both of these regions is predicted to narrow by around 1 percentage point only the next decade. In the Middle East, the gender participation gap is 56.4 per cent and is expected to remain above 55 per cent in 2024.

Large pools of economically inactive women represent foregone economic potential. From a more positive perspective, the large cohort of inactive women also represents a potential means to accelerate growth in output and employment, which could help to offset the adverse effects of demographic shifts and population ageing, which is already affecting some countries. To achieve this potential will require a strong policy framework for integrating women into economies, reducing inhibitive cultural barriers and a general shift to more positive attitudes regarding the role of women in society in those regions where they are most excluded.

Tackling the employment challenges in developing countries will require ambitious but differentiated approaches

The large remaining productivity gaps between the developed and developing regions highlight the need to accelerate productivity growth going forward in the developing world. This will be essential to generate meaningful and sustainable improvements in living standards and to grow the middle class. One barrier to this goal has been the limited growth in wage and salaried employment opportunities in many developing countries, as large shares of workers remain trapped in vulnerable jobs on their own account or in subsistence-oriented agriculture or family enterprises. Productivity improvements will require new wage employment opportunities that can help to pull workers out of the informal economy and give them a chance to earn a decent living.

While achievements in reducing the number and shares of workers living in poverty have been nothing short of remarkable, more than half of the developing world's workers remain either poor or near poor, with around 88 per cent still living below the US-equivalent poverty line, and progress in reducing the numbers of moderately poor and near poor workers has not kept pace with the gains achieved in reducing extreme poverty. This calls for further investment in social protection systems that can shield vulnerable households from economic shocks, allowing them to maintain acceptable minimum living standards and invest in their families' health, education and skills development.

Over the past two decades, economic and labour market trends throughout much of the developing world have supported large, measurable gains in living standards. This, in turn, has helped to initiate the process of rebalancing global growth towards reduced reliance on consumption in advanced economies and stronger domestic demand with more sustainable growth in developing regions. Prospects for sustainable and equitable global economic growth and stability will rely very heavily on further success in this regard.

Structure of the report

The remainder of this report is organized around two main topics. First, it demonstrates that placing greater emphasis on employment will support and accelerate the overall process of development. Second, the report examines "what works" in terms of policies that are effective in boosting quality employment and more inclusive growth.

The first section (Chapters 2 to 4) explores the links between development and employment. The second section starts with an analysis of structural transformation in developing countries (Chapter 5). The report then examines the role of effective labour institutions (Chapter 6), well-designed social protection systems (Chapter 7), income distribution measures (Chapter 8) and migration (Chapter 9) as forces for economic development. The report examines performance in 145 developing countries (DCs), defined according to the World Bank's criteria as those with per capita incomes falling below US$12,000 at market exchange rates. Countries are grouped in three categories (see Appendix A below for a list of countries in each category):

(i) least developed countries (LDCs), as defined by the United Nations' criteria, which are those that fall below US$1,000 average per capita income and include, in addition, a few countries whose structural characteristics place them within this group;

(ii) lower middle income countries (LMIs), which include economies where average per capita income ranges between US$1,000 and US$4,000; and

(iii) emerging economies (EEs) with average per capita income ranging between US$4,000 and US$12,000.

Advanced economies (AEs) are those with average per capita income above US$12,000.

The typology of country categories is then further refined and explored for characteristics and policies that may explain the varying degrees of success in terms of outcomes among the 145 DCs. One such characteristic is the degree of reliance on extractive resources and industries. Another characteristic is country reliance on macroeconomic drivers of growth, such as being investment led, export led or consumption led. Additionally, to capture country granularity, country narratives and examples have proved to be useful.

Appendix A

Country classification used in the report

LDCs 49 countries	Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, Sudan, Tanzania, Timor-Leste, Togo, Tuvalu, Uganda, Vanuatu, Yemen, Zambia *UN definition of LDCs according to income criterion (GNI per capita <US$992 for inclusion, >US$1,190 for graduation), human assets index and economic vulnerability index.*
LMIs 44 countries	Albania, Armenia, Belize, Bolivia, Cameroon, Cabo Verde, the Congo, Côte d'Ivoire, Egypt, El Salvador, Fiji, Georgia, Ghana, Guatemala, Guyana, Honduras, India, Indonesia, Iraq, Kenya, Dem Rep. Korea, Kosovo, Kyrgyzstan, the Marshall Islands, Micronesia Federal States, Moldova, Mongolia, Morocco, Nicaragua, Nigeria, Occupied Palestinian Territory, Pakistan, Papua New Guinea, Paraguay, the Philippines, Sri Lanka, Swaziland, Syrian Arab Republic, Tajikistan, Tonga, Ukraine, Uzbekistan, Viet Nam, Zimbabwe *WB income category: lower middle income (GNI per capita US$1,026 – US$4,035) + low income (GNI per capita <US$1,025) countries that are not classified as LDCs.*
EEs 52 countries	Algeria, American Samoa, Antigua and Barbuda, Argentina, Azerbaijan, Belarus, Bosnia and Herzegovina, Botswana, Brazil, Bulgaria, Chile, China, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, Gabon, Grenada, Islamic Republic of Iran, Jamaica, Jordan, Kazakhstan, Latvia, Lebanon, Libyan Arab Jamahiriya, Lithuania, The former Yugoslav Republic of Macedonia, Malaysia, Maldives, Mauritius, Mexico, Montenegro, Namibia, Palau, Panama, Peru, Romania, Russian Federation, Saint Lucia, Saint Vincent and the Grenadines, Serbia, Seychelles, South Africa, Suriname, Thailand, Tunisia, Turkey, Turkmenistan, Uruguay, Bolivarian Republic of Venezuela *World Bank income category: upper middle income (GNI per capita US$4,036 – US$12,475) with the exceptions of Angola and Tuvalu (LDCs)*

PART I

Jobs as drivers of development

Growth patterns in developing countries

2

Introduction

This chapter examines patterns of economic growth in developing countries (DCs), including whether there has been any catch-up with advanced economies (AEs). It reviews growth trends over the past three decades in three different groups of countries: emerging economies (EEs), lower-middle-income countries (LMIs) and least developed countries (LDCs) (section A). The sectoral composition of economic growth is also examined. In particular, the role of manufacturing and extractive industries in leading economic growth and development is assessed (section B). The sectoral analysis is expanded in Chapter 5, where the importance of productive transformation as part of the development process is discussed further.

A. Economic growth performance

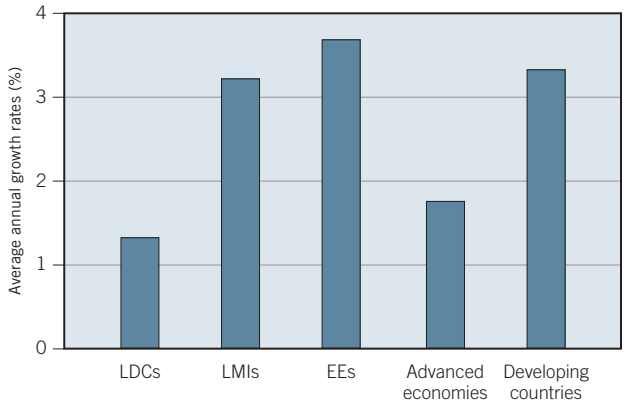
Developing countries as a group have grown faster than advanced economies, but there has been substantial variation between them…

The process of economic convergence between DCs and AEs has proceeded unevenly over the past three decades. Between 1980 and 2011, per capita income in DCs grew, on average, by 3.3 per cent per annum – much faster than the 1.8 per cent per capita growth recorded in AEs (see figure 2.1).[1] However, the process of convergence was highly differentiated between groups of DCs. EEs had a higher average growth rate for GDP per capita, of 3.7 per cent per annum, over this period, suggesting that they will achieve convergence sooner than the average DC. LMIs had a slightly lower growth rate for GDP per capita than EEs over the same period, of 3.2 per cent per annum, indicating a slower convergence with AEs. By contrast, LDCs had a GDP per capita growth rate over the period of 1.3 per cent per annum, less than that of AEs; as a result there has been no convergence over the past 32 years.

Looking beyond these averages, there was substantial variation between the countries within each of these country groups (figure 2.2).

1. All GDP growth rates are in real terms, using constant 2005 US$.

Figure 2.1 GDP per capita average annual growth rates, 1980–2011



Source: ILO calculations based on World Bank, *World Development Indicators*.

…with growth accelerating in many countries since the early 2000s

Table 2.1 shows GDP per capita growth performance for the three decades of the 1980s, 1990s and the 2000s. It shows that for DCs, annual rates of GDP per capita growth picked up from an average of 1.6 per cent in the 1980s, to 3.2 per cent in the 1990s and to 5 per cent in the 2000s. This acceleration applies to each of the three income categories within this group of countries. In the 2000s, LDCs had an average annual GDP per capita growth rate of 3.6 per cent, LMIs 4.5 per cent, and EEs 5.5 per cent. LDCs began the 1980s with a negative GDP per capita growth rate, while EEs and LMIs had positive growth rates, but those rates were lower than the average for AEs. The growth performance of LMIs and EEs began to exceeded that of AEs in the 1990s, picking up speed in the 2000s, with LDCs joining the pattern in that decade.

Table 2.1 also shows that among those DCs that are more reliant on extractive industries, natural resources were of most benefit to countries in the lower

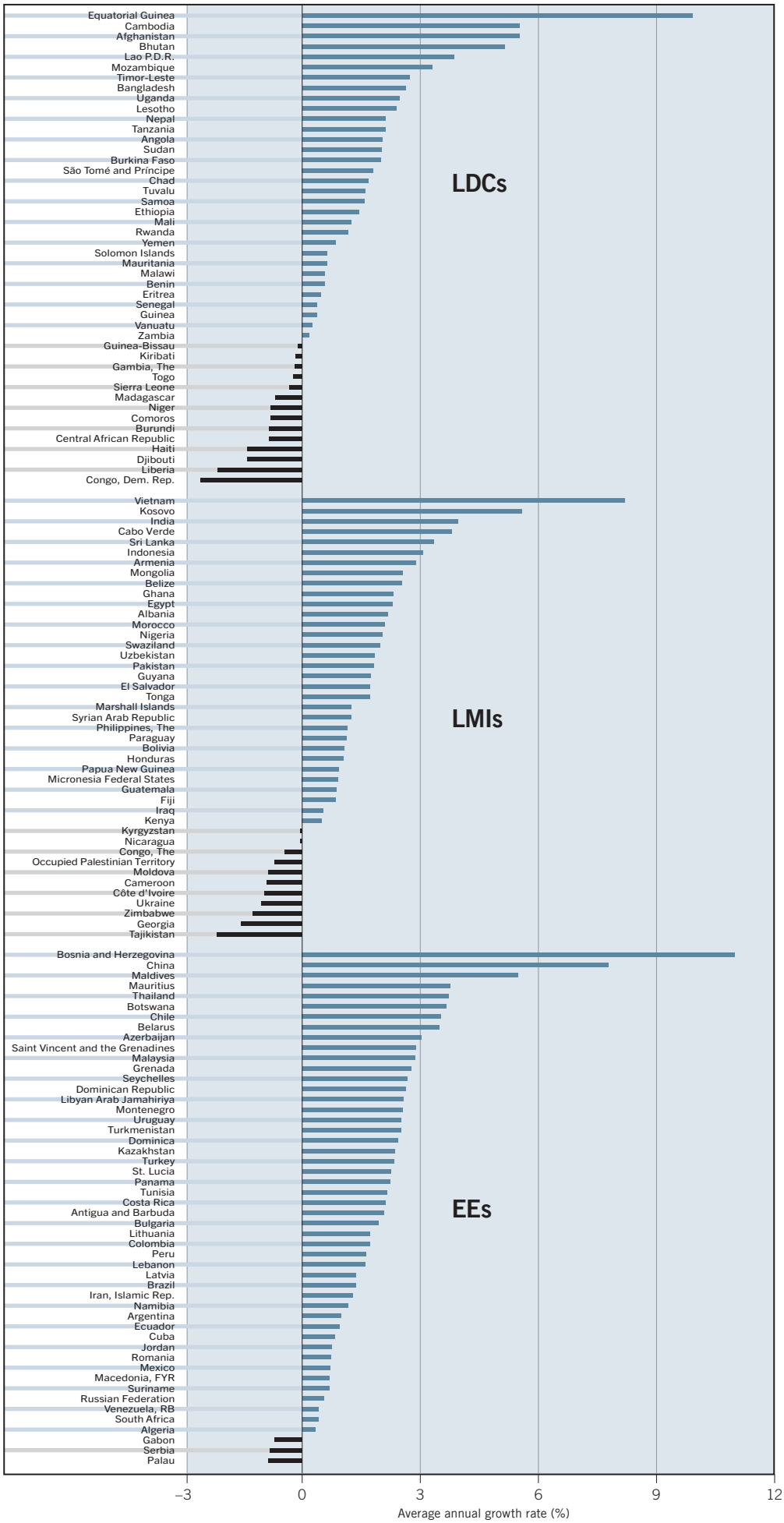
Table 2.1 GDP per capita annual growth rates, period average (per cent per annum)

		1980–89	1990–99	2000–11
Advanced economies		2.6	1.8	0.8
Developing countries		1.6	3.2	5.0
LDCs[1]		–0.1	0.3	3.6
LMIs[2]		2.4	2.6	4.5
EEs[3]		1.7	3.7	5.5
Non-extractive reliant	LDCs	0	1.5	3.1
	LMIs	1.8	2.5	4.7
	EEs	1.9	3.4	5.5
Extractive reliant	LDCs	–0.4	–1.3	3.1
	LMIs	1.1	1.5	3.8
	EEs	–0.2	1.7	2.3

[1] Data missing for: Afghanistan, Cambodia, Djibouti, Eritrea, Ethiopia, Guinea-Bissau, Liberia, Mauritania, Myanmar, Sao Tome and Principe, South Sudan, Timor-Leste, Tuvalu, Yemen. [2] Data missing for: Armenia, Georgia, Iraq, Kosovo (as defined in United Nations Security Council Resolution No. 1244 of 1999), Kyrgyzstan, Marshall Islands, Micronesia Federal States, Moldova, Syrian Arabic Republic, Tajikistan, Ukraine, Uzbekistan, Zimbabwe. [3] Data missing for: Azerbaijan, Belarus, Bosnia and Herzegovina, Gabon, Kazakhstan, Latvia, Lithuania, Montenegro, Namibia, Russian Federation, Serbia, The former Yugoslav Republic of Macedonia, Turkmenistan.

Source: ILO Research Department calculation based on World Bank, *World Development Indicators 2013*.

Figure 2.2 GDP per capita, average annual growth rate, 1980–2011



Note: The average annual growth rate is calculated between the earliest and latest years for which data were available.

Source: ILO Research Department, based on World Bank, *World Development Indicators*.

Box 2.1 Theories to explain cross-country development patterns

There are many and diverse theories of what drives growth and development. For the purpose of this enquiry, growth literature is divided into two broad sets. One set explains economic change in terms of the quantum of growth. The other seeks to explain this change in terms of the composition of growth. There is also a crossover literature which explains the quantum of growth through its composition.

Essentially, the quantum literature, with its genesis in Mill (1848), Marshall (1890) and Say (1803), has explained macroeconomic change in countries through growth rates determined by the accumulation of physical capital (Solimano, 1996). Their neoclassical successors, notably Solow (1956, 1957), Harrod (1949) and Domar (1952, 1957), pondered exogenous factors, such as the rate of population growth (Solimano, 1996). The logical implication of these models, which sought to explain economic change in terms of simply the quantum of growth, was that there would be eventual convergence across countries (see the Solow–Swan model, in particular). The past two centuries have not borne this out.

According to other theories, economic change could not be explained well by the quantum of growth alone. The components of this growth mattered very much. The progenitors of this line of thinking include Lewis (1954), Verdoorn (1941), Kaldor (1961) and the structural tranformationists, such as Chang (2002), Lin (2012), Rodrik (2005) and Hausmann and Klinger (2006). Lewis provided the broadest model of macroeconomic change being determined not just by the quantum of growth, but by sectoral change from a subsistence to a capitalist sector. Verdoorn focused on industry, Kaldor on the role of manufacturing, with the transformationists following in the tradition with their own approaches.

Other theories combine both views. They also seek to differentiate capital into physical and human capital (e.g., Arrow, 1962; Becker, 1962; Lucas, 1988; Mankiw, Romer and Weil, 1992). Dutz et al. (2012) seek to use intangible knowledge capital as well.

Table 2.2 GDP per capita annual growth rates, before and after the economic crisis (per cent per annum)

	2000–07	2008–12
Advanced economies	1.5	–0.1
Developing countries	4.9	4.4
LDCs[1]	3.4	2.2
LMIs[2]	4.5	4.4
EEs[3]	5.4	4.9

[1] Data missing for: Afghanistan, Cambodia, Djibouti, Eritrea, Ethiopia, Guinea-Bissau, Liberia, Mauritania, Myanmar, Sao Tome and Principe, South Sudan, Timor-Leste, Tuvalu, Yemen. [2] Data missing for: Armenia, Georgia, Iraq, Kosovo (as defined in United Nations Security Council Resolution No. 1244 of 1999), Kyrgyzstan, Marshall Islands, Micronesia Federal States, Moldova, Syrian Arabic Republic, Tajikistan, Ukraine, Uzbekistan, Zimbabwe. [3] Data missing for: Azerbaijan, Belarus, Bosnia and Herzegovina, Gabon, Kazakhstan, Latvia, Lithuania, Montenegro, Namibia, Russian Federation, Serbia, The former Yugoslav Republic of Macedonia, Turkmenistan.

Source: ILO Research Department calculation based on World Bank, *World Development Indicators 2013*.

income categories in the 2000s, giving LDCs and LMIs higher GDP growth rates compared with EEs.[2] Among those DCs that are less reliant on extractive industries, EEs had the highest GDP growth rates in the 2000s. Table 2.2 shows that growth in LDCs was also hardest hit by the global economic crisis.

Over the past 33 years, the quantum of GDP growth per capita has served to distinguish between LDCs, LMIs and EEs. However, in the past decade, GDP per capita growth rates for all three income categories have picked up and have converged into a narrower range, from 3.6 per cent to 5.5 per cent per annum. If the quantum of GDP growth does not vary consistently between LDCs, LMIs and EEs over time, the question arises of whether the composition of GDP growth affords a more consistent explanation of distinguishing between their performance.

2. Countries with natural resources rents above 10 per cent of GDP are classified here as "extractive reliant".

B. The composition and nature of economic growth

Sectoral analysis highlights the leading role of manufacturing

There has been heated debate regarding the role of manufacturing as a driver of economic growth in DCs. Table 2.3 presents the value added growth rate by sector for different country groups over the past three decades. The table shows that the earlier observed pick-up in growth in DCs – from 1.6 per cent in the 1980s to 3.2 per cent in the 1990s and 5 per cent in the 2000s – was not led by agricultural growth, which remained relatively unchanged at about 3.5 per cent per annum. Manufacturing growth over the period picked up from 4.7 per cent to 7.2 per cent per annum. Industrial growth followed, with a pick-up over this period from 3.5 per cent to 6.8 per cent per annum. Services growth also picked up, from 3.7 per cent to 6.4 per cent per annum.

This follows the pattern posited by Lewis, (1954), who argued that a movement of surplus labour from low productivity, subsistence agriculture to higher productivity sectors would boost economic growth.

It is important to distinguish between industry and manufacturing. The two main components of industry are manufacturing and extractives. Hence the implication of table 2.3 is that DC growth over the past third of a century has been led a bit more by manufacturing and a bit less by extractives and services.

This is where a first pattern emerges in the sectoral differences between the three income groups: LDCs, LMIs and EEs. The three income categories all followed the broad Lewisian pattern over the 1980s to the 2000s, of growth being led by sectors other than agriculture. However, table 2.3 shows that, over this period, growth in the higher income groups, namely EEs and LMIs, was consistently higher for manufacturing than for industry. Conversely, LDC growth over this period was higher for industry than manufacturing.

Thus, the higher income groups among DCs have relied more on manufacturing growth to lead their GDP growth over the past third of a century than have the LDCs, which have relied more on extractives to lead their GDP growth. Services growth has consistently been placed third in the composition of GDP growth for all three DC income categories, although it has gained strength over the most recent decade.

Table 2.3 Growth rates by sector, period annual averages (per cent per annum)

	Agriculture			Industry (including manufacturing)			Manufacturing[4]			Services		
	1980–89	1990–99	2000–11	1980–89	1990–99	2000–11	1980–89	1990–99	2000–11	1980–89	1990–99	2000–11
Developing countries	3.6	2.8	3.5	3.5	5.8	6.8	4.7	7.0	7.2	3.7	4.9	6.4
LDCs[1]	2.7	3.2	4.3	4.1	4.0	7.5	3.8	5.6	5.8	2.8	2.2	6.7
LMIs[2]	3.1	2.8	3.2	4.9	4.9	5.8	5.9	5.3	5.9	5.3	5.3	7.3
EEs[3]	3.9	2.8	3.5	3.2	6.0	7.0	4.4	7.5	7.4	3.4	4.9	6.1

[1] Data missing for: Afghanistan, Djibouti, Eritrea, Guinea, Guinea-Bissau, Equatorial Guinea, Haiti, Cambodia, Liberia, Myanmar, Niger, Rwanda, Solomon Islands, Somalia, South Sudan, Sao Tome and Principe, Chad, Timor-Leste, Tuvalu, Tanzania, Samoa, Yemen. [2] Data missing for: Armenia, Micronesia Federal States, Georgia, Iraq, Democratic People's Republic of Korea, Kyrgyzstan, Kosovo (as defined in United Nations Security Council Resolution No. 1244 of 1999), Moldova, Marshall Islands, Nigeria, Nicaragua, Occupied Palestinian Territory, Paraguay, Syrian Arab Republic, Ukraine, Uzbekistan. [3] Data missing for: American Samoa, Azerbaijan, Bosnia and Herzegovina, Botswana, Belarus, Bulgaria, Kazakhstan, Lebanon, Libyan Arab Jamahiriya, Lithuania, Maldives, Montenegro, Palau, Romania, Russian Federation, Serbia, The former Yugoslav Republic of Macedonia, Turkmenistan. [4] Missing also: Burundi, Central African Republic, Mozambique, Sierra Leone, Vanuatu (LDCs); Albania, Cameroon, Cabo Verde, Egypt, Kyrgyzstan, Mongolia, Uzbekistan (LMIs); Brazil, Namibia (EEs).

Source: ILO calculations based on IMF *World Economic Outlook*, April 2013, and World Bank, *World Development Indicators 2013*.

Table 2.4 Growth rates by sector, period annual averages (per cent per annum)

	GDP		Agriculture		Industry (including manufacturing)		Manufacturing		Services	
	2000–07	2008–11	2000–07	2008–11	2000–07	2008–11	2000–07	2008–11	2000–07	2008–11
Developing countries	6.7	6.2	3.4	3.5	7.1	6.7	7.9	5.8	6.7	6.0
LDCs[1]	6.9	4.8	3.7	4.8	9.4	3.9	6.5	6.5	7.0	5.8
LMIs[2]	6.4	6.5	3.3	3.7	6.1	5.6	6.3	5.6	7.2	7.5
EEs[3]	6.8	6.2	3.4	3.3	7.2	7.0	8.3	5.6	6.5	5.5
Non-extractive reliant										
LDCs	5.5	5.5	3.6	3.9	7.0	7.0	6.3	6.2	5.9	5.7
LMIs	6.5	6.8	3.2	3.8	6.9	6.1	6.7	6.2	7.4	7.9
EEs	7.2	6.7	3.4	3.4	7.7	7.6	8.6	5.9	6.6	5.7
Extractive reliant										
LDCs	7.4	2.8	3.9	6.7	11.5	1.3	7.2	7.4	9.2	6.1
LMIs	5.9	5.6	3.5	3.3	4.7	4.8	5.5	4.4	6.4	6.3
EEs	5.1	3.6	4.2	2.7	3.6	0.8	4.5	0.8	6.3	3.8

[1] Data missing for: Afghanistan, Cambodia, Djibouti, Eritrea, Ethiopia, Guinea-Bissau, Liberia, Mauritania, Myanmar, Sao Tome and Principe, South Sudan, Timor-Leste, Tuvalu, Yemen. [2] Data missing for: Armenia, Georgia, Iraq, Kosovo (as defined in United Nations Security Council Resolution No. 1244 of 1999), Kyrgyzstan, Marshall Islands, Micronesia Federal States, Moldova, Syrian Arabic Republic, Tajikistan, Ukraine, Uzbekistan, Zimbabwe. [3] Data missing for: Azerbaijan, Belarus, Bosnia and Herzegovina, Gabon, Kazakhstan, Latvia, Lithuania, Montenegro, Namibia, Russian Federation, Serbia, The former Yugoslav Republic of Macedonia, Turkmenistan.

Source: ILO calculation based on IMF, *World Economic Outlook*, April 2013, and World Bank, *World Development Indicators 2013*.

The relatively greater reliance of LDCs on extractives growth made the group more vulnerable to the global crisis. The large drop in LDCs' growth during the crisis is largely accounted for by a cut of more than half in their industrial growth rates, while their manufacturing growth rates remained constant over this period. The industrial growth rates plunged for the more extractive-reliant LDCs.

The fact that EEs and LMIs relied more heavily on manufacturing growth to lead their GDP growth while LDCs appear to have relied more on extractive growth to lead their GDP growth over the past third of a century, also implies that EEs and LMIs will have built up higher shares of manufacturing in their overall economies than have LDCs.

Indeed, shares in manufacturing move in lockstep up the income ladder, from LDCs to LMIs to EEs, as seen in table 2.5. Over this 30-year period, manufacturing in LDCs remained in the range of 9 to 10 per cent of GDP, in LMIs in the range of 16 to 19 per cent, and in EEs in the range of 19 to 26 per cent. Table 2.5 also shows that, in DCs, the share of agriculture in GDP went down over the same period. The shares in agriculture over the past three decades have been the lowest for EEs, followed by LMIs and then LDCs.

These patterns suggest that, over the long term, the share of manufacturing growth in total growth explains the differences in per capita incomes across developing countries (see also Appendix). That said, manufacturing has had a very rough ride in an increasingly competitive global market. This aggregate result could, therefore, be based on the manufacturing gains of a few large countries, achieved at the expense of a number of small ones, whose manufacturing sectors have shrunk over time. The first test to explore this possibility is the removal of one such manufacturing giant, China, from among the EEs. However, that still leaves EEs in the same band as LMIs, with a manufacturing share in GDP ranging between 17 per cent in 1980 and 18 per cent in 2010. The manufacturing

Table 2.5 Value added by sector as percentage of GDP

	Agriculture				Industry (excluding manufacturing)[6]				Manufacturing[6]				Services			
	1980[4]	1990	2000	2010[5]	1980[4]	1990	2000	2010[5]	1980[4]	1990	2000	2010[5]	1980[4]	1990	2000	2010[5]
Developing countries	15.0	15.0	12.2	9.5	16.8	16.0	16.0	16.4	17.6	18.9	22.2	23.8	49.9	50.2	50.6	51.5
LDCs[1]	29.7	29.4	29.4	23.3	14.3	15.0	16.8	21.4	9.0	9.1	10.4	10.2	47.4	47.0	43.9	45.7
LMIs[2]	27.5	23.7	19.6	14.8	14.3	13.8	13.8	13.3	16.0	17.8	18.8	18.6	41.7	44.5	47.5	53.1
EEs[3]	11.2	11.9	9.6	7.5	17.7	16.8	16.6	17.1	18.5	19.7	23.6	25.9	52.1	52.0	51.7	51.3
EEs[4] (excluding China)	7.8	7.8	6.8	6.2	19.2	19.2	18.4	17.2	17.4	18.0	19.0	18.4	55.0	55.6	57.5	59.8

Notes: Aggregates were calculated based on nominal values at constant 2005 US$.

[1] Data missing for: Afghanistan, Djibouti, Eritrea, Guinea, Guinea-Bissau, Equatorial Guinea, Haiti, Cambodia, Liberia, Myanmar, Niger, Rwanda, Solomon Islands, Somalia, South Sudan, Sao Tome and Principe, Chad, Timor-Leste, Tuvalu, Tanzania, Samoa, Yemen. [2] Data missing for: Armenia, Micronesia Federal States, Georgia, Iraq, Kyrgyzstan, Kosovo (as defined in United Nations Security Council Resolution No. 1244 of 1999), Moldova, Marshall Islands, Nigeria, Nicaragua, Democratic People's Republic of Korea, Paraguay, Occupied Palestinian Territories, Syrian Arab Republic, Ukraine, Uzbekistan. [3] Data missing for: American Samoa, Azerbaijan, Bosnia and Herzegovina, Botswana, Belarus, Bulgaria, Kazakhstan, Lebanon, Libyan Arab Jamahiriya, Lithuania, Maldives, Montenegro, Palau, Romania, Russian Federation, Serbia, The former Yugoslav Republic of Macedonia, Turkmenistan. [4] Earliest year available. [5] Latest year available. [6] Missing also: Burundi, Central African Republic, Mozambique, Sierra Leone, Vanuatu (LDCs); Albania, Cameroon, Cabo Verde, Egypt, Kyrgyzstan, Mongolia, Uzbekistan (LMIs); Brazil, Namibia (EEs).

ILO calculation based on IMF, *World Economic Outlook*, April 2013, and World Bank, *World Development Indicators 2013*.

share in GDP still separates LDCs from LMIs and EEs quite consistently over the past three decades.

The second test is to examine the number of countries in which the manufacturing share dropped significantly over the past three decades. Figure 2.3 shows that more than half of developing countries in each income category saw contractions in their manufacturing shares in GDP between 1980 and 2011. While there has been much churning in the manufacturing sector, in terms of share of GDP, in these DCs most changes have been relatively small, indicating a relative stability in their manufacturing shares.

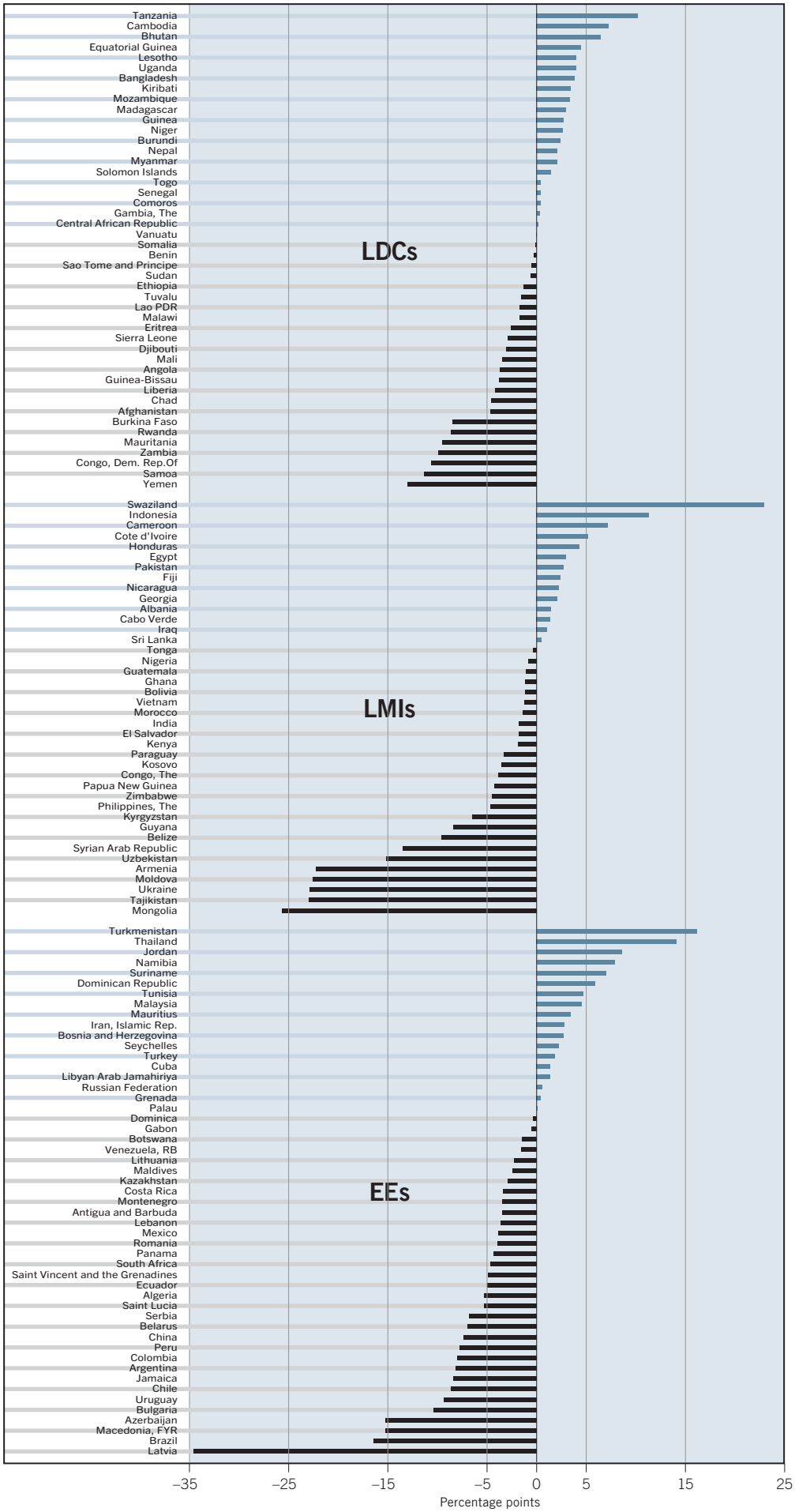
Moving up the income ladder in resource-rich countries: The examples of extractives-based growth in Azerbaijan…

Azerbaijan is an oil-rich country whose specialization in the production of oil dates back to the nineteenth century. Following its independence in 1991, the country went through a difficult decade. Since the end of the 1990s, Azerbaijan has maintained macroeconomic stability in terms of price stability and public deficits. Given the size of its natural resource endowment, Azerbaijan faced the dual challenges of transitioning from a state to a market economy on the one hand, while managing a high-growth resource sector on the other.

Azerbaijan has achieved substantial progress in terms of human development, as can clearly be seen in figure 2.4. Since 2000, poverty and inequality have declined while GDP per capita has grown quickly. Strong investment in social protection has allowed the country to avoid the high degree of inequality often associated with resource-based economies.

The strong correlation between Azerbaijani economic performance and oil prices underscores the continued reliance of the country on its energy exports. The rapid rise in oil-related exports resulted in a high exports-to-GDP ratio, which peaked in 2007, before the onset of the global financial crisis. Rising oil prices and the realization of much-needed investment in the energy sector helped the economy to grow rapidly from 1999 onwards.

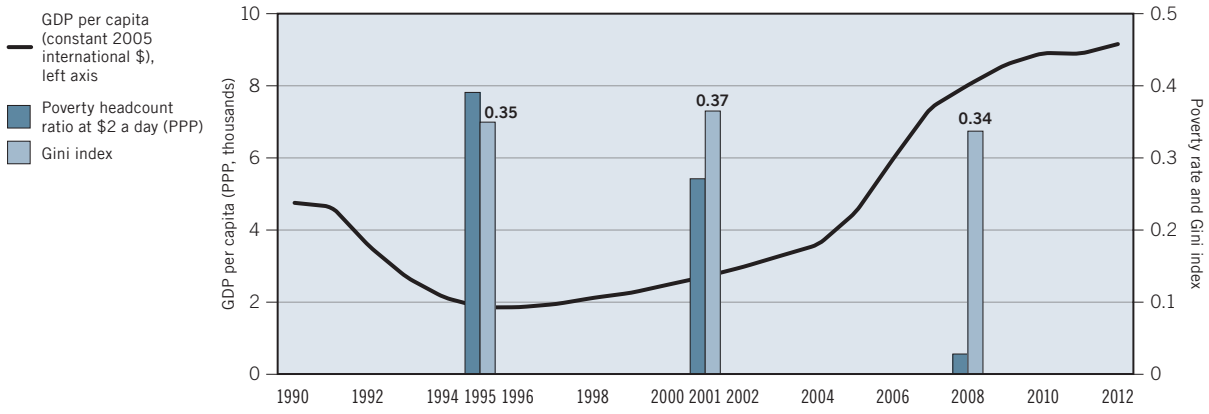
Figure 2.3 Change in the share of manufacturing contribution to GDP, 1980–2011 (percentage points)



Note: The change in the share of manufacturing contribution to GDP is calculated between the earliest and latest years for which data were available.

Source: ILO Research Department, based on World Bank, *World Development Indicators*.

Figure 2.4 Income per capita, poverty and inequality in Azerbaijan



Note: Poverty headcount ratio and Gini index are scaled from 0 to 1 (right axis).

Source: ILO calculations based on World Bank, *World Development Indicators*.

Oil-related revenues have allowed the Azerbaijani Government to invest in social protection (ILO, 2012; WHO, 2010). The largest means-tested programme is the Targeted Social Assistance, launched in 2006, in the midst of the oil boom. The programme was progressively scaled up to reach about 10 per cent of the population in 2012 and accounted for 0.8 per cent of GDP in 2010 (ILO, 2012). It has been found to be relatively well targeted, with 50 per cent of its expenditures going to the bottom income decile of the population (World Bank, 2010). Increases in the minimum wage[3] have also helped to reduce inequality (World Bank, 2010). Over the period 2001–2008, inequality (measured by the Gini coefficient) decreased by 8 per cent (World Bank, 2013), from 0.37 to 0.34, which is low by resource-rich country standards and average by regional standards.

While Azerbaijan has managed its growing oil revenues rather well, its reserves-to-production ratio was about 20 at the end of 2012 (BP, 2013). This means that oil windfalls will be winding down and therefore diversification of Azerbaijan's productive sectors will be necessary to ensure the sustainability and furthering of achievements in terms of standards of living and human development.

…and manufacturing in Indonesia, a resource-rich economy

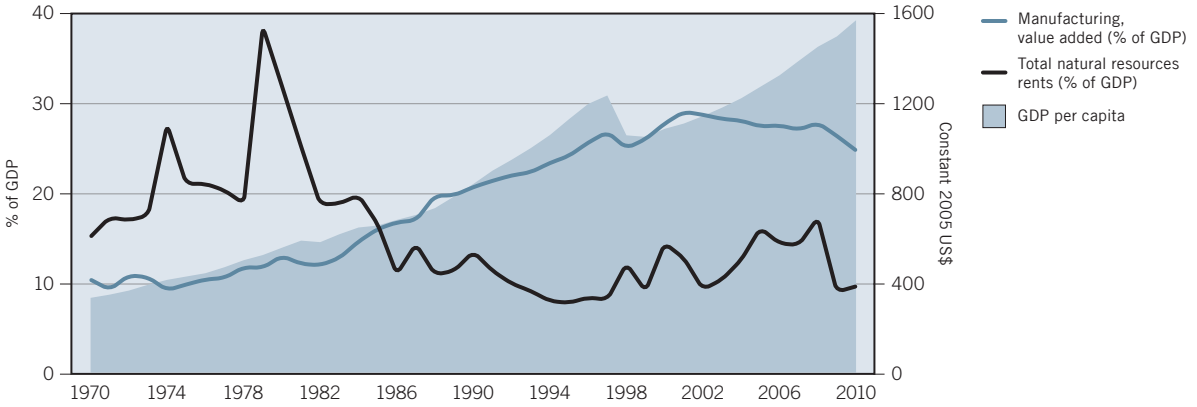
Indonesia is one of the countries that suffered considerably from the 1997 East Asian financial crisis. After averaging an annual growth rate of 7.6 per cent between 1990 and 1997, the economy contracted by 13.1 per cent in 1998. This was also a period of major political transition. The economy resumed growing as early as 2000, on a trend close to pre-1998 levels (figure 2.5).

Indonesian economic growth has been characterized by strong development in the manufacturing sector, particularly from 1982 to 2001, as seen in figure 2.5.

The management of oil revenue windfalls has been a remarkable achievement by Indonesia. As prices soared during the 1970s, resources available to the Government were invested in agriculture – through input subsidies and the introduction of more productive species, thus triggering a Green Revolution. As oil prices fell during the first half of the 1980s, the Government progressively implemented a series of economic reforms aimed at, among other things, diversifying the

3. Over the 2000s, the minimum wage has increased both in nominal terms and as a fraction of the average wage (source: The State Statistical Committee of the Republic of Azerbaijan).

Figure 2.5 Income per capita, manufacturing and natural resources in Indonesia (1970–2010)



Source: ILO calculations based on World Bank, *World Development Indicators*.

Government's fiscal resources away from oil revenues and opening up the economy in order to boost the competitiveness of the labour-intensive manufacturing sector.

The diversification of the economy is also reflected in the composition of exports. In 1980, exports of fuel and mining products represented 75 per cent of total merchandise exports, with manufactured goods accounting for merely 2 per cent. The country successfully stimulated manufacturing for export, especially during the 1980s, at a time when oil-related revenues were shrinking. From 1992 to 2009, the value of manufactured goods exported exceeded that of fuel and mining products (World Bank, 2013).

Appendix A

Econometric evidence

The purpose of this appendix is to test three propositions:

- proposition 1: GDP growth is more consistently led by manufacturing growth than by growth in other sectors;
- proposition 2: The share of manufacturing in GDP increases going up the per capita GDP ladder, hence explaining the long-term persistence of differences in income levels between LDCs, LMIs and EEs; which leads to proposition 3.
- proposition 3: If GDP growth is led by manufacturing growth, and manufacturing share in GDP increases moving up the per capita income ladder, then manufacturing growth will help GDP growth more moving up the per capita income ladder. That is, higher per capita income countries with higher manufacturing shares will have higher GDP growth.

If these propositions are borne out, it will suggest that, for DCs, manufacturing sector growth is a key determinant of moving up the per capita income ladder.

Table 2A.1 lends econometric robustness to the tabular results in tables 2.3 and 2.5, which generally support the first two propositions. First, in support of proposition 1, (looking at columns 1 and 3 which consider manufacturing alone), manufacturing is significantly and positively correlated to GDP growth and GDP per capita growth, supporting the tabular result in table 2.3. This shows that manufacturing growth may have been consistently associated with GDP growth in DCs over the past three decades. The coefficient of 0.42 for GDP growth shows that a 1 percentage point increase in the manufacturing growth rate is associated with a 0.4 percentage point increase in the GDP growth rate. Likewise, the coefficient of 0.41 for per capita GDP growth shows that a 1 percentage point increase in manufacturing growth rate is associated with a 0.4 percentage point increase in per capita growth. The R^2 shows that about 44 per cent of the variation in GDP growth is explained by manufacturing growth.

Table 2A.1 Fixed effect (within) estimator, GDP and manufacturing growth

(Dependent variable)	(Five-year average growth rate)			
	GDP per capita growth		GDP growth	
	(1)	(2)	(3)	(4)
Manufacturing growth (5-year average)	0.409*** (0.053)	0.312*** (0.038)	0.423*** (0.054)	0.339*** (0.042)
Industry growth (excl. manufacturing) (5-year average)		0.168*** (0.028)		0.172*** (0.030)
Constant	0.004** (0.002)	0.000 (0.002)	0.025*** (0.002)	0.020*** (0.002)
Observations	593	593	583	583
R^2	0.436	0.591	0.446	0.560
R^2 (overall)	0.412	0.552	0.471	0.564
Adjusted R^2 (including fixed effects)	0.536	0.663	0.5297	0.6257

Note: Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Source: ILO calculations using World Bank, *World Development Indicators* data.

Table 2A.2 Fixed effect (within) estimator, GDP per capita and manufacturing share

(Dependent variable)	GDP per capita			
	(Full sample) (1)	(Only LDCs) (2)	(Only LMIs) (3)	(Only EEs) (4)
Manufacturing as % GDP	0.030*** (0.004)	0.026*** (0.007)	0.029*** (0.006)	0.058*** (0.007)
Industry (excl. manufacturing) as % GDP	0.032*** (0.003)	0.027*** (0.004)	0.032*** (0.006)	0.053*** (0.006)
Services as % GDP	0.029*** (0.003)	0.018*** (0.004)	0.028*** (0.004)	0.051*** (0.006)
Constant	4.833*** (0.214)	4.761*** (0.237)	4.694*** (0.321)	3.481*** (0.518)
Observations	3,428	1,145	1,006	1,277
R^2	0.424	0.481	0.395	0.544
R^2 (overall)	0.650	0.361	0.352	0.374
Adjusted R^2 (including fixed effects)	0.968	0.942	0.905	0.883

Note: Robust standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$
Source: ILO calculations using World Bank, *World Development Indicators* data.

Table 2A.3 Fixed effect (within) estimator, GDP and manufacturing growth by income group

(Dependent variable)	(Five-year average growth rate)					
	GDP per capita growth			GDP growth		
	(LDCs) (1)	(LMIs) (2)	(EEs) (3)	(LDCs) (4)	(LMIs) (5)	(EEs) (6)
Manufacturing growth (5-year average)	0.235*** (0.070)	0.506*** (0.073)	0.516*** (0.060)	0.293*** (0.082)	0.502*** (0.063)	0.503*** (0.074)
Constant	0.003 (0.003)	0.000 (0.002)	0.009*** (0.002)	0.029*** (0.003)	0.021*** (0.002)	0.024*** (0.002)
Observations	193	174	226	193	169	221
R^2	0.262	0.640	0.460	0.249	0.671	0.501
R^2 (overall)	0.468	0.483	0.408	0.435	0.534	0.474
Adjusted R^2 (including fixed effects)	0.5023	0.6573	0.5364	0.4498	0.6965	0.5357

Note: Robust standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$
Source: ILO calculation using World Bank, *World Development Indicators* data.

Moving on to columns 2 and 4 which consider manufacturing and the rest of industry (mainly extractives), table 2A.1 further shows that the coefficient for manufacturing at 0.34 is twice that for the rest of industry alone (mainly extractives), at 0.17. So, a 1 percentage point increase in manufacturing growth leads to a 0.34 percentage point increase in GDP growth, but a 1 percentage point increase in the rest of industry's growth rate leads to a much smaller 0.17 percentage point increase in GDP growth rate. The R^2 shows that about 60 per cent of the variation in GDP growth is explained by both manufacturing and extractives.

Second, in support of proposition 2, table 2A.2 shows that the share of manufacturing in GDP is also significant and positively correlated to GDP per capita, as is the share of the rest of industry. Both sectors are more significantly correlated to GDP per capita than services. The coefficients for both manufacturing and the rest of industry are low, at 0.03, but sectoral variation in shares explains about two-thirds of the variation in GDP per capita. Table 2A.2 also shows that the

coefficients increase moving up the income ladder. The manufacturing coefficient goes up from 0.026 for LDCs, to 0.029 for LMIs and 0.058 for EEs.

Third, table 2A.3 gives support for proposition 3, that manufacturing growth will contribute more to GDP growth in countries higher up the income ladder. The table shows that the coefficient for manufacturing growth contributing to per capita GDP growth goes up from 0.235 for LDCs, to 0.506 for LMIs and to 0.516 for EEs. The R^2 explains about 40 per cent of the variation in GDP per capita growth.

In essence, the results obtained here tested for 145 DCs observed over the past three decades support Kaldor's first law, that manufacturing growth is the more important determinant of GDP growth. Proposition 2, that the manufacturing share in GDP increases going up the income ladder, explaining the variation in GDP per capita between LDCs, LMIs and EEs, is a modest step forward in the Kaldorian tradition. Proposition 3, implied from the first two propositions, that manufacturing growth will therefore contribute more towards GDP growth going up the income ladder, from LDCs to LMIs to EEs, is also a modest step forward in this tradition.

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Employment patterns and their link with economic development

3

Introduction

The majority of the population in developing countries (DCs) have low incomes and cannot afford *not* to work, given the limited availability of social protection or other forms of transfers (Majid, 2001; Chapter 7). Hence, employment growth has been observed to closely track labour force growth, rather than being led by economic demand (ILO, 2011). A corollary is that unemployment in DCs is not an adequate measure of the state of the labour market. Instead, the type of work performed and the income and working conditions attached to it are of paramount importance in assessing employment performance in DCs.

The purpose of this chapter is (a) to discuss the employment dynamics in DCs; (b) to observe the job quality patterns in these countries; and (c) to examine how job quality can drive development.

A. Employment patterns in developing countries

The level of employment and unemployment is mainly supply driven

Employment growth in DCs as a group was more than double that in advanced economies (AEs), over the past two decades (table 3.1). The difference between the two groups is narrower if only women's employment growth is taken into consideration. For youth, employment growth was negative for emerging economies (EEs) and AEs over this period, but positive and comparatively strong in least developed countries (LDCs), where relatively high population growth rates prevailed.

The employment growth in DCs reflects mainly demographic developments. Figure 3.1 shows employment growth and the growth of the working age population over the past two decades. The growth rate of the working age population in DCs over this period has been double that of AEs. The figure confirms that the

Table 3.1 Employment growth rate by gender and age group

Total employment, average annual growth rates (%)

	1991–2000	2000–2013p	1991–2013p
AEs	0.9	0.7	0.8
DCs	1.8	1.6	1.7
LDCs	2.8	2.8	2.8
LMIs	2.1	1.8	1.9
EEs	1.4	1.1	1.2

Male employment, average annual growth rates (%)

	1991–2000	2000–2013p	1991–2013p
AEs	0.6	0.6	0.6
DCs	1.8	1.6	1.7
LDCs	2.9	2.6	2.7
LMIs	2.1	1.9	2.0
EEs	1.3	1.2	1.2

Female employment, average annual growth rates (%)

	1991–2000	2000–2013p	1991–2013p
AEs	1.2	0.9	1.0
DCs	1.9	1.5	1.7
LDCs	2.8	3.0	2.9
LMIs	2.3	1.5	1.8
EEs	1.5	1.1	1.3

Youth employment, average annual growth rates (%)

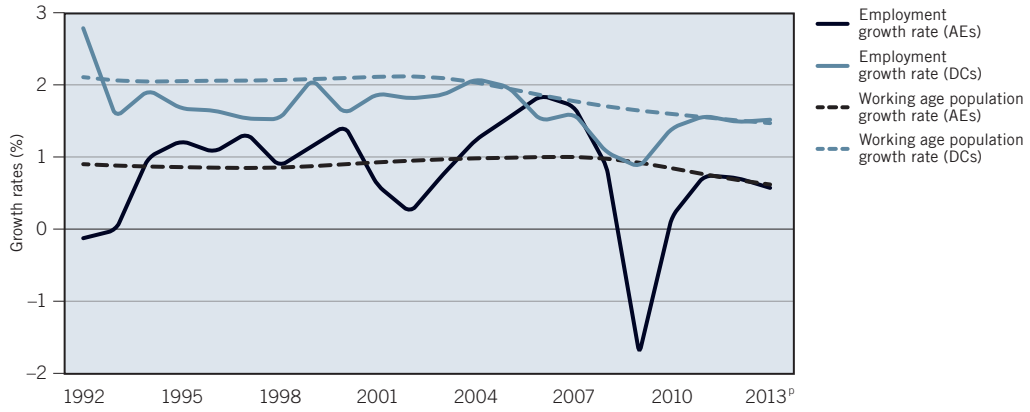
	1991–2000	2000–2013p	1991–2013p
AEs	–1.0	–1.3	–1.2
DCs	–0.4	0.0	–0.1
LDCs	2.5	2.2	2.3
LMIs	1.2	0.0	0.5
EEs	–2.3	–0.9	–1.5

Adult employment, average annual growth rates (%)

	1991–2000	2000–2013p	1991–2013p
AEs	1.2	1.0	1.1
DCs	2.5	1.9	2.2
LDCs	2.9	3.0	3.0
LMIs	2.4	2.2	2.3
EEs	2.4	1.5	1.9

Notes: p = projection; figures for 2013 are preliminary estimates.
Source: ILO, *Trends Econometric Models*, October 2013.

Figure 3.1 Employment and working age population growth rates

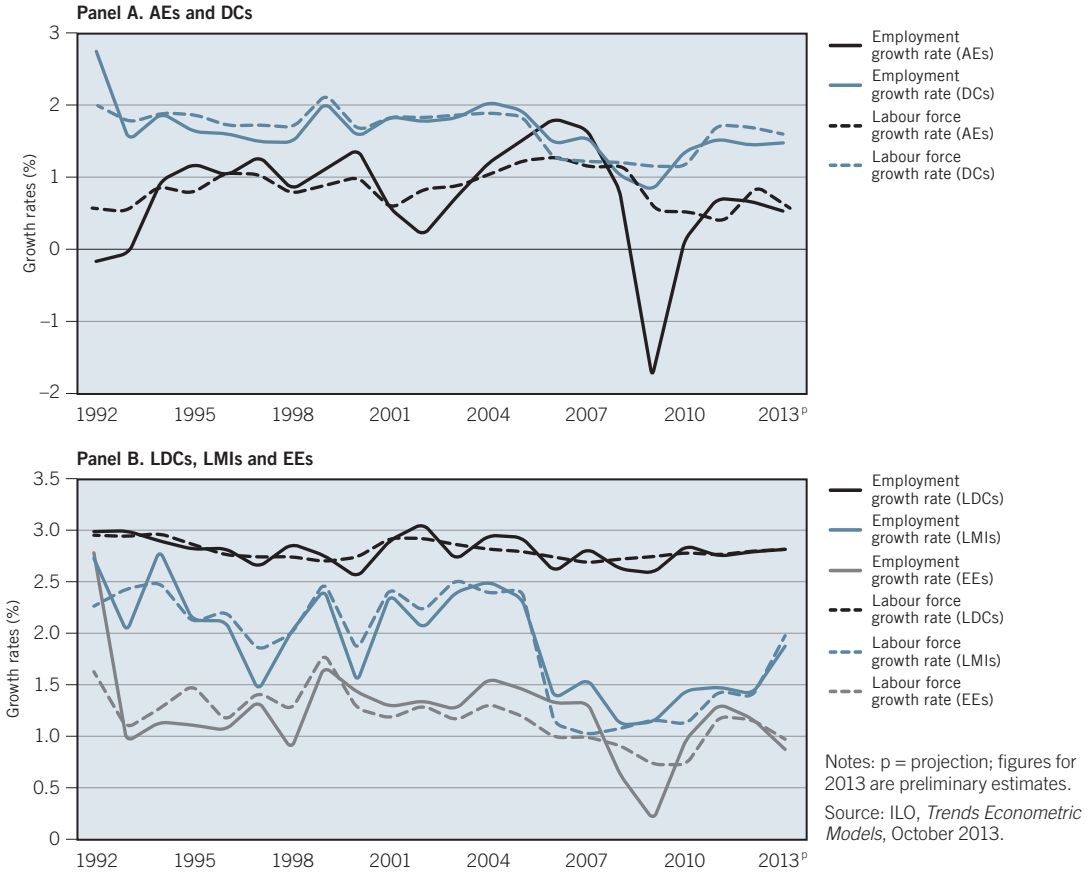


Notes: p = projection; figures for 2013 are preliminary estimates.
Source: ILO, *Trends Econometric Models*, October 2013.

demographically given supply of the working age population in DCs corresponds approximately to their long-term trend in employment growth.

The second point to note is that employment growth has tracked labour force growth quite closely for DCs, over the past two decades, and much more closely than is the case in AEs (figure 3.2, panel A). Labour force participation reflects the portion of the working age population that is active in the labour market, and thus includes the employed and the unemployed seeking work. Within DCs, employment growth has been driven much more by demographic growth for the lowest income category – LDCs – while lower demographic growth for lower middle

Figure 3.2 Employment and labour force growth rates



Notes: p = projection; figures for 2013 are preliminary estimates.

Source: ILO, *Trends Econometric Models*, October 2013.

Table 3.2 Unemployment rate by gender and age group

Total unemployment rate (%)

	1991	2000	2007	2013p
AEs	6.9	6.5	5.6	8.1
DCs	6.1	6.3	5.4	5.6
LDCs	5.8	5.9	5.7	5.9
LMIs	5.5	5.9	5.5	5.2
EEs	6.6	6.6	5.3	5.8

Male unemployment rate (%)

	1991	2000	2007	2013p
AEs	6.4	6.0	5.3	8.0
DCs	6.0	6.2	5.2	5.3
LDCs	5.2	5.1	5.0	5.2
LMIs	5.1	5.7	5.1	4.7
EEs	6.8	6.8	5.4	6.0

Female unemployment rate (%)

	1991	2000	2007	2013p
AEs	7.6	7.1	6.0	8.3
DCs	6.4	6.5	5.8	6.0
LDCs	6.7	6.9	6.5	6.7
LMIs	6.4	6.5	6.3	6.3
EEs	6.4	6.5	5.2	5.6

Youth unemployment rate (%)

	1991	2000	2007	2013p
AEs	14.0	13.3	12.5	17.9
DCs	11.6	12.8	11.5	12.5
LDCs	10.2	10.7	9.8	10.4
LMIs	11.7	13.0	12.5	13.2
EEs	11.8	13.3	11.4	12.9

Adult unemployment rate (%)

	1991	2000	2007	2013p
AEs	5.4	5.4	4.6	6.9
DCs	4.2	4.5	3.8	4.1
LDCs	4.0	3.9	4.1	4.2
LMIs	3.4	3.8	3.6	3.4
EEs	4.7	5.0	3.9	4.6

Notes: p = projection; figures for 2013 are preliminary estimates.

Source: ILO, *Trends Econometric Models*, October 2013.

income countries (LMIs), which is even more pronounced in emerging economies (EEs), is also reflected in lower employment growth (figure 3.2, panel B). As labour force growth slows, the demographic supply side pressure for labour absorption weakens, and demand side economics begins to play a greater role in determining employment growth. Figure 3.2 shows that the global crisis hit employment growth in AEs and EEs sharply, but the effect was less pronounced in LMIs and LDCs.

Table 3.2 shows that the impact of the crisis raised unemployment in AEs from under 6 per cent before the global crisis, to 8.1 per cent in 2013. For DCs as a group, unemployment rates rose only from 5.4 per cent to 5.6 per cent, on average, over the same period.

However, the crisis did hit youth unemployment in DCs more visibly, with DCs seeing a rise of 1 percentage point between 2007 and 2013, 0.6 percentage points for LDCs, 0.7 percentage points for LMIs and 1.5 percentage points for EEs. While long-term unemployment rates over the past two decades remain within a pretty constant band range of 5.6 per cent to 6.1 per cent for DCs, the ratio of youth unemployment to adult unemployment does show a gradual increase over this period for LMIs and for EEs.

Income levels drive labour force participation in complex ways in developing countries

The absence of significant social protection or transfers, low incomes and high demographic growth of the working age population in DCs make joining the labour force more compulsive than in AEs. Hence, an increase in, or an already high labour force participation is not necessarily a positive economic indicator in low-income countries. As income increases (or social protection systems are created), all income groups would prefer, or would be expected, to educate their children and this would lower labour force participation rates.

A second behavioural factor, namely female labour force participation, can have a non-linear effect across income groups – possibly following a U-shape. Low incomes could push more women into the labour force, particularly in LDCs. Higher incomes could enable them to leave the labour force, a scenario which might be more extensive in LMIs (ILO, 2012). Higher incomes for many households in EEs could again push up female labour force participation as more women are educated and households can afford to pay for housework-relieving services or technology, in conjunction with global changes in attitudes towards women working and accepted practices.

This complex set of factors – demographic, income levels and behavioural elements – make labour force participation difficult to read as a target or an outcome indicator.

Table 3.3 illustrates all three factors that affect the labour force participation rate. The income effect is visible, with the labour force participation rate for DCs higher at 65 per cent in 2013 compared to AEs at 60 per cent. Rising income and education effects are also evident over time, with the labour force participation rate for DCs falling from 68 per cent in 1991 to 65 per cent by 2013. A negative income effect, the compulsion to work in order to provide any income at all, kept the labour force participation rate high and constant for LDCs – at 74 per cent – while higher and rising incomes lowered labour force participation rates for LMIs and EEs over the period. The sharp drop in youth participation rates in EEs over the 20 years covered in this analysis can largely be attributed to a rise in secondary and tertiary education enrolment rates.

Table 3.3 Labour force participation rate

Total labour force participation rate (%)

	1991	2000	2007	2013p
AEs	60.7	60.5	60.6	60.2
DCs	67.9	66.5	65.1	64.5
LDCs	74.5	73.4	73.9	74.1
LMIs	61.5	60.4	60.0	58.1
EEs	71.5	69.8	67.2	66.9

Youth labour force participation rate (%)

	1991	2000	2007	2013p
AEs	53.9	51.0	48.4	45.7
DCs	59.9	53.6	50.0	48.2
LDCs	63.7	61.4	60.5	59.9
LMIs	49.8	46.9	44.6	40.5
EEs	67.5	58.1	51.9	50.7

Male labour force participation rate (%)

	1991	2000	2007	2013p
AEs	72.7	70.7	69.7	68.5
DCs	82.5	80.6	78.9	78.6
LDCs	84.1	82.9	82.7	82.6
LMIs	82.3	80.7	79.9	78.8
EEs	82.3	80.0	77.1	77.0

Adult labour force participation rate (%)

	1991	2000	2007	2013p
AEs	62.3	62.5	63.0	62.7
DCs	71.3	71.4	70.7	69.8
LDCs	80.4	79.9	80.8	81.2
LMIs	66.8	66.4	66.3	64.6
EEs	73.0	73.4	72.0	71.0

Female labour force participation rate (%)

	1991	2000	2007	2013p
AEs	49.5	50.9	52.0	52.2
DCs	53.1	52.2	51.2	50.3
LDCs	65.2	64.1	65.2	65.8
LMIs	40.1	39.7	39.7	37.0
EEs	60.5	59.6	57.3	56.9

Notes: p = projection; figures for 2013 are preliminary estimates.
Source: ILO, *Trends Econometric Models*, October 2013.

B. Measures of job quality in developing countries

Given the limitations of employment and unemployment as indicators of the state of labour markets in DCs, it is crucial to examine job quality patterns. There are three key indicators of job quality that the ILO proposed and has monitored for Millennium Development Goal (MDG) 1b. These are the share of working poor, the share of workers in vulnerable employment and labour productivity. The working poor gives a headcount of the proportion of workers living below the US$1.25 poverty line. Vulnerable employment gives a headcount of the working population judged to be at greater risk of weak and unreliable incomes. Two categories of employment fall into the vulnerable definition: contributing family workers and the self-employed. Labour productivity indicates potential income for workers. At the macroeconomic level, labour productivity trends provide an important indication of the evolution of output capacity and the use of new technology.

These three dimensions of job quality, as defined in MDG 1b, are also correlated with employment informality (box 3.1).

Wage employment is on the rise in the majority of developing countries

Wage and salaried employment (or dependent employment) has long been the norm in AEs, with vulnerability, defined as self-employment and contributing family work, being at a relatively low level. Over time, DCs have been catching up with this pattern.

Box 3.1 Informality, working poverty and vulnerable employment

Though there are a number of country based definitions on informal employment, at the international level there was a major breakthrough in the definitional aspect at the 15th International Conference of Labour Statisticians (ICLS) in 1993. The 15th ICLS adopted an operational definition of the informal sector based on three criteria: non-registration of the enterprises, small size in terms of employment and non-registration of the employees of the enterprise. It adopted an enterprise-based concept, which refers to all employment in unincorporated enterprises owned by individuals or households, for which no accounts permit financial separation of the enterprise's production activities from the other activities of the owners.

The concept of informal sector was expanded into a wider definition of "informal economy" in 2002 in recognition of the diversity of informality across countries and to capture "informal employment without secure contracts, worker benefits or social protection both inside and outside the informal enterprises" (ILO 2002: p.12). The new definition also refers to "all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements". Informal employment in informal enterprises (small and registered or unincorporated enterprises) was deemed to include employers, employees, own account operators, and unpaid family workers in informal enterprises. Informal employment was also recognized as occurring outside the informal enterprises (for formal enterprises, for households, or with no fixed employer), including: domestic workers, casual or day labourers, temporary or part-time workers, industrial outworkers (including homeworkers), and unregistered or undeclared workers.

Based on the wider "informal economy" definitions, informal employment as a job-centred concept was agreed by the 17th ICLS in 2003 to refer to jobs that generally lack basic social or legal protection or employment benefits, irrespective of whether they are performed inside or outside the informal sector. In addition to informal sector employment, it also includes informal employment in formal enterprises, employers and own-account workers, contributing unpaid family workers, own-account workers producing goods exclusively for their own household's consumption, members of informal producer cooperatives.

Informal employment is widespread in DCs but is also increasingly common in AEs. Many of those counted as being informally employed are either without a proper labour contract or social security coverage or are self-employed in precarious conditions. Often, informal employment is a necessity for those unable to find formal jobs and in the absence of other means of income or publicly provided social protection. Informal employment sometimes reflects an effort to avoid taxation and regulation. Whatever the cause, informal employment typically entails lower, more volatile pay, worse working conditions and lower productivity than employment in formal arrangements.[1]

The phenomenon of informality has long been recognized. Originally, it was thought of in terms of a traditional, non-industrialized sector that would gradually be absorbed into the modern economy as economic development progressed (Lewis, 1955). However, by the early 1970s, an ILO world employment mission to Kenya concluded that, rather than shrinking, informal employment had continued to grow (ILO, 1972). One of the key challenges that emerged in describing and analysing the phenomenon of informality was the need to establish a clear, operational definition and a framework that allowed for precise statistical measurement of the extent and evolution of informality. Over the years, several attempts to address this need have led to an array of different indicators following different statistical definitions and standards and drawing on various sources. These measures of informality are often not comparable across and within countries, due to the different definitions used and variations in statistical sources on which the measures draw.

The most recent attempt – a 2003 resolution adopted by the ICLS on measuring the informal economy – has led to the collection of data on informal employment in 47 countries for the period 2007 to 2010.[2] To date, this is the most extensive measure of informal activities in different regions. It provides data on various aspects of the issue of informality, including the distinction between informal employment and the informal sector.

On the basis of these new data, and in combination with previous data-gathering on informality in the ILO's Key Indicators of the Labour Market database (KILM), an attempt was made to develop a synthetic informal employment indicator. This new indicator aggregates information across different sources and definitions to produce an estimate that matches as closely as possible with the 2003 ICLS resolution on measuring informal employment. The resulting estimate takes the heterogeneity of informality measurements directly into account and also addresses the sample selection bias that results from missing observations. This box summarizes the construction of the indicator, key results and dynamics and analyses the dynamics of informal employment in comparison with other measures of job quality in DCs.

The ILO synthetic informal employment indicator

The ILO synthetic informal employment indicator (SInEmp) has been developed in an attempt to derive comparable and time-differentiated information on informal labour markets across a large number of DCs. The indicator is expected to achieve two main objectives:

- *to make informality statistics more comparable across and within countries* in order to address the problem that available data on informal labour has been collected from heterogeneous sources and often based on non-comparable informality definitions;
- *to estimate missing informal employment data*, in particular out-of-sample prediction for countries for which only a few datapoints are being observed.

To estimate missing informal employment data, an empirical model relates known drivers of informality, such as GDP per capita and a country's productivity growth, to the share of informal employment in total employment. The estimation strategy explicitly takes into account the fact that coverage and sources of the original data on informal employment that are used are heterogeneous. This allows the construction of longer time series, making use of all

available information while still producing estimates in line with the most up-to-date definition of informal employment, as set out in the 2003 ICLS resolution on measuring the informal economy.

Dynamics of informality in developing countries

Over the past two decades, informality rates have taken very different pathways across DCs. In particular, the worldwide decline in working poverty that took place over the same period was not matched by a general decline in informality in these countries. Indeed, transition economies in Eastern Europe and Central Asia have experienced large increases in the incidence of informal employment following their economic transformation in the early 1990s. This increase in informality occurred despite a relatively quick economic recovery in most of these economies, beginning in the second half of the 1990s in the majority of cases. On the other hand, economies in Latin America and some Asian economies have experienced sometimes rapid declines in informality over the past 15 to 20 years. Despite the diverging evolution of informality, however, informality rates remain higher on average in Latin American and Asian economies than in Eastern European and Central Asian economies (see ILO, 2014).

Links between job quality and informality

Changes in the incidence of informal employment can be expected to be linked to variations in other labour market and social indicators. In particular, the precariousness and volatility of pay, and the lack of employment protection and social protection, all of which are typically associated with informality, should have consequences for the extent of vulnerable employment and working poverty. A careful analysis reveals, however, that shifts in informality rates do not seem systematically to match changes in working poverty or vulnerable employment. For instance, in countries such as Armenia, where the increase in informality occurred over a period during which working poverty and vulnerability were declining, other factors seem to play a role in rising informality. In particular, it seems that countries in Eastern Europe and Central Asia had experienced very low informality rates prior to 1991, due to their institutional and political systems. As these countries started to transit towards market-based systems during the 1990s, they experienced increases in informality even while average incomes and productivity began to rise after the initial transition shocks.

An empirical analysis of the relationship between informality on the one hand and working poverty and vulnerable employment on the other demonstrates the important link between the different sides of the labour market. Table 3.4 summarizes the key results of the estimation procedure. Across all specifications, informal employment is a significant driver of poor job quality, whether it is working poverty or the incidence of vulnerable employment. However, the inclusion of regional dummies is important, at least for specifications with working poverty, as otherwise the equation is either unstable (equation 2) or the effects are barely or not significant (equations 2, 4 and 8). This indicates that, for certain regions, transition dynamics can indeed occur that contradict the overall pattern of a significant correlation between the incidence of informal employment and other indicators of poor job quality.

Table 3.4 Determinants of job quality

Dependent variable	Working poverty				Vulnerable employment			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Working poverty (lagged)	0.990***	1.001***	0.989***	0.999***				
	(0.005)	(0.003)	(0.005)	(0.003)				
Vulnerable employment (lagged)					0.987***	0.995***	0.987***	0.994***
					(0.003)	(0.001)	(0.003)	(0.002)
Informal employment	0.003**	0.002*	0.003**	0.001	0.005**	0.003**	0.005**	0.003*
	(0.001)	(0.001)	(0.001)	(0.001)	(0.002)	(0.001)	(0.002)	(0.001)
Labour force participation rate			0.007**	0.008***			0.008*	0.009**
			(0.003)	(0.003)			(0.004)	(0.004)
Regional dummies	Yes	No	Yes	No	Yes	No	Yes	No
Observations	2,420	2,420	2,420	2,420	2,420	2,420	2,420	2,420
R^2	98.5	98.5	98.5	98.5	99.5	99.5	99.5	99.5
Number of countries	132	132	132	132	132	132	132	132

Notes: Panel-corrected standard errors in parentheses: *** p<0.01, ** p<0.05, * p<0.1. Regional dummies are included in equations 1, 3, 5 and 7 according to the regional classification used in the ILO *Global Employment Trends* report. Working poverty is measured at the level of US$2 per person, per day.

Source: ILO Research Department based on ILO, *Global Employment Trends Database*.

[1] For an overview of the different varieties of informality and their interaction see ILO-WTO, 2009.

[2] Available at: http://laborsta.ilo.org/applv8/data/INFORMAL_ECONOMY/2012-06-Statistical%20update%20-%20v2.pdf [28 Apr. 2014].

Table 3.5 Share of employment by status

	Shares of status in total employment (%) – total									
	1991					2013[p]				
	Wage and salaried workers	Employers	Own-account workers	Contributing family workers	Vulnerable employment	Wage and salaried workers	Employers	Own-account workers	Contributing family workers	Vulnerable employment
AEs	82.3	3.9	10.8	3.1	13.9	86.3	3.6	9.0	1.0	10.0
DCs	32.7	2.4	35.6	29.3	64.9	42.6	2.0	40.5	14.9	55.4
LDCs	13.0	1.0	45.0	41.0	86.0	18.0	1.2	53.2	27.6	80.8
LMIs	26.4	2.5	48.6	22.5	71.1	31.7	2.1	50.5	15.7	66.2
EEs	41.0	2.7	25.0	31.4	56.3	58.2	2.2	29.0	10.6	39.6

Note: p = projection

Source: ILO, *Trends Econometric Models*, October 2013.

Table 3.5 shows that AEs had a share of wage and salaried employment of 82 per cent in 1991, which increased by 4 percentage points to 86 per cent by 2013. Conversely, their share in vulnerable employment dropped from 14 per cent to 10 per cent over this period.

In DCs, wage and salaried employment stood at just one-third of total employment in 1991, increasing by around 10 percentage points to 43 per cent by 2013. This increase was accompanied by a corresponding decline in the incidence of vulnerable employment, entirely driven by a reduction in family work. DCs' self-employment share actually increased by 5 percentage points over this period.

The increase in the wage employment share in DCs over time, and converse decline in vulnerability, escalates as countries move up the income ladder. Since 1991, the increase in the incidence of wage and salaried employment has been stronger in EEs than in other developing countries.

Working poverty is receding and a middle class is emerging

DCs have substantially reduced the share of working poor (defined as workers earning less than US$1.25 a day – calculated in purchasing power parity (PPP) terms) over the past two decades, with the decline accelerating as countries move up the income ladder.

Table 3.6 shows that the incidence of working poverty in DCs dropped from 45 per cent in 1991 to 14 per cent in 2013. EEs performed better in this respect than their LDC and LMI counterparts. This still left 375 million working poor in DCs in 2013, with over one-third of the employed in LDCs among the working poor, 20 per cent in LMIs and just 4 per cent in EEs.

In terms of timing, the larger reductions in the share of working poor seem to have come not in the 1990s, but in the 2000s, especially for LDCs and LMIs, while progress for EEs was impressive over both decades.

If the MDG 1 goal of halving poverty by 2015 is extended to the working poor, then DCs as a whole have already met this goal, while LDCs will just meet it by 2015.

The great majority of countries saw a decrease in the share of working poor under the US$2 PPP level; the improvement was greater than 25 percentage points in over one-third of LDCs, one-quarter of LMIs and less than one-tenth in EEs (figure 3.3). Furthermore, three LDCs, one LMI and one EE have reduced the share of working poor by more than 50 percentage points.

Table 3.6 Working poverty

Total US$1.25 (PPP) working poor (millions)	1991	2000	2007	2013[p]
DCs	811	693	491	375
LDCs	133	156	146	138
LMIs	293	292	245	190
EEs	384	245	100	47

Total US$2 (PPP) working poor (millions)	1991	2000	2007	2013[p]
DCs	1,234	1,198	989	839
LDCs	176	219	232	242
LMIs	475	530	514	471
EEs	583	450	243	126

Share of working poor in total employment, US$1.25 (PPP) (%)	1991	2000	2007	2013[p]
DCs	45.1	32.7	20.4	14.4
LDCs	65.8	60.4	46.2	37.4
LMIs	45.7	37.5	27.3	19.4
EEs	40.3	22.6	8.4	3.7

Share of working poor in total employment, US$2 (PPP) (%)	1991	2000	2007	2013[p]
DCs	68.6	56.6	41.1	32.2
LDCs	87.1	84.6	73.6	65.2
LMIs	74.0	68.2	57.3	48.2
EEs	61.1	41.6	20.4	10.0

Notes: p = projection; figures for 2013 are preliminary estimates.
Source: ILO, *Trends Econometric Models*, October 2013.

Figure 3.4 presents the distribution of income for LDCs, LMIs and EEs among five income classes: the extremely poor (earning less than US$1.25 a day), the moderately poor (between US$1.25 and US$2 a day), the near poor (between US$2 and US$4 a day), the developing middle class (between US$4 and US$13 a day) and the developed middle class, earning more than US$13 a day.

Progress in LDCs was limited, with the extreme working poor increasing by about 6 million, and the moderately poor increasing by 60 million. The near poor, living on US$2–4 a day, saw the largest increase. LMIs saw more progress in reducing extreme working poverty, from 293 million to 190 million, while the next three income groups grew. EEs saw dramatic reductions in both extreme and moderate working poverty, with some expansion of the near poor group and more rapid expansion of the developing middle class.

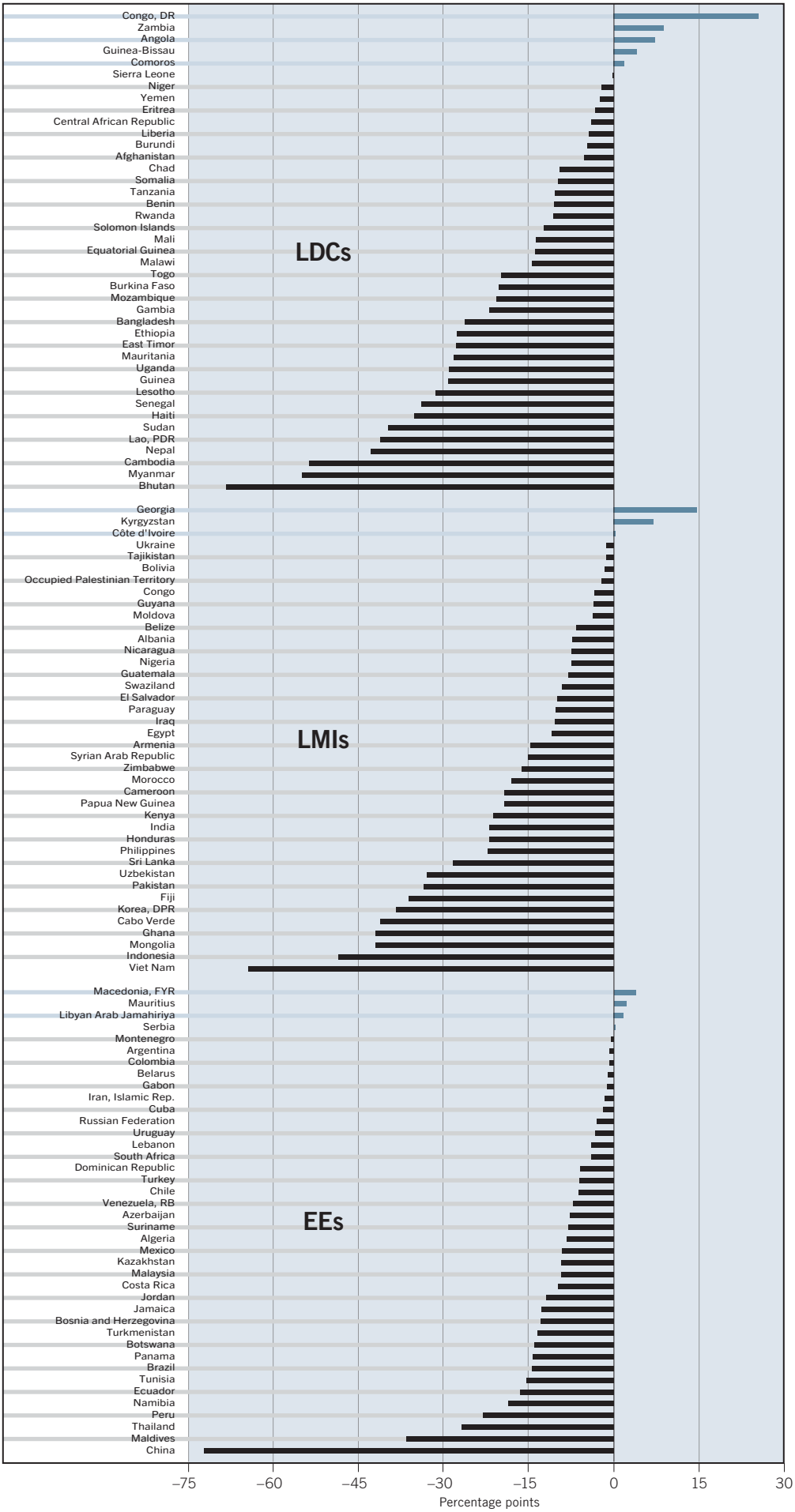
Labour productivity is growing, but achieving parity with AE levels is still in the distant future

Labour productivity growth was higher for DCs than for AEs, with faster growth in the higher income DC categories. However, there is still a significant gap between productivity in DCs and that in AEs, with full parity a long way off.

Table 3.7 shows that, between 1991 and 2013, AEs had a labour productivity growth rate of 1.4 per cent per annum. Compared to this, DCs as a whole had a labour productivity growth rate that was more than double that of AEs, at 3.2 per cent per annum. The labour productivity growth rates ranged from 2.3 per cent per annum for LDCs, to 2.9 per cent per annum for LMIs, to 3.7 per cent per annum for EEs.

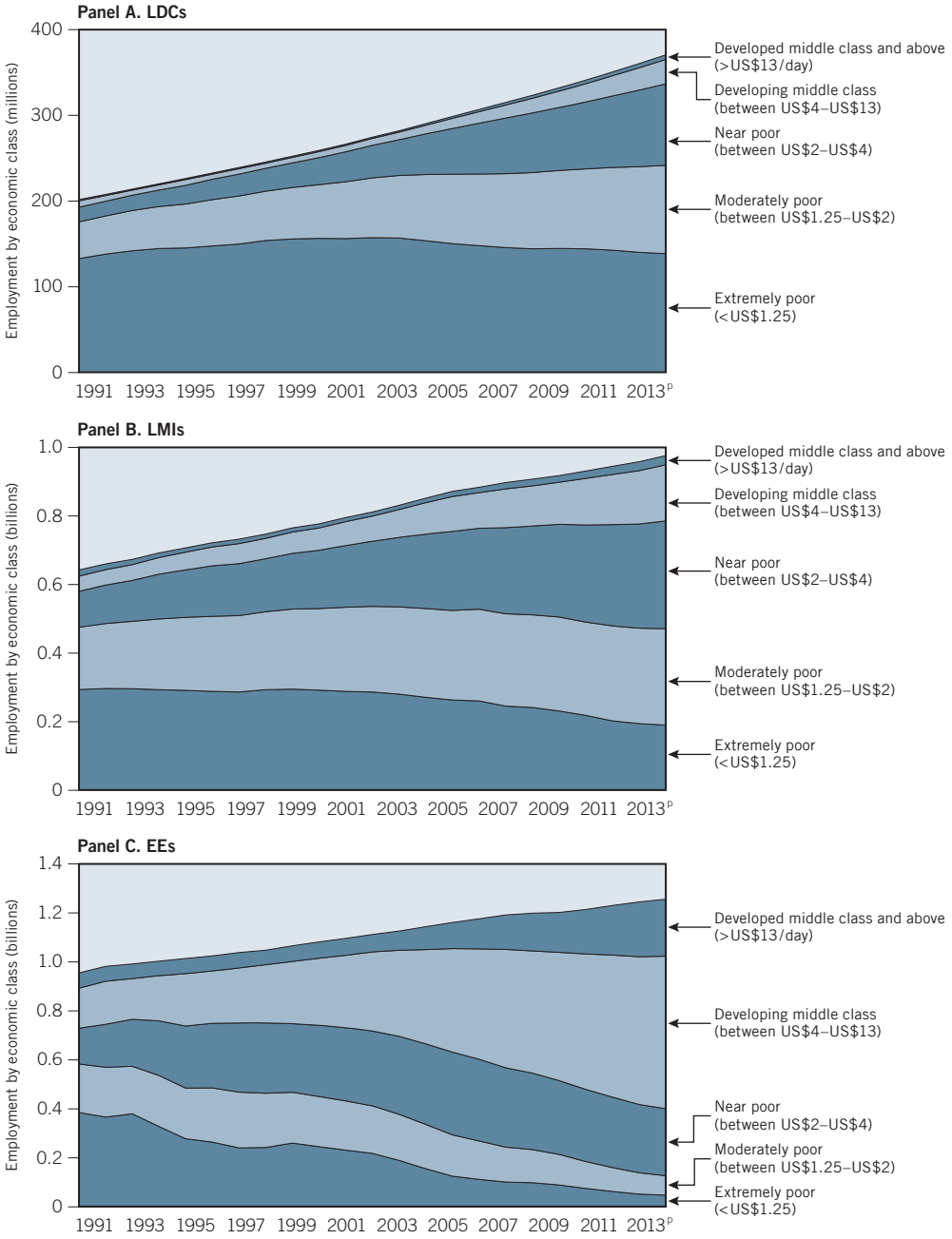
Productivity growth has been led by a few star performers, most notably China with an average growth rate of 9 per cent (figure 3.5). The average productivity growth rate was above 3 per cent in 20 per cent of LDCs, 18 per cent of LMIs and 12 per cent of EEs. Moving up the income ladder, the share of weak performers, with increases of less than 1 per cent or actual decreases in productivity growth rates, declines. Negative productivity growth rates were observed in 23 per cent of LDCs, 18 per cent of LMIs and 10 per cent of EEs.

Figure 3.3 Change in the share of working poor (< US$2 per day) between 1991 and 2013



Source: October 2013 update of the model in S. Kapsos and E. Bourmpoula: Employment and economic class in the developing world, ILO Research Paper No. 6 (Geneva, 2013); ILO, *Trends Econometric Models*, October 2013.

Figure 3.4 Employment by economic class



Note: p = projection.

Source: October 2013 update of the model in S. Kapsos and E. Bourmpoula: Employment and economic class in the developing world, ILO Research Paper No. 6 (Geneva, 2013); ILO, *Trends Econometric Models*, October 2013.

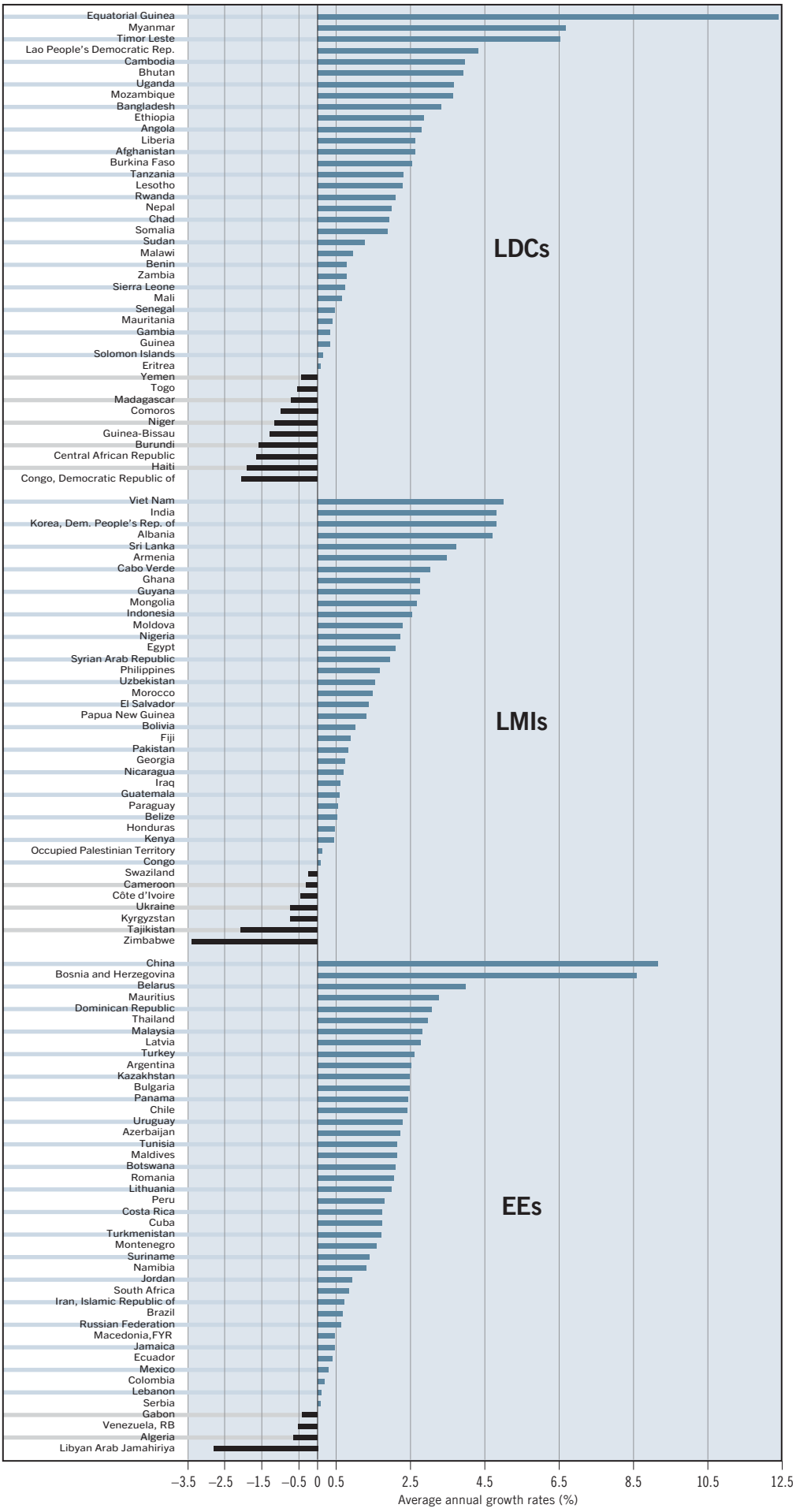
Table 3.7 Labour productivity growth

Output per worker (constant 2005 international $), average annual growth rates (%)			
	1991–2000	2000–2013p	1991–2013p
AEs	2.0	0.9	1.4
DCs	1.6	4.3	3.2
LDCs	1.0	3.3	2.3
LMIs	1.5	3.8	2.9
EEs	1.9	4.9	3.7

Notes: p = projection; figures for 2013 are preliminary estimates.

Source: ILO, *Trends Econometric Models*, October 2013; World Bank, *World Development Indicators 2013*.

Figure 3.5 Productivity growth rate, 1991–2013



Source: ILO, *Trends Econometric Models*, October 2013.

Major sectoral changes are taking place which affect job growth and quality

Consistent with the Lewis model of development, the incidence of agricultural employment has tended to decline in DCs (table 3.8). Around 38 per cent of all jobs were in the agricultural sector in 2013, compared with 54 per cent in 1991. In LDCs, about two-thirds of total employment is still located in agriculture, 42 per cent in the case of LMIs and around one-quarter in EEs.

One aspect in which the findings differ from the Lewis model of development is that, for DCs, the incidence of industrial employment increased only modestly. Meanwhile, in AEs, industrial employment shares went down over this period, from 31 per cent of total employment in 1991 to 23 per cent in 2013.

Between 1991 and 2013, LDCs' industrial employment share barely inched up, from 8.1 per cent of total employment to 9.5 per cent, whereas, for LMIs and EEs, the increase was larger, at about 5 percentage points. The services sector has continued to be the largest sector in DCs over the past two decades. Table 3.8 shows that DCs' share of services rose from 27 per cent of total employment in 1991 to nearly 40 per cent by 2013, while AEs' share in services neared three-quarters of total employment by 2013.

Figure 3.6 decomposes total GDP growth into productivity growth and employment growth. Employment growth is further decomposed into an economic employment effect, a behavioural labour force participation effect and a demographic working age population effect. The figure confirms the observation made earlier that total employment growth is driven almost entirely by working age demographics. But, in addition, the results show the relative roles of productivity and employment. The role of productivity in overall growth increases as countries climb the income ladder from LDCs to LMIs to EEs. The share of growth attributable to productivity growth also shows a greater increase for the non-extractive-based economies among the DCs, highlighting the importance of the role of manufacturing as opposed to extractive industries in generating productivity – and, by extension, more productive jobs.

Figure 3.7 further decomposes productivity growth into two sources. One source of productivity growth is through structural change, with labour moving from lower productivity sectors to higher productivity sectors. Structural change is often a more significant factor for EEs and LMIs than for LDCs. For LMIs and EEs, it accounts for about one-quarter of overall productivity growth from 2000 onwards. A second source of productivity growth is through within-sector technical change. Within-sector technical change accounts for the other three-quarters of productivity growth in the past decade.

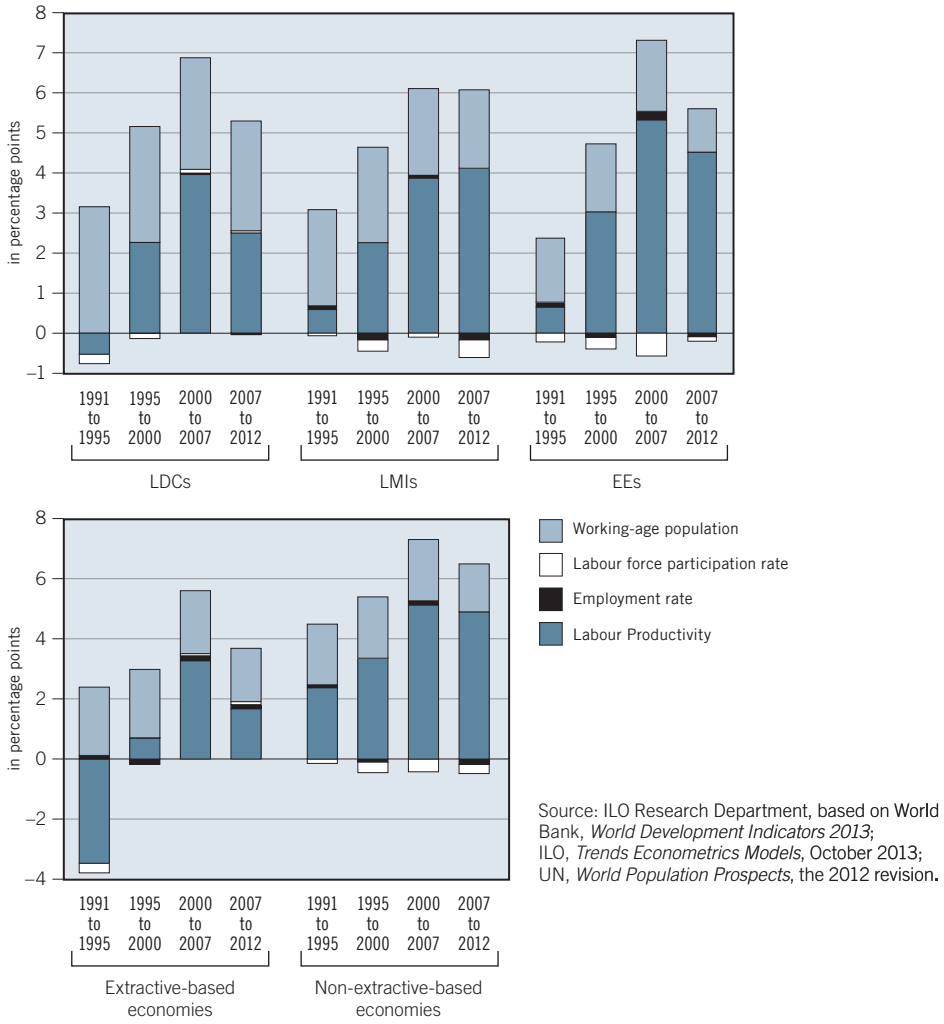
Table 3.8 Share of employment by sector

Employment in agriculture, total (%)					Employment in industry, total (%)					Employment in services, total (%)				
	1991	2000	2007	2013[p]		1991	2000	2007	2013[p]		1991	2000	2007	2013[p]
AEs	6.6	4.7	3.5	3.2	AEs	30.9	27.1	24.7	23.2	AEs	62.5	68.2	71.8	73.7
DCs	53.7	48.5	42.1	37.6	DCs	19.4	19.0	21.6	23.0	DCs	26.9	32.5	36.3	39.4
LDCs	73.7	70.9	65.5	64.9	LDCs	8.1	7.7	9.2	9.5	LDCs	18.1	21.5	25.3	25.6
LMIs	55.9	52.4	47.3	41.8	LMIs	17.1	17.2	20.0	22.1	LMIs	26.9	30.4	32.8	36.1
EEs	48.1	40.4	32.2	26.4	EEs	23.2	22.9	26.0	27.5	EEs	28.7	36.7	41.7	46.0

Note: p = projection

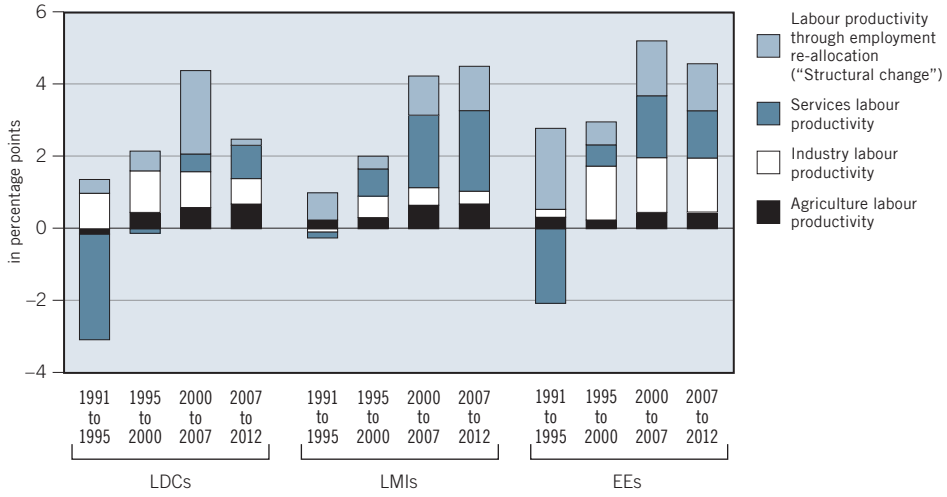
Source: ILO, *Trends Econometric Models*, October 2013.

Figure 3.6 Growth decomposition



Source: ILO Research Department, based on World Bank, *World Development Indicators 2013*; ILO, *Trends Econometrics Models*, October 2013; UN, *World Population Prospects*, the 2012 revision.

Figure 3.7 Productivity decomposition



Notes: Productivity decomposition is based on data for 66 countries (13 LDCs, 26, LMIs and 27 EEs) and follows the methodology described in ILO, *Global Employment Trends 2013* (Ch. 4).

Source: ILO Research Department, based on World Bank, World Development Indicators; ILO, *Trends Econometrics Models*, October 2013; UN, *World Population Prospects*, the 2012 revision.

C. Quality jobs are drivers of development

All three indicators of job quality – the share of working poor, proportion of vulnerable workers and labour productivity – improve with increasing income, as DCs climb higher up the income ladder. This correlation could reflect different directions of causality, with higher per capita incomes leading to better health and education, which in turn boost productivity as well as improving job quality, further raising per capita incomes.

This relationship can be tested, using productivity as a proxy for economic growth, and wage and salaried employment as an indicator of job quality. Wage and salaried employment is the reciprocal of vulnerable employment. So, as the share of vulnerable employment goes down, the share of wage and salaried employment goes up. The share of wage and salaried employment in total employment also tends to increase as a result of structural change away from agriculture – indeed, low-income self-employment and vulnerability predominate in the agricultural sector.

Figure 3.8 suggests that there is, indeed, a cross-country association between the incidence of wage and salaried employment and labour productivity. There is a clear positive correlation, with one-third of the variation in productivity explained by variation in the share of wage earners. Again, the correlation could go both ways, with higher productivity enabling wage employment, or wage employment enabling higher productivity. But causality is aided by the observation that structural change implies a simultaneous increase in wage employment *and* an increase in labour productivity (box 3.2). Hence, workers moving from self-employment in agriculture to wage employment in non-agricultural sectors also increase their productivity, whereas within-sector increases in labour productivity need not necessarily be associated with a simultaneous increase in wage employment in that sector. Therefore improved job quality (as proxied by wage employment) is not only a good indicator of labour market progress but also a determinant of higher per capita incomes.

Figure 3.8 Share of wage and salaried workers and productivity

Source: ILO, *Trends Econometrics Models*, October 2013.

Box 3.2 Job quality and structural transformation

An improvement in job quality, such as an increase in the share of wage and salaried workers or, equivalently, a decrease in the share of vulnerable employment in total employment, is often linked with structural transformation. This arises because a movement of labour from the agricultural sector (typically characterized in DCs by a high degree of vulnerable employment and low productivity) to the industry or services sector tends to lead to an increased share of wage workers (better quality jobs) and, simultaneously, to an increase in overall labour productivity. A few country examples help to illustrate the linkages between job quality and structural transformation.

Senegal showed a steady increase in the share of wage and salaried workers, from an estimated 12 per cent in 1991 to 26 per cent in 2013 (figure 3.9). The share of working poor decreased by 34 percentage points over the same period, while productivity (output per worker) increased by an average of 0.5 per cent per annum. Agriculture accounted for 54 per cent of total employment in 1991, declining to 35 per cent in 2013.

Viet Nam also had a rapid and steady increase in the share of wage and salaried workers, rising 22 percentage points, accompanied by a dramatic decrease in the working poor, a high degree of structural transformation and a significant increase in productivity. In 1991, 76 per cent of total employment was in the agriculture sector, compared to 46 per cent in 2013. Between 1996 and 2004, the period for which data are available, the employment share in manufacturing increased from 8 per cent to 12 per cent (source: ILO, 2013). The share of working poor dropped impressively, to one-third of the 1991 level by 2013, and productivity grew at an average of 5 per cent per annum.

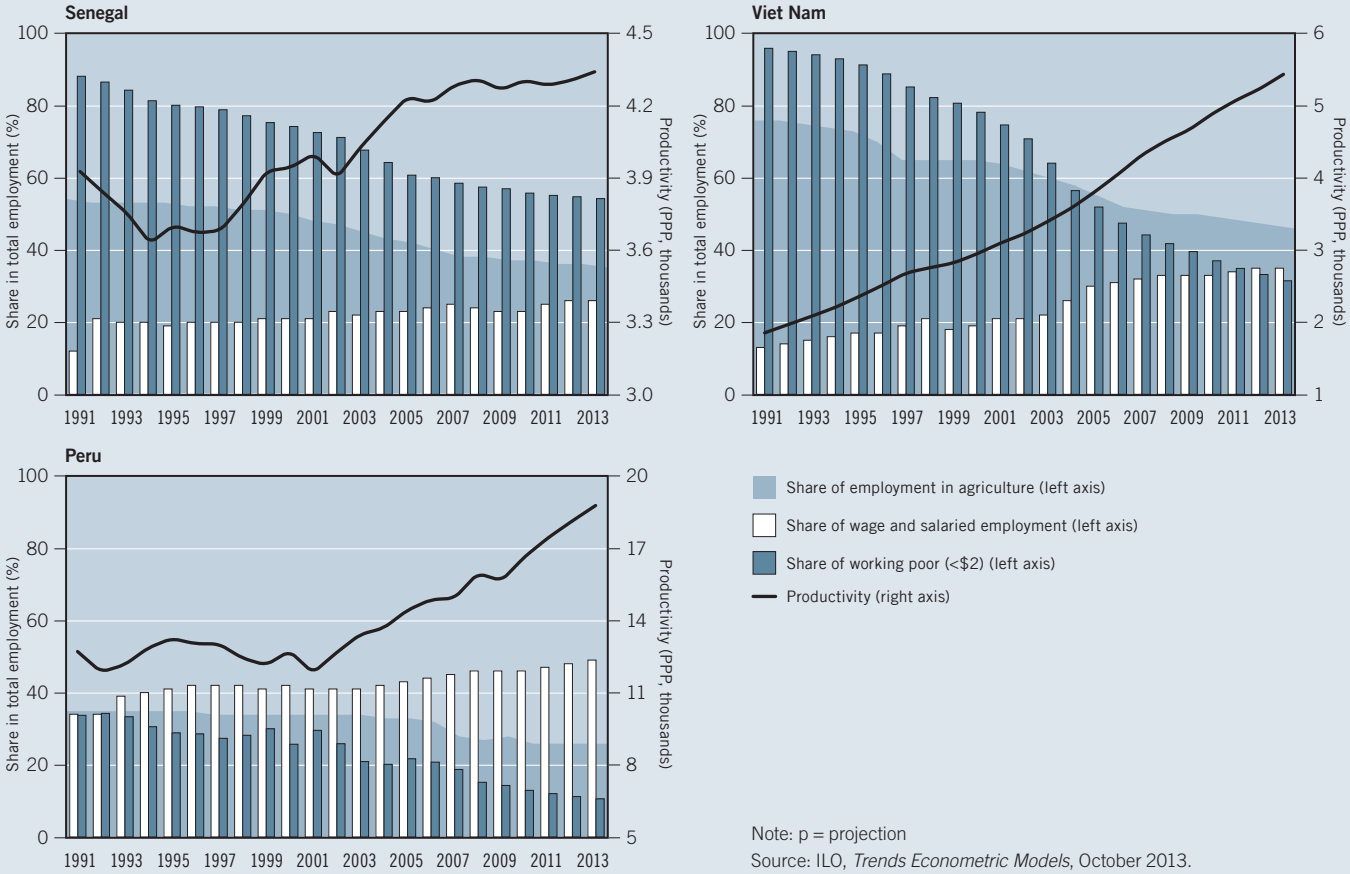
In Peru, the share of wage and salaried workers increased by an estimated 15 percentage points, from 34 per cent in 1991 to 49 per cent in 2013. In the same period, productivity increased significantly, growing by an average of 1.8 per cent per annum, and the share of working poor decreased by 23 percentage points, estimated at 11 per cent of total employment in 2013. Structural transformation has also taken place, increasingly in the 2000s, with the share of employment in agriculture at 26 per cent of total employment in 2013 compared to 35 per cent in 1991.

Conclusion

This chapter finds that the quantum of employment growth is not the best estimator of improvement or distress in the labour markets of developing countries (DCs). The reason is that, in DCs, lack of social protection compels the poor and low-income segment of the labour force to undertake any form of work, which causes employment growth to be largely determined by labour force growth. Employment growth is then determined more by demographic supply side factors than by economic demand side factors. This consideration makes job quality a better estimator of labour market improvement or distress.

Job quality is measured in terms of three key indicators that the ILO estimates for MDG 1b – namely, the working poor, vulnerability and labour productivity – all of which consistently climb up the per capita income ladder across DCs.

Figure 3.9 Wage and salaried employment, labour productivity, working poverty and sectoral employment patterns in Senegal, Viet Nam and Peru, 1991–2013



Note: p = projection
Source: ILO, *Trends Econometric Models*, October 2013.

This empirical regularity, which reveals a strong correlation between job quality and per capita incomes, must, however, be viewed as a two-way relationship. Climbing up the per capita income ladder may well allow improvements in job quality; however, equally, improvements in job quality can also provide a boost up the income ladder – resulting in development. In this chapter, rates of reduction in vulnerability are seen to correspond closely to increases in labour productivity.

Human capital is seen to increase, moving up the per capita income ladder. This empirical regularity clearly works to improve job quality – by increasing prodctivity, allowing DCs to climb up the income ladder. This is established further in the following chapter on decomposing growth patterns.

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Decomposing growth patterns

4

The roles of investment, consumption, government expenditure, exports and education

Introduction

The purpose of this chapter is to decompose economic growth into its traditional factors, namely domestic demand and net exports. In addition, the chapter examines the role of investment in physical and human capital in boosting productivity in developing countries (DCs).

A. Trends in growth composition

The investment effort has increased significantly in most developing countries…

Table 4.1 disaggregates the GDP of DCs into its macroeconomic components, namely household consumption, government expenditure, investment, exports and imports. Household consumption is the largest component of GDP, but its share has tended to decline with increasing income, from a band range of 70 to 80 per cent of GDP for the least developed countries (LDCs) from 1980 to 2010, to a band range of 60 to 70 per cent of GDP for lower middle income countries (LMIs) over the same period, and a band range of 45 to 60 per cent of GDP in emerging economies (EEs). By contrast, household consumption in advanced economies typically is higher than for EEs, in a band range of 58 to 61 per cent.

A second macroeconomic component that consistently separates LDCs from LMIs, and LMIs from EEs, is investment. For LDCs, investment was in the range of 15 to 24 per cent of GDP between 1980 and 2010. For LMIs, investment picked up in lockstep over this period, to a band range of 22 to 32 per cent of GDP. For EEs, investment picked up further, to a band range of 27 to 36 per cent of GDP.

Table 4.1 Domestic demand, exports and imports as percentage of GDP

	1980	1990	2000	2010
LDCs				
Household consumption expenditure	79.5	75.7	73.7	71.8
Government consumption expenditure	13.4	12.3	11.4	10.7
Gross capital formation	15.4	14.7	20.0	23.8
Exports	16.7	16.4	23.6	27.1
Imports	25.0	21.1	28.7	33.2
LMIs				
Household consumption expenditure	69.4	66.2	66.8	61.5
Government consumption expenditure	11.5	11.9	11.2	11.0
Gross capital formation	21.9	24.8	22.3	31.3
Exports	18.2	16.3	22.8	23.8
Imports	21.2	19.3	23.0	27.6
EEs				
Household consumption expenditure	61.9	59.2	56.6	46.5
Government consumption expenditure	12.4	13.6	14.8	14.2
Gross capital formation	27.2	26.6	26.5	36.4
Exports	16.6	19.7	27.4	30.6
Imports	18.1	19.1	25.6	27.7

Note: The numbers represent weighted averages (with each country weighted by its share in world GDP total, in purchasing power parity (PPP) terms).

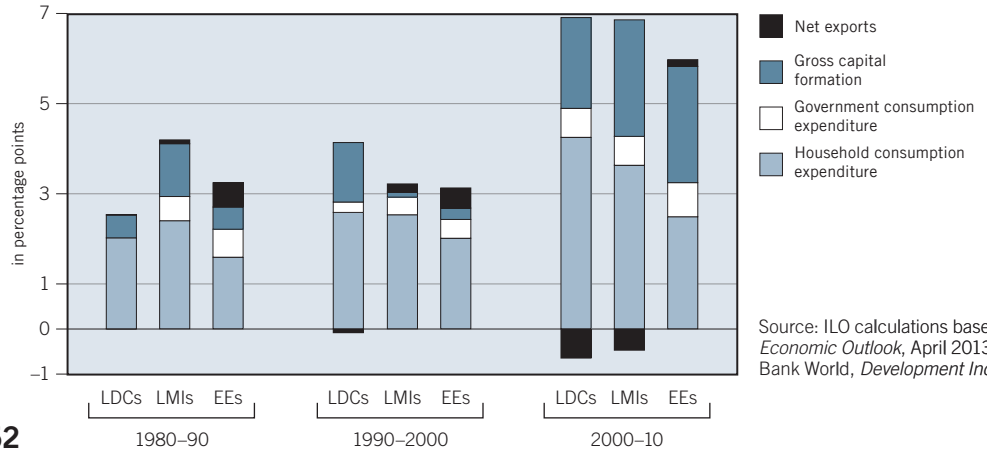
Source: ILO calculations based on IMF, *World Economic Outlook*, April 2013, and World Bank, *World Development Indicators 2013*.

...while the patterns concerning net exports are less clear cut...

Interestingly, the share of exports in the overall economy does not distinguish between LDCs, LMIs and EEs as consistently as does investment.

It is important to distinguish between shares in GDP, as presented in table 4.1, and contribution to economic growth, as shown in figure 4.1. In the 1980s, net exports from LDCs and LMIs were weak, with domestic consumption and investment contributing more to the growth of these economies. In the 1990s, net exports contributed more strongly than investment to economic growth in LMIs and EEs, while domestic consumption continued to play the largest role in

Figure 4.1 Decomposition of economic growth: Contribution to average annual GDP growth during the period 1980–2010 (percentage points)



Source: ILO calculations based on IMF, *World Economic Outlook*, April 2013, and World Bank World, *Development Indicators 2013*.

Table 4.2 Domestic and foreign sources of investment funding (percentage of GDP)

	1980	1990	2000	2010
LDCs				
Gross fixed capital formation	14.7	14.7	19.1	22.6
Gross domestic savings	7.0	9.4	14.9	17.5
Foreign direct investment	0.8	0.2	2.4	3.5
Official development assistance	6.6	10.7	7.2	6.6
Memorandum item: Personal remittances received	2.2	2.6	3.7	6.2
LMIs				
Gross fixed capital formation	20.8	23.5	21.2	28.0
Gross domestic savings	19.0	21.9	22.1	27.5
Foreign direct investment	0.4	0.6	0.5	1.8
Official development assistance	2.7	3.4	1.1	0.6
Memorandum item: Personal remittances received	2.5	2.1	2.8	4.0
EEs				
Gross fixed capital formation	24.6	22.5	25.1	34.1
Gross domestic savings	25.7	27.3	28.6	39.2
Foreign direct investment	0.7	0.8	3.0	3.2
Official development assistance	0.4	0.5	0.2	0.1
Memorandum item: Personal remittances received	0.6	0.6	0.8	0.7

Note: The numbers represent weighted averages (with each country weighted by its share in world GDP total, in PPP terms).

Source: ILO calculations based on IMF, *World Economic Outlook*, April 2013, and World Bank, *World Development Indicators 2013*.

driving economic growth in all three income groups. In the 2000s, the contribution of both domestic consumption and investment to economic growth increased sharply, with net exports playing a relatively minor, or even negative, role across the income groups.

…and higher domestic savings, rather than FDI or external aid, have been the main funding source of the increased investment effort

To fund investment, DCs have relied more on domestic savings and less on foreign direct investment (FDI) and external aid (table 4.2). Over the past three decades, domestic savings increased for all three categories of DCs, and domestic savings as a share of national income tended to be higher in EEs than in other DCs.

Over the same period, FDI rose modestly – from under 1 per cent of GDP for each of the income groups in 1980 to 3 per cent of GDP for LDCs and EEs and about 2 per cent of GDP for LMIs. Official development assistance remained relatively important for LDCs, not least because most assistance is targeted at that group and other very-low-income countries. Official development assistance for LDCs fluctuated between 1980 and 2010, but the trend rate was just under 7 per cent of GDP. For LMIs, external assistance tapered off over this period, from under 3 per cent of GDP to 0.5 per cent. For EEs, external assistance was negligible over this period.

Remittances increased over this period for LDCs, from 2 per cent of GDP to over 6 per cent. For LMIs, remittances picked up from 2.5 per cent of GDP to 4 per cent. Remittances for EEs remained under 1 per cent of GDP over this entire period (see Chapter 9 for an analysis of these trends and their impacts).

B. Different patterns of growth: The examples of Brazil and China

Brazil

Brazil, a country of continental scale with a fast-growing population of 180 million, has traditionally been oriented towards its domestic market. Import-substitution industrialization policies were implemented actively until the 1980s, through subsidies and tariff and non-tariff protections, to develop Brazil's industrial sector and orient it towards serving the domestic rather than the export market. While such policies facilitated the emergence of a modern manufacturing sector, the country's external deficit has persisted (Amann, 2005).

Over the past decade, Brazil has been doing particularly well, with the economy benefiting from booming external demand for commodities and favourable terms of trade, as well as significant and widespread growth in domestic consumption. GDP per capita grew by 2.6 per cent per year on average between 2004 and 2012, and the poverty headcount ratio was more than halved between 2001 and 2009, from 22 per cent to 10 per cent (figure 4.2).

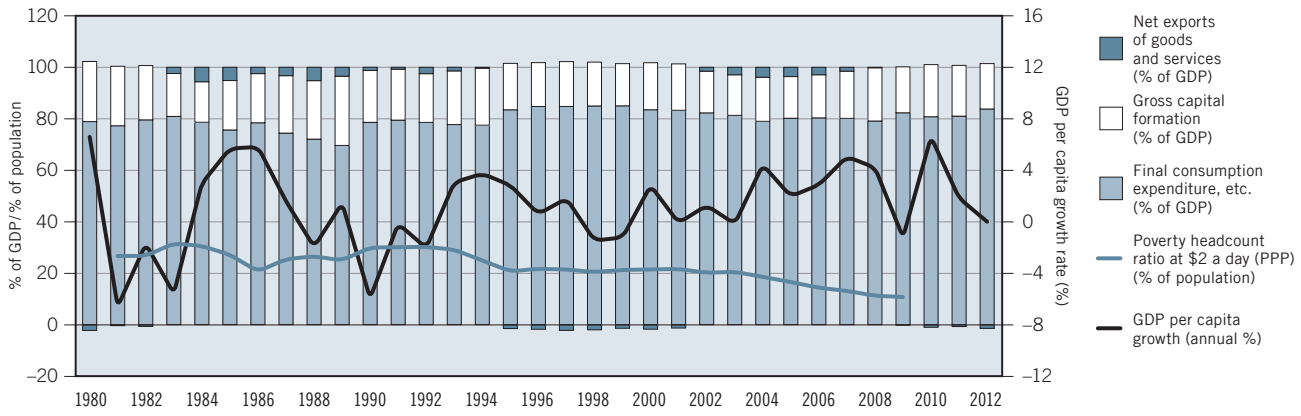
In comparison with the "Brazilian miracle" of the 1970s, the achievements of the past decade seem to rest on sounder foundations. External vulnerability in particular is much lower. The burden of external debt is low and declining, substantial foreign reserves have been accumulated and the short-term component of external debt is much lower than in the past.

While Brazil's previous growth episodes were often followed by high inflation, price levels have been relatively stable over the past 10 years, with an average annual inflation rate of 6.5 per cent between 2002 and 2012.

Another important development is the increasing openness of the Brazilian economy. The country has lowered tariffs and other trade impediments since the late 1980s and is now strongly integrated in the world economy: the trade-to-GDP ratio in 2012 was 26 per cent, compared with 15 per cent in 1990.

Brazil's major achievements over the past decade are to have achieved relatively high levels of domestic demand-led growth and poverty reduction while reducing inequality, maintaining macroeconomic stability and reducing external vulnerability, thus creating the conditions for more sustainable growth and development. The higher mean level and lower volatility of Brazilian growth over the past decade, despite the troubles in the global environment, suggest that the country may be on a path of sustainable consumption-led growth.

Figure 4.2 Composition of economic growth in Brazil, 1980–2012



Source: ILO calculations based on World Bank, *World Development Indicators 2013*.

There are, however, challenges that the Brazilian economy will have to face in order to continue its impressive growth and development. Supply-side constraints, such as a low investment-to-GDP ratio, inadequate infrastructure and insufficient spending on workforce training and education (IMF, 2012; Canuto et al., 2013) need attention if further sustainable growth is to be generated. The dynamism of domestic demand has been driven in part by household indebtedness, which poses potential problems, as episodes of credit boom may be followed by periods of deleveraging. Hence, steps to control excessive growth of credit may be warranted. Raising the investment-to-GDP ratio through necessary investments in education, social services and infrastructure can offer a way to maintain strong domestic demand while fostering productivity gains. Reforms to improve the conditions in which the manufacturing sector operates – to help avert a so-called "competitiveness cliff"[1] (Canuto et al., 2013) – seem crucial.

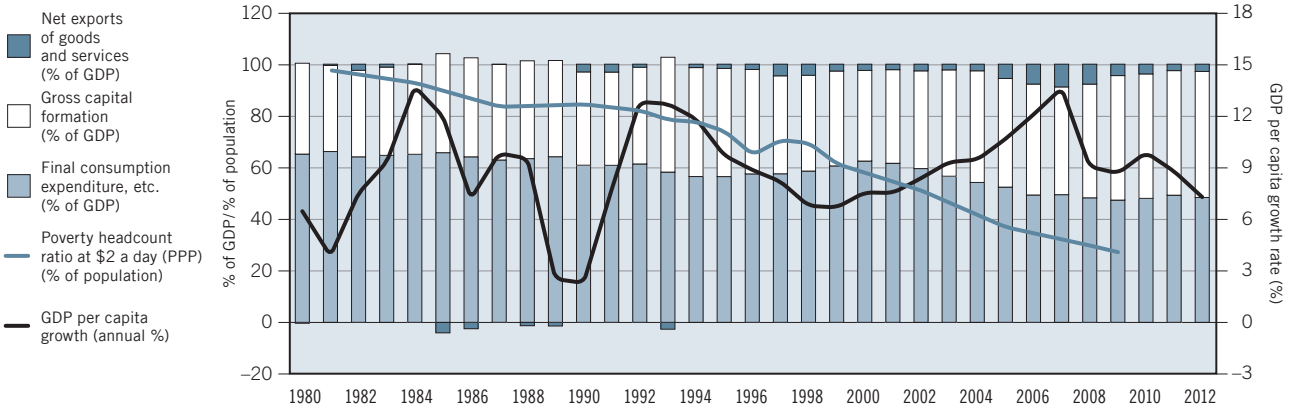
China

Over the past 30 years, China has achieved economic growth at an unprecedented pace. No other country in history has been able to grow at 10 per cent annually for such a long period. The strong growth has allowed the country to lift several hundreds of millions of households out of poverty (figure 4.3).

China's growth model has been associated with very high saving and investment rates and a reliance on exports rather domestic demand as an outlet for its fast-growing manufacturing sector.

The persistently high investment rate increased from 36 per cent of GDP during the 1980s to 42 per cent during the 2000s. Moreover, since the onset of the financial crisis in 2008, the Government has stimulated investment further, to 48 per cent of GDP, in an attempt to offset the decline in global demand for Chinese exports. China has relied to a great extent on domestic savings to satisfy its investment needs.

Figure 4.3 Composition of economic growth in China, 1980–2012



Source: ILO calculations based on World Bank, *World Development Indicators 2013*.

1. After several years of strong expansion, the Brazilian economy is now facing considerable competitiveness challenges, mainly related to supply-side difficulties rather than to insufficient aggregate demand. The main factors that have been inhibiting exports and industrial production expansion are a low and decreasing rate of entry of firms into export markets, a clear decline in the share of products with higher technological content, an inefficient logistics infrastructure and the fact that trade openness in Brazil is among the lowest in the world (Canuto et al., 2013).

Chinese economic growth has been heavily outward-oriented. Trade as a share of GDP grew from 24 per cent to 40 per cent between 1980 and 2000. Following China's accession to the World Trade Organization, its trade-to-GDP ratio grew to 70 per cent in 2007, before declining to 58 per cent in the wake of the crisis. In comparison with other East-Asian countries that industrialized earlier than China, China has accumulated trade surpluses at an earlier stage of development. The unprecedented growth has allowed China to reach the status of middle-income country in a very short time span.

In recent years, growth has been more moderate, there has been increasing reliance on credit and there have been recurring episodes of inflation, which suggest that the Chinese growth model needs to shift from extensive to intensive growth (IMF, 2013a).

After having boosted investment dramatically in response to the 2008 trade collapse, the Chinese Government showed in its twelfth Five-Year Plan (2011–2015) a strong willingness to rebalance its growth model towards domestic consumption and away from exports and investment.

This reorientation includes steps to reduce the national saving rate, which has been the highest among the large economies for more than 20 years. The high overall saving rate is explained by the fact that all three sectors of the economy – corporate, household and government – have a high propensity to save (Ma and Yi, 2010). The fact that since the 1980s, the saving rate of Chinese households has been rising can appear puzzling as it is at odds with the standard prediction, according to which households experiencing fast-growing incomes reduce their savings in order to smooth consumption over time. However the ongoing restructuring of the economy (which has been under way since 1979) has introduced income uncertainty and led to the erosion of social protection system that existed previously, based on state-owned enterprises. Faced with gaps in health and pension coverage over a sustained period, households have saved more to finance their retirement, healthcare and other needs (Shimek and Wen, 2008).

Accordingly, rebalancing Chinese growth towards private consumption has required social policies that build a social protection system that provides Chinese households with enough economic security for them to reduce their saving rate. In this regard, efforts to extend coverage and increase benefits in terms of old-age income security and healthcare have been introduced gradually over recent years. The twelfth Five-Year Plan lays out measures to extend the coverage of the urban basic pension scheme, introduce a new rural pension scheme, expand medical insurance coverage and extend unemployment insurance. The plan also commits the Government to continue its policy of substantial minimum wage increases, which contributed to lifting Chinese real average wages by 62.1 per cent between 2007 and 2012 (*China Statistical Yearbook 2013*, table 4-11). The Chinese Government's willingness to rebalance its economy and boost domestic consumption by increasing wages and extending social protection coverage and benefits is encouraging. In the past 2 years, consumption has contributed more than half of Chinese economic growth, exceeding the contribution of investment.

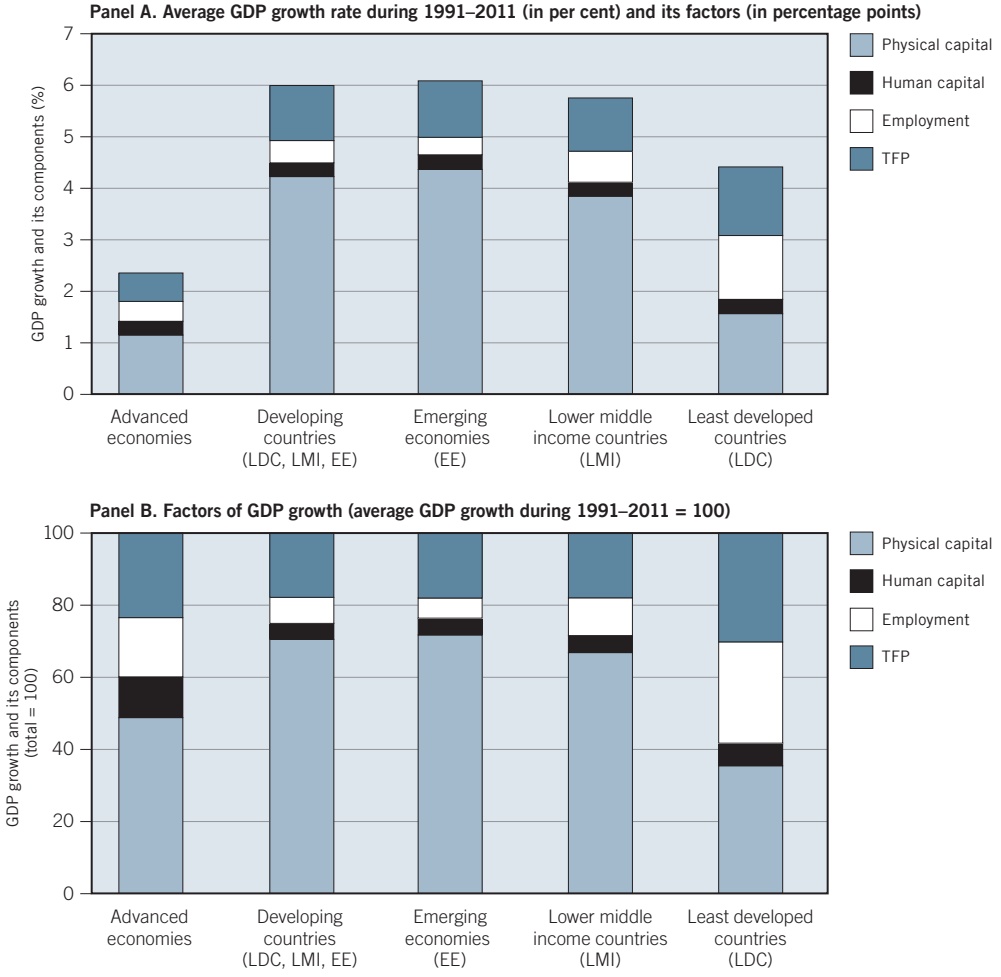
Reforms aimed at increasing the efficiency of the allocation of resources across firms, thus boosting total factor productivity, as well as reforms facilitating the growth of the service sector could prove complementary to these policies expanding domestic demand.

C. The role of human capital

Beyond investment in physical capital, it is instructive to examine the pattern of investment in human capital: that is, the contribution that education and training of the labour force make to growth. While the quantum of physical capital does play a role in explaining differences in GDP per capita, the relative investment in human capital adds more explanatory power, not least because physical and human capital may be complements. More broadly, human capital is a key factor in enhancing labour productivity and job quality, and hence GDP growth (see box 4.1).

Figure 4.4 provides evidence for the role of human capital in GDP growth, by decomposing this growth between 1991 and 2011 into physical capital, labour, human capital and a residual taken to be total factor productivity (TFP) (Inklaar and Timmer, 2013). The traditional decomposition of GDP growth over time is usually in terms of just three elements: capital, labour and TFP. However, the Penn World Table and its methodology permit labour to be differentiated by educational levels. These educational levels allow labour to be weighted by primary, middle and higher level educational attainment. In effect this allows GDP growth to be decomposed into a fourth element, human capital.

Figure 4.4 Decomposition of output growth into physical capital, human capital, employment and total factor productivity, 1991–2011



Note: Growth decompositions are based on data for 55 DCs (12 LDCs, 16 LMIs, 27 EEs) and 37 advanced economies.

Source: ILO calculations based on IMF, *World Economic Outlook*, October 2013; ILO, *Trends Econometrics Models*, October 2013; Groningen Growth and Development Centre, *Penn World Table*, version 8.0.

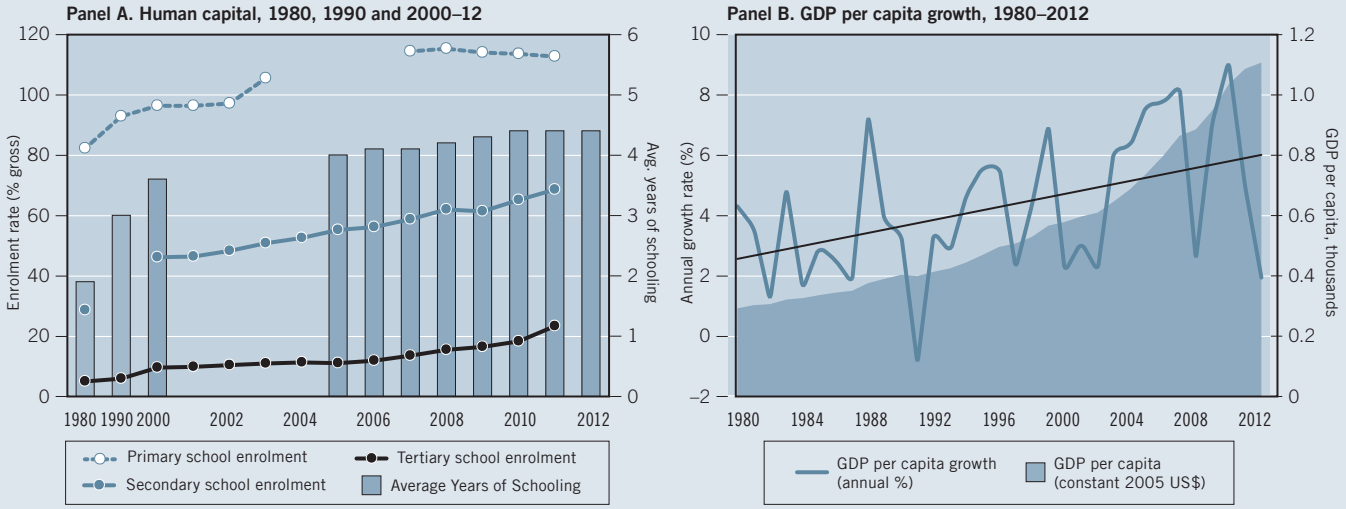
Box 4.1 Human capital, productive employment and development

Human capital plays a critical role in generating growth, along with the accumulation of physical capital. It is a crucial input to increasing productivity levels and is a key indicator of job quality in developing countries.

India

India provides an impressive case of a country that steadily improved its human capital, accompanied by a rapid increase in GDP per capita. Figure 4.5, panel A shows that average years of schooling (AYS) in India showed a large increase in the past three decades: from 1.9 in 1980 to 4.4 in 2012, more than double. In parallel, the enrolment rate for primary, secondary and tertiary education increased significantly. In the same period, GDP per capita increased from US$292 in 1980 to US$1,107 in 2012, with an average growth rate of 4.3 per cent per annum (figure 4.5, panel B). The country's large pool of labour with increased human capital has provided a sound basis for development with gradually improving employment quality and productivity.

Figure 4.5 Human capital and GDP per capita growth in India

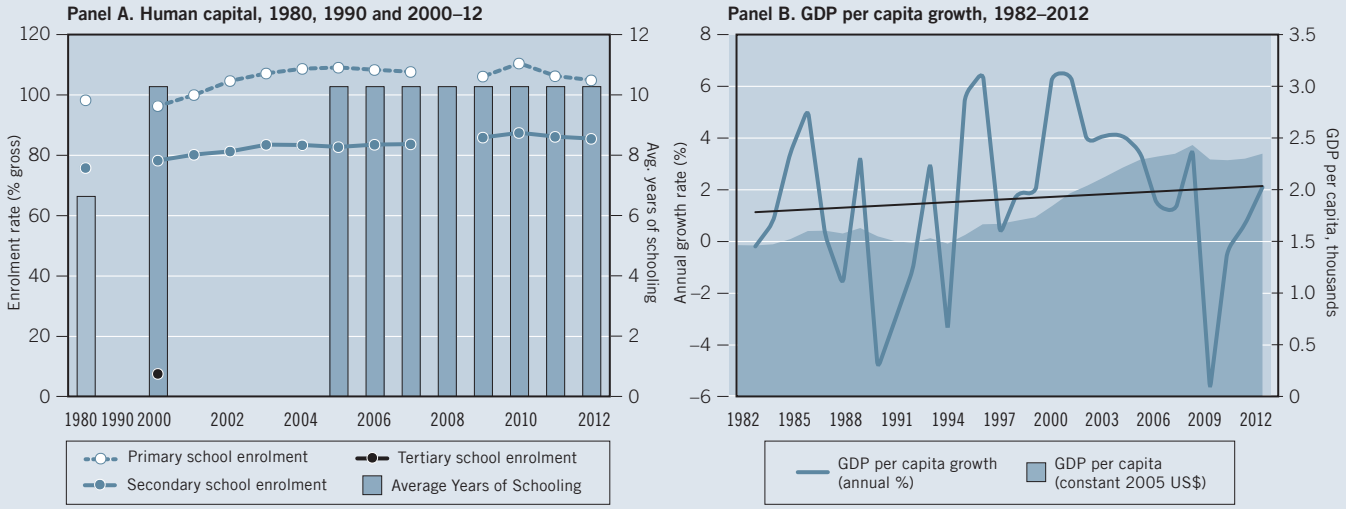


Source: World Bank, *World Development Indicators 2013*; Barro and Lee (2000).

Samoa

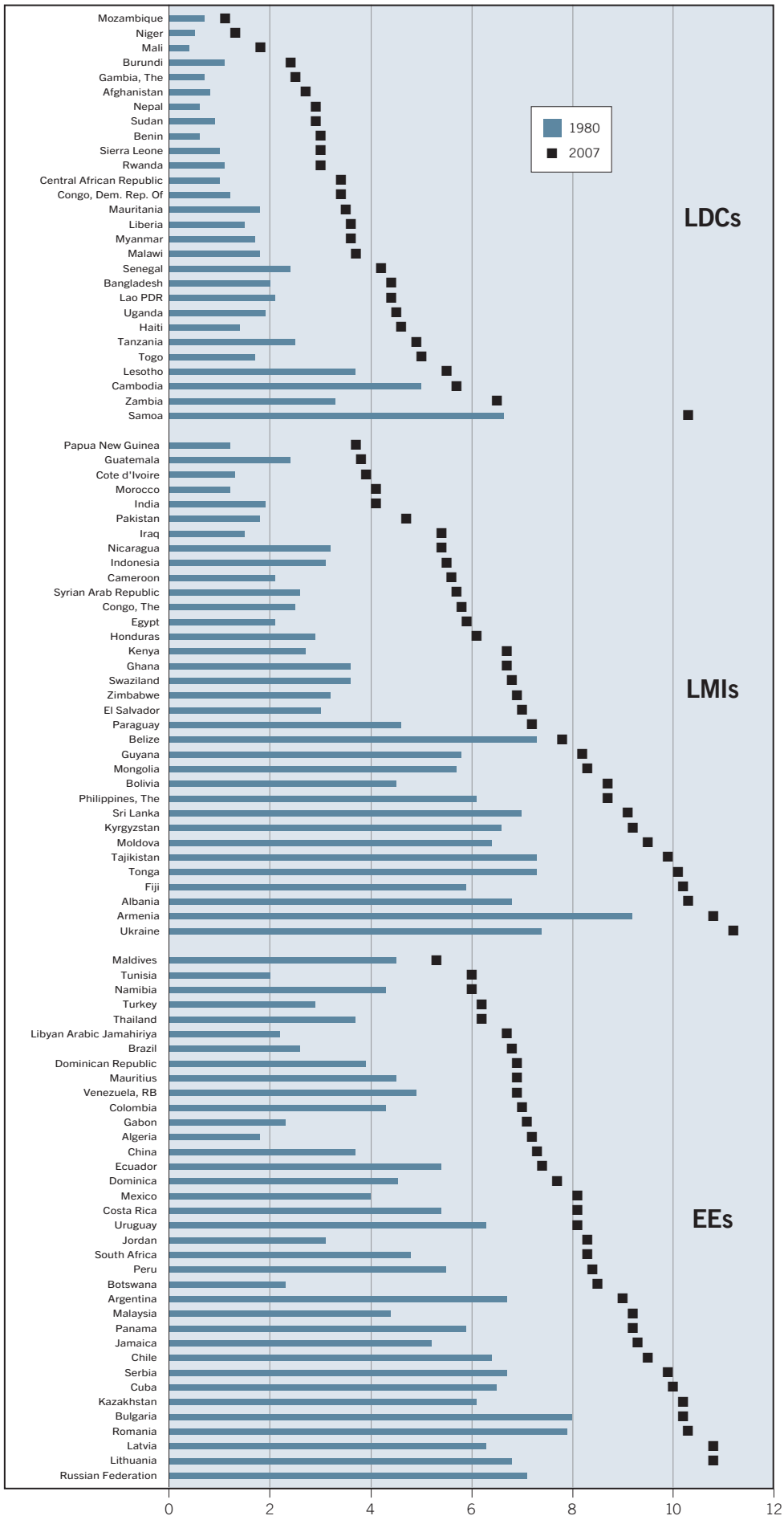
Since 2000 Samoa has had the highest AYS among the LDCs, at 10.3, up from 6.7 in 1980. Primary and secondary school enrolment rates also increased, by 7 and 10 percentage points respectively, between 1980 and 2012. During these three decades, GDP per capita grew from US$1,465 in 1982 to US$2,350 in 2012, with a trend of increasing growth over this period (figure 4.6).

Figure 4.6 Human capital and GDP per capita growth in Samoa



Source: World Bank, *World Development Indicators 2013*; Barro and Lee (2000).

Figure 4.7 Average years of schooling for adults over age 25, 1980 and 2007



Note: The figure shows the average years fo schooling in the earliest and latest years for which data were available.

Source: Barro-Lee (2000); World Bank *EdStats*; Human Development Report Office as of 15 October 2012.

Box 4.2 The role of investment and employment in development in Cabo Verde

Cabo Verde, which became independent in 1975, was not endowed with the ideal conditions for economic growth. The country's small population is scattered across small islands, and it is insulated in the Atlantic Ocean within the Sahelian belt. The country has no substantial mineral resources, and water supplies are scarce (AFDB, 2010). Yet, in spite of these obstacles, the economic performance of Cabo Verde has been outstanding. From 1980 to 2010, the annual GDP growth rate has averaged 6.1 per cent (figure 4.8). As a result of that sustained growth, Cabo Verde graduated from the LDC category and joined the "middle-income countries" in 2008.

As a small country, Cabo Verde has a history of massive emigration and has benefited from very high levels of remittances. Remittances accounted for about 18 per cent of GDP on average in the 1980s and 1990s, and 11.8 per cent from 2000 to 2011. These transfers allowed the country to maintain a moderate current account balance deficit while having a high trade deficit.

While remittances and official development assistance (ODA) (figure 4.9) have been on decreasing trends since the 1990s, foreign direct investment (FDI) started increasing in the mid-1990s. The net inflow of FDI has been strongly positive; it peaked at 14.4 per cent of GDP, before declining steeply in the aftermath of the 2008 global financial crisis. The high level of FDI is accompanied with a very high ratio of investment (public and private) to GDP, which peaked at 47 per cent in 2007 (figure 4.9).

Cabo Verde has ensured macroeconomic stability and credibility, notably by pegging its currency against the euro and keeping its tax system simple while fighting against corruption. Such macroeconomic discipline combined with stable democratic institutions allowed the massive influx of capital behind the country's fast economic growth (AFDB, 2012).

Another characteristic of the Cabo Verdean economy is the large and increasingly important services sector (figure 4.8). Tourism is a crucial part of the Cabo Verdean economy, and represents a large share of FDI through foreign-owned resorts (AEO, 2013). In 2012, the number of tourists visiting the island totalled 537,000, exceeding the national population for the first time.

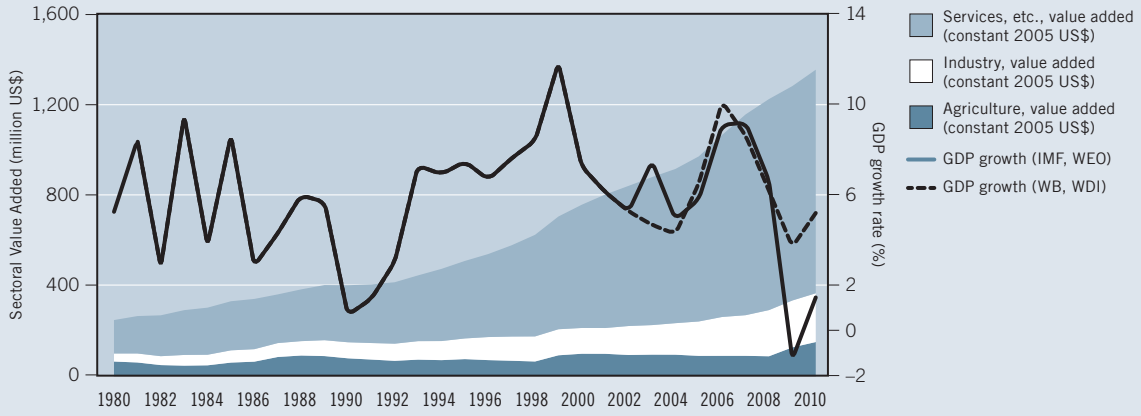
The overall dependence on tourism, FDI, ODA and remittances implies a strong vulnerability to external shocks. The drop in GDP growth and FDI that occurred following the financial crisis suggests that diversifying the Cabo Verdean economy could lead to real gains.

Cabo Verde has prospered despite many vulnerabilities, such as the lack of natural resources, an adverse climate and vulnerability to external shocks. This success was made possible by the building of stable and democratic institutions, an emphasis on macroeconomic stability and strong investment in human capital through social security and education spending. ODA and remittances made a major contribution to growth up until the late 1990s, but as their relative importance declined over the past decade, they have been increasingly complemented by FDI.

In comparing AEs with DCs as a group, physical capital does not appear to be a constraint for DCs (figure 4.4, panel A). However, physical capital does appear to be constrained for LDCs as it accounts for only 35 per cent of GDP growth between 1991 and 2011. For LMIs, physical capital accounts for about 66 per cent of GDP growth over this period, while for EEs it accounts for about 72 per cent of GDP growth.

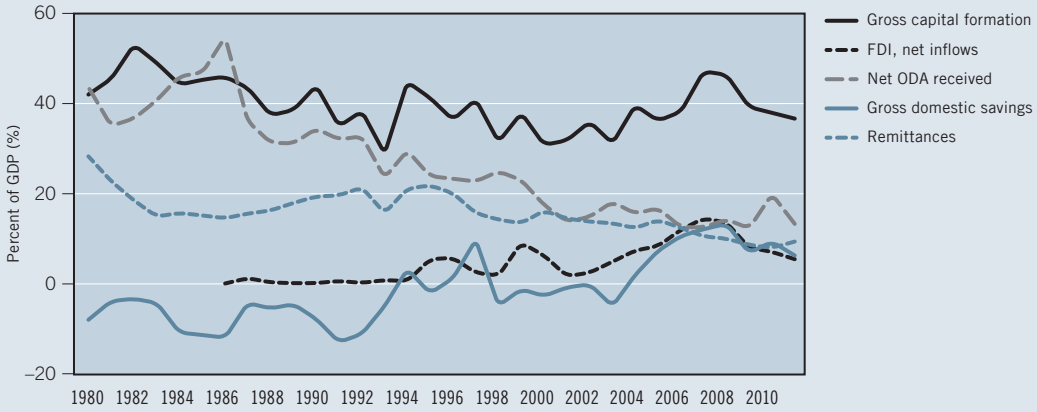
But the more critical finding (figure 4.4, panel B) is in the role of human capital in AEs compared with DCs. Human capital accounted for about 11 per cent of GDP growth between 1991 and 2011 for AEs. This was more than double the share of human capital in GDP for DCs. It is this difference in human capital

Figure 4.8 GDP growth and sectoral composition, Cabo Verde



Source: World Bank, *World Development Indicators 2013*; IMF, *World Economic Outlook*, October 2013.

Figure 4.9 Investment in Cabo Verde, 1980–2011 (per cent of GDP)



Source: World Bank, *World Development Indicators 2013*.

that is likely to explain the much higher relative contribution of TFP for AEs, of almost one-quarter of total GDP growth compared with 18 per cent of GDP growth for DCs.

All DCs improved their educational outcomes between 1980 and 2007 (figure 4.7). In terms of attainment of an arbitrary threshold, say 6 years of schooling, the LDCs' much lower base meant they have struggled to catch up with LMIs and EEs. Despite big improvements by LDCs, only two had average years of schooling above 6 years in 2007, compared with only one in 1980. The number of LMIs with above 6 years of schooling more than doubled, from 30 per cent in 1980 to 62 per cent in 2007. EEs made a huge improvement, from 25 per cent above 6 years of schooling in 1980 to all but one country in 2007.

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PART II

Policies for developing with jobs

Productive transformation, decent work and development

5

Introduction

Evidence from the previous chapters suggests that development involves a process of structural change which is only imperfectly reflected in annual economic growth figures. Indeed, the experience of countries which sustained economic growth over a significant period of time highlights the importance of broad-based economic growth along with quality job opportunities (Chapter 4). These involve profound changes in the composition of the enterprise mix with increased importance of medium-sized enterprises and a closing of the productivity gap between smaller and larger enterprises. At the same time, natural resource constraints and the need to ensure the environmental sustainability of growth and development have become global concerns for governments and the private sector alike. On the other hand, the rapid expansion of demand for green investment and consumer goods and services has significant potential to create more and better jobs. For developing and emerging economies it can also provide an opportunity to 'leapfrog' and make use of the latest technology in terms of energy and resource efficiency, land management and renewable energy.

The purpose of this chapter is to deepen the analysis by examining in greater detail the process of productive transformation which lies at the heart of development. Productive transformation is defined here as a process of change into higher value added products. It typically involves shifting resources between sectors (e.g., relocating labour from low-productivity activities, such as subsistence farming, to higher productivity ones) as well as within them (Imbs and Wacziarg, 2003).

The chapter starts with a discussion of productive transformation and the role that decent work plays in such a process (Section A). It then examines a key external issue which often arises in the process of productive transformation, namely competitiveness concerns along with respect for international labour standards (Section B). Finally, concluding remarks are presented (Section C).

A. Productive transformation through economic and social upgrading

The dynamics of productive transformation are driven by (a) productive investment in physical capital, including in particular infrastructure, which expands countries' economic potential; and (b) the ability to diversify into new products and technologies – the so-called productive capabilities (Nübler, 2014a). The acquisition of productive capabilities is also determined by a range of processes, including through socialization, e.g. from the family and community environments in childhood and throughout one's life; formal learning in education systems; technical learning within production systems; and learning by experience (Andreoni and 0'Sullivan, 2014).[1] Hence, productive transformation is driven by the simultaneous evolution of investment (i.e., expanded productive capacity) and the development of capabilities through knowledge acquisition and other processes.

This means that development cannot be achieved by growth which is confined to the "modern" sector of the economy, driven only by trade and investment liberalization or the exploitation of natural resources. Instead, development should be viewed holistically as the productive transformation of the entire economy and labour market.

Also, development cannot be achieved by unsustainable exploitation of natural resources or through a model whose environmental impact undermines vital natural processes such as the climate or the water cycle and which entails costs in terms of human health. A number of reports by intergovernmental organizations (ILO 2012 and 2013a, OECD 2012, World Bank 2012) and the private sector (McKinsey 2011) have highlighted that the business-as-usual model of economic growth and development based on 'grow now, clean up later' is no longer viable. It has in fact become counter-productive and will lead to increasing losses in human well-being and ultimately in value-added and employment. This section illustrates the process of productive transformation, taking into account the different starting positions of countries and the growth context in the 21st century.

Productive transformation entails investing the revenues from natural resources productively, sustainably and equitably …

In many developing countries, the main opportunities to expand and prosper are associated with the extraction of non-renewable natural resources such as oil, gas and minerals. Income and export earnings from such resources can be crucial at initial stages of development. However, in and of itself, the extraction and export of natural resources does not necessarily engender development. Extractive industries typically create only a limited number of jobs, often with very specific skills, and the potential to generate decent jobs for the country as a whole is small. The challenge is therefore to translate revenues from natural resources into decent work opportunities through investment in new economic activities and in essential services like education, which trigger the process of productive transformation, job creation and development.

In this respect, it is crucial for developing countries to design policies and contracts for natural resource exploitation in the best interests of the country as a whole. This means addressing the risk of corruption in both the sale of rights and

1. Technological change, thus viewed, takes place through the entire production process incrementally, and is not focused narrowly in R&D departments (Chang and Andreoni, 2014).

Box 5.1 Developmental management of natural resources: The case of Malaysia

When Malaysia gained independence in 1957, rubber and tin constituted over half of its economic base (Arif and Tengku Mohd Ariff, 2001). Since the 1980s, however, the Malaysian economy engaged in a process of diversification and, by the end of the 1990s, the share of manufacturing in the economy had already exceeded 30 per cent. Over the past two decades, average per capita income grew at around 3.4 per cent per year. The incidence of working poverty was cut from 10.5 per cent in 1991 to 1.3 per cent in 2012 and considerable progress has also been made in reducing the incidence of vulnerable employment, as documented in Chapter 3.

A first factor behind these achievements was the selection of palm oil as an engine of agricultural productivity growth. The oil palm had first been introduced to Malaysia in 1875; however, production did not reach economies of scale. From the early 1960s, replanting grants were offered to encourage owners of rubber plantations to switch to palm oil production (Pletcher, 1991). The state also acquired and developed foreign-owned oil palm estates. By 2012, Malaysia was the world's second largest producer of palm oil (UN, 2013).

Second, direct forward linkages were developed with industries that use palm oil, such as palm oil processing, oleo-chemicals, biotechnology, biodiesel and biomass industries. Fiscal incentives were used to attract investments in strategic areas related to palm oil. Higher duties were imposed on crude palm oil exports, while at the same time tax exemptions were granted to processed palm-oil based exports – with a view to encouraging higher value added production and export diversification.[1] These diversification efforts were also successful. By 2012, processed palm oil exports had reached 2.8 times the volume of crude palm oil exports (MPOB, 2013).

Third, from the 1980s, the Government decided to use some of the revenues from production and exports of palm oil products to support the development of non-resource-based industries, such as electronics. Through strategic interventions, Malaysia upgraded its production and export structure over time to include high-technology, skill-intensive products (Lall, 1995).

The country still faces the challenge of creating sufficient numbers of decent jobs. The Government has adopted measures to broaden access to quality technical education and vocational training, and to expand the coverage of the Skills Development Fund (OECD, 2012). More fundamentally, the strengthening of labour market institutions and tackling barriers to formal employment would enhance the linkages between the most dynamic sectors and the rest of the economy, making growth more inclusive (see Chapters 6 and 8). These are areas where there is significant scope for social dialogue.

[1] Bleaching earth, a key ingredient in the palm oil processing industry, was initially subject to tariffs and import quotas until internal production capabilities were developed. However, in order to cap costs during the import substitution phase, subsidies were provided to ensure that the price of bleaching earth purchased by domestic industries was on a par with world prices.

the distribution of revenues from production and exports (Chang and Andreoni, 2014). It also means avoiding negative impacts through ambient contamination and possible competition for scarce resources such as water and, in the case of renewable natural resources, a sustainable use and management of the resource.

Second, if properly managed and led, the extraction of natural resources can create forward and backward linkages with the rest of the economy, thus becoming an engine of broader-based growth (see box 5.1 for the example of Malaysia). Renewable natural resources such as fertile soils, forests, fisheries, solar or wind energy offer many opportunities for economic diversification on a long-term and sustainable basis. Governments in developing countries should find ways to create national capabilities to exploit renewable natural resources productively and for the long run. In the event of the award or sale of rights to a foreign company, the sales process and the resulting contracts should be designed to facilitate a transfer

of technological, managerial and production capabilities in line with the provisions of the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (ILO, 2006).

Third, the method used to invest the income from natural resources is critical, particularly proceeds from non-renewable ones. It is sometimes argued that the income from natural resources should be invested in financial assets to ensure a financial return to later generations, while reducing the risk that production and exports associated with the extraction of natural resources might crowd out other activities – a situation known as the "Dutch disease". Such an approach can be valid in advanced economies such as Norway, where well-developed manufacturing and services existed before oil and gas exploitation began. However, in developing countries with surplus labour it is essential to use the resources at least in significant part to build a broad-based productive foundation and enhance productive capabilities.

Investing in diversification that builds on the natural resource base (for example, broadening the scope of forest use from timber to paper-making and furniture production) and using fiscal revenues to build productive capabilities is therefore a natural option for developing countries.

The case of Malaysia provides an interesting example of how to move forward in this respect (box 5.1). The United Arab Emirates has also managed to diversify its production base by building an aluminium industry, taking advantage of the availability of a large oil sector (Chang and Andreoni, 2014). The idea of "transforming" oil into aluminium also allowed the United Arab Emirates to develop backward and forward linkages between the oil sector and the rest of the economy. In 2010, manufacturing accounted for around 10 per cent of GDP, a significant jump from its 0.9 per cent share in 1975 (World Bank, 2013).

… boosting agricultural productivity and incomes …

Agriculture often represents the largest source of employment in developing countries, notably LDCs. Many of these countries are characterized by a deep economic dualism: a traditional sector based mainly on low-productivity subsistence agriculture and a nascent modern sector consisting of mines, plantations, manufacturing or high-end services, which uses production techniques that help to achieve much higher labour productivity than in the traditional sector. One of the major avenues for productive transformation involves exploiting the opportunity presented by the significant difference in productivity between the two sectors of the economy. This has been a major factor in the transformation of the emerging economies of East and South-East Asia for example.

For this strategy to be effective, it is of paramount importance to maximize the rate at which labour from agriculture can be absorbed into the modern sector. However, given the small base of the modern sector, this process of labour reallocation can initially be slow and only a small proportion of the agricultural labour force will find significantly more productive employment in the modern sector in the short to medium term. Therefore there must also be a second prong of employment policy that is directed at raising growth, productivity and labour demand in agriculture, rather than sole reliance on the growth of modern sector employment and the wider rural economy. Otherwise many poor and underemployed rural workers will have no prospect of economic advancement while they wait for their turn to secure a job in the modern sector. Furthermore, there is a risk of "premature exit" of labour from agriculture, as in many developing countries,

where the destination was not the modern sector but rather the low-productivity urban informal economy (Lee, 2014).

Thus there is a significant pathway for advancing overall productive transformation through change within the agricultural sector itself. An employment-based approach can support overall growth and transformation, as shown by the Green Revolution in Asia, where agricultural productivity gains provided rising incomes for those employed in the agricultural sector. This sets in motion a virtuous circle of productivity and employment growth that is a powerful means for reducing rural poverty. In fact, the World Development Report 2008 concluded that improved productivity and incomes in smallholder farmers are the most effective way to reduce poverty (World Bank, 2008).

Agricultural growth is also necessary for generating those goods, principally food, which are increasingly demanded by a growing labour force in the modern sector, and for the agricultural sector to feed itself. As the food crisis of 2007 demonstrated, low-income countries can face tight foreign exchange constraints and can be dependent on food imports that expose them to shortages and rising prices which cause food insecurity and social unrest. Domestic production of food can also be an important element of food security and more sustainable development of the modern sectors (Lee, 2014).

Finally, agriculture offers new opportunities for growth and economic transformation with the emergence of global food chains, agribusiness and the increasing demand for biofuels. "New agriculture" exports (horticultural products such as fruit, vegetables, cut flowers, livestock and fish products) which, in 2006, accounted for 47 per cent of developing country agricultural exports (World Bank, 2008) typically have high value added.

Box 5.2 highlights the example of agricultural transformation in Brazil. There are others, such as Chile with its major advances in exports of fresh fruit, wine and salmon (Andreoni 2013a) and Peru, which has become the world's largest exporter of fresh and canned asparagus.

Other countries, for example Uganda and Madagascar, have exploited the consumer preference for organically grown food, one of the fastest growing segments in the market which often commands premium prices. They show that significant improvements in agricultural productivity and sustainability can be achieved by poorer countries with large numbers of subsistence farmers. In the case of Uganda, agriculture is the biggest contributor to GDP and employs two thirds of Uganda's workforce. Output is produced by 4.5 million smallholder farmers. Since the mid-1990s, more and more farmers have embarked on a transition to organic farming for export (ILO, 2012).

All cases highlight the crucial role played by a range of institutions in financing, generating and disseminating agricultural techniques which are specifically adapted to local needs. In Madagascar, for example, technology transfer, finance and access to external markets by a multinational enterprise were pivotal (ILO, 2012). As a result, agriculture – which has often been regarded as a "sunset" sector – has become a new frontier for technological innovation, productive jobs and equity.

… enhancing spillover effects arising from manufacturing …

Many studies show that high productivity growth rates were achieved in countries that were able to shift production from traditional to modern activities, in particular to tradable and industrial products, and to diversify their export base

Box 5.2 Agricultural transformation: The case of Brazil

Over the past 30 years, Brazil has been among the most active countries in terms of its use of policies designed to expand agricultural production. These efforts, along with a range of social policies (Chapter 7), have been instrumental in reducing poverty in the country. In addition, Brazil is today among the top three producers and exporters of orange juice, sugar, coffee, soybeans, beef, pork and chicken, as well as having caught up with the large grain exporters. At the centre of the transformative policy package implemented in Brazil, there is a network of intermediate institutes which have fostered technological change, diversification and upgrading in agriculture, thereby contributing to poverty alleviation.

Brazil boasts one of the most well-developed and well-funded agricultural research systems in the developing world. A pivotal role has been played by EMBRAPA (*Empresa Brasileira de Pesquisa Agropecuária*), the national agricultural research agency of Brazil. Established in 1972 as a public corporation, Embrapa created its network of national and regional centres during its first decades of existence. It also increased its internal capabilities by signing partnership agreements with US universities, giving Embrapa's staff access to postgraduate training. According to the Brazilian Government, Embrapa has made more than 9,000 technologies available to Brazilian farmers since its inception.

Perhaps the most remarkable achievement of Embrapa has been the development of the Cerrado – a vast semi-arid region long considered to be "unproductive". The programme introduced "new varieties, cultural practices, zoning, tillage, biological fixation of nitrogen, development of livestock for both meat and milk, vegetables, fruit, irrigation and knowledge of the Cerrado natural resource basis" (Alves, 2010). As a result of these innovations, in 2010 the Cerrado accounted for 70 per cent of Brazil's farming output.

Another key break-through has been the development of an ethanol cluster which includes all elements from optimized sugar cane production by selecting the best varieties and improved farming methods – also led by Embrapa – to advanced farm machinery such as combine harvesters for sugar cane and computer-controlled, integrated sugar cane and ethanol refineries. All stages and components of the process are today made in Brazil with many companies concentrated in a sugar and ethanol cluster in Riberão Preto, a traditional center of sugar cane growing in São Paulo State (Macedo 2006). Ethanol today provides between one third and one half of the transport fuel for Brazil's car fleet and its production employs several hundred thousand workers (IRENA 2014). Almost all new cars are equipped with 'flex-fuel' technology also developed and manufactured by the local subsidiaries of global car manufacturers. The country has reaped the fruits of a three decade-long commitment to developing ethanol initially to provide energy security and later as a competitive substitute for oil-based petrol.

The latest frontier for agricultural development in Brazil is its contribution to the fight against climate change. Government along with Embrapa and the private sector have launched a major initiative to reduce the contribution of agriculture to climate change. Land use continues to be Brazil's biggest source of greenhouse gas emissions. They mostly come from the continued conversion of forests to land for farming and pasture, but also the release of carbon from the soil through conventional farming methods and the use of chemical fertilizers. A programme to reduce greenhouse gas emissions by over 30 per cent by 2020 includes a large rural extension effort with more than 20,000 qualified technicians to reach 900,000 farmers.[1]

[1] See Ministerio de Agricultura, Pecuaria e Abastecimento, undated. Available at http//www.agricultura,gov.br/ [18 May 2012].

(Chang and Andreoni, 2014; Hausmann et al., 2007; Rodrik, 2009). Manufacturing has been identified as a "leading sector" in the process of productive transformation because it not only leads to technological and organizational change within itself, but also triggers transformation in other sectors, with significant economic and knowledge spillovers to the rest of the economy.

As noted above, much of the technological change in agriculture would not have been possible without the development of manufacturing industries in fertilizers, irrigation equipment, engineering and agricultural machinery. Similarly, many of

Box 5.3 Manufacturing with quality jobs in South Africa

During the apartheid period, despite some successes in establishing certain upstream industries based on natural resources, South Africa's industrial policy was burdened with many facets that ultimately undermined its medium- and long-term viability (Chang, 1998). With the end of apartheid, the newly elected South African Government tried to develop a new industrial policy framework (Chang, 1998; Tregenna, 2012). The new industrial policies involved an array of innovative measures – such as, investment incentives, human resource development, support for research and development, provision of information on production methods and international market conditions, etc. – that were intended to increase productivity.

The policy shift was meant to address two goals. First, there was a productive transformation goal of expanding the manufacturing base and, in particular, of medium- to high-technology manufacturing. Second, the Government policy made a priority of reducing unemployment and social tensions though the support of economic sectors that were expected to have relatively high employment intensity. Yet, until recently, the manufacturing sector contributed more in terms of value added and productivity than in terms of jobs.

With this in mind, a new industrial policy strategy was launched recently, called the Industrial Policy Action Plan 2013–16. This is designed to build greater complementarity between manufacturing development and job creation. The new policy is structured along transversal measures and sector-specific programmes. It includes a targeted effort to develop energy-efficiency and renewable energy production and use in South Africa. Initial investments in these are to create a net gain of over 200,000 direct jobs (Maia et al., 2011).

the productivity increases in services, in logistics and retail, require manufacturing to produce computing, transport, and mechanized warehousing capabilities.

Manufacturing is regarded as a learning centre, with positive spin-offs to other sectors where sound internal economic linkages are established (Chang and Andreoni, 2014). Much of the productivity growth in the last two centuries has been driven not just by technological change but also by organizational change originating in manufacturing.

Furthermore, an abundant body of evidence shows that manufacturing has the potential to generate quality jobs both directly and indirectly through linkages to other sectors and income-induced effects.[2] And, correspondingly, policies to promote quality jobs are crucial for the upgrading of manufacturing and the adoption of new technologies (see box 5.3 for the case of South Africa).

China's automobile industry also offers an interesting case in point. In the 1980s, the automobile industry was identified as a priority for economic development. Using an infant industry strategy, import tariffs and quotas were imposed, with import tariffs reaching as high as 200–300 per cent in the 1980s and 100–200 per cent in the early 1990s (Huang, 2003). Foreign investors were subject to regulation with local content requirements and joint venture rules with indigenous firms. In the late 1990s the Government loosened entry restrictions on foreign automobile manufacturers.

While these efforts were rewarded with significant increases in production, there is growing awareness of the need to support further progress to promote dialogue between employers and workers on innovative practices and training, and to achieve an adequate degree of job stability, as well as health and safety at work. Workers' voice and collective bargaining that keeps wage growth in line

2. See Lavopa and Szirmai (2012) for a review of the literature.

with productivity growth are key ingredients for both sustainable development and aggregate demand that benefits all industries, including the car industry itself. Social protection – an area where China has made significant progress, as discussed in Chapter 7 – can also contribute to strengthening both labour relations in the automobile sector and domestic demand.

Equally impressive has been the development of a modern renewable energy in China. The country accounts for nearly 2 million of the estimated 6.5 million renewable energy jobs worldwide in 2013 (IRENA 2014). About 1.6 million of these are in photovoltaic equipment manufacture and installation. China has effectively become a world leader in the manufacture of renewable energy based on a clear and stable policy signal in the form of a target for the share of renewables in the energy mix, rapid learning within the renewable sector in China and massive investments – to a large extent by the enterprises themselves – in training and human resources development. Incomes, working conditions and job satisfaction in the renewable sector are all higher than in the conventional energy sector (ILS, 2010). China also provides another striking example of technological leapfrogging in its public transport infrastructure. In a very short period of time the country has equipped mega-cities like Beijing and Shanghai with state-of-the-art subway systems and deployed one of the largest high-speed railway networks in the world.

… and making services rich in quality job opportunities.

While manufacturing has often proved an important driver of productivity gains, it is typically not able to provide sufficient quality jobs for displaced agricultural workers and the millions of new workers that enter the labour market in developing countries every year. Instead, the service sector has tended to be the main provider of new jobs, although many are in the informal economy (McMillan and Rodrik, 2011; Timmer and Vries, 2009).

The role of services in development has several dimensions. First, there is well-established evidence on the interactions between manufacturing and services, given the outsourcing of services activities from manufacturing firms to service providers; but also the changing technological linkages between manufacturing and services, in particular in production-related services (Park, 1989; Park and Chan, 1989). In addition, the higher incomes associated with manufacturing growth tend to be disproportionately spent on services, including public services, personal services, retail trade, etc. (Guerrieri and Meliciani, 2005).

Second, beyond their links with manufacturing, services can also be a "leading sector" in economic development (Roncolato and Kucera, 2013). Some countries, largely small states and islands, have adopted service-led development strategies, mainly driven by services exports. This is, for instance, the case in the areas of tourism, finance and business services in countries such as Fiji, Maldives, Malta, Mauritius and Panama. The spread of information and communication technologies (Nübler, forthcoming), along with declining transportation costs, have facilitated this process.

Indeed, in the light of the new possibilities that have opened up for trade in commercial services, such as IT-enabled services, software production, call centres, back office services, finance, banking and consulting, the service sector may have the potential in some countries to become a leading complement to manufacturing development. Brown et al. (2011) discuss "digital Taylorism" as a new technology in services that has the potential to generate a new wave of

Box 5.4 Training services in Ethiopia

Many companies in sub-Saharan Africa report difficulties in finding workers with skills profiles that match job requirements (Ansu and Tan, 2012). Sometimes, the geographic distribution of workers does not match companies' locations, or the most able among the graduates are attracted by better job opportunities and higher wages abroad (see Chapter 9). Other workers appear to be "over-skilled" for the tasks they perform in their jobs, especially if they are employed in informal enterprises.

In common with other developing countries, Ethiopia has been experiencing a number of education gaps, in addition to the problem of "over-skilled" workers. In response to these challenges, the Government launched a vocational training and technical education strategy (TVET), with a view to providing demand-driven curricula and other services, responding to key structural changes in the economy and certifying quality standards. The traditional apprenticeship system was integrated into the technical and vocational education and training (TVET). Finally, the TVET national strategy adopted a truly comprehensive approach whereby quality improvements were achieved by acting upon each specific component of the programme.

As a result of this comprehensive programme, Ethiopia currently possesses the second highest number of training institutions in Africa, 30 per cent of them provided by private actors. Between 1999 and 2007, enrolment in TVET in Ethiopia increased by a factor of over 55 and the quality and relevance of skills acquired through the new system has also improved significantly (Baraki and Kemenade, 2013).

Finally, Ethiopia offers other good examples in this area. For decades already, Ethiopia has demonstrated that a relatively poor country can be home to a world class service company like Ethiopian Airlines. With a determined effort to internalize competencies, the airline has been self-sufficient not only in pilot and flight services, but also in aircraft maintenance and pilot training while acquiring the latest aircraft models available. The challenge has been to replicate this practice in other sectors and enterprises.

employment opportunities for developing countries to enhance employment in the business services sector.[3]

Third, and more fundamentally, some services, such as education, health and finance, form an essential part of the productive transformation process. Education and health are "public goods" generating significant positive externalities that facilitate structural change. The case of training services in Ethiopia is presented in box 5.4.

Likewise, a well-functioning banking and insurance system is crucial for the creation and growth of enterprises in all sectors. As noted in Chapter 4, domestic savings have increased in the majority of developing countries. The way in which these savings are invested in the real economy, including for the establishment and expansion of small and medium-sized enterprises, is a major determinant of development. A stable, real-economy oriented banking system is an important driver of formal enterprises and formal jobs (ILO, 2013b).

3. The authors observe that companies in developed economies simplify, standardize and modularize business processes – in the same way that firms have modularized manufacturing processes. By dividing processes into narrow and standardized tasks, the tasks can be translated into digitalized procedures and performed by computers. This enhances the tradability of business services. Those countries which have developed the right knowledge structure with high shares of workers with tertiary education will be able to take advantage of these emerging opportunities and attract business services. Brown et al. (2011) conclude that, in combination with global technology networks and the low wage costs of highly educated workers in developing countries, these technologies offer opportunities for developing countries to provide digitalized business services to national and international markets, and to attract outsourcing in services.

Table 5.1 Estimation of the links between wage and salaried employment and productive transformation patterns

IAI	71.819*** (19.594)	AGRI	–0.376 (0.278)
TAI	30.529* (16.389)	Constant	11.134 (12.926
SERV	0.331** (0.159)		
EXTRACT	0.345** (0.134)	Observations	91
		F-statistic	14.42***
FOOD	–0.167 (0.173)	Adjusted R^2	0.47

Notes: The share of wage employment (NVE) was regressed on six different variables: the industrial advance index (IAI), measuring the importance of manufacturing in the economy; the technological advance index (TAI), measuring the level of technology within manufacturing; the share of commercial service exports (SERV); the share of non-renewable extractive resource exports (EXTRACT); the share of food exports (FOOD); and the share of agricultural raw materials exports in total exports (AGRI). The values for IAI and TAI are between 0 and 1, whereas the values for the variables SERV, EXTRACT, FOOD, AGRI and the NVE are all in percentage points. Standard errors are given in brackets. * = significant at 10 per cent; ** = significant at 5 per cent; *** = significant at 1 per cent.

Source: Nübler, 2014 (forthcoming).

In all cases, productive transformation should go hand in hand with policies to promote decent work

The process of productive transformation, and therefore development, cannot be sustained unless it goes hand in hand with decent work. Unless a sufficient number of good jobs are created, under-employment will remain significant, thereby perpetuating low-productivity traps. There are sometimes significant gaps between economic growth and the extent to which wages and working conditions and the incomes of the self-employed are improved. This tends to be associated with higher labour turnover and social unrest, which may destabilize economic growth.

There is a strong association between productive transformation and job quality. The share of wage and salaried employment in total employment reflects the share of workers in jobs outside the traditional economic activities such as low-productivity subsistence agriculture or work in the crafts and trade sector in the informal economy. Wage employment is associated with greater employment security. Table 5.1 suggests that a range of variables that are proxies for productive transformation are associated with the incidence of wage and salaried employment (Nübler, forthcoming). The share of manufacturing in the economy has the biggest positive impact on wage employment. Other factors include the prevalence of new technology, as well as services and extractive industry exports. The case of Singapore illustrates these findings (box 5.5).

Box 5.5 The role of a skilled workforce in the take-off process in Singapore

Singapore's high-quality labour force has frequently been cited as the primary contributor to its economic success (see, for example, Pang et al., 1989). In 1957, Singapore's literacy rate was 52.3 per cent (Saw, 2012), a level below the average in least developed countries today. Between 1959 and 1965, the unemployment rate averaged 13.9 per cent (Blake, 1967). According to Gopinathan (1986), the colonial education system had been "one of benign neglect, doing the minimum necessary for some groups and stirring only when they saw their interests threatened" (p. 80). With between 25,000 and 30,000 new entrants to the labour market every year, industrialization was viewed as the only way to prevent unemployment levels from spiralling. Today, the unemployment rate is one of the lowest in the Asian region and living standards rank high by international comparison.

Embracing the principle that "people are Singapore's only productive asset", the Government set out to implement education and training initiatives that were specifically geared towards the manufacturing sector and designed to upgrade the skills profile of the workforce.

The Government played an active role in moulding the labour force to ensure sustained development. First, policies were geared towards equipping students with the knowledge and skills necessary for Singapore's industrialization efforts. The school system acquired a "technical bias" with heavier emphasis on the study of mathematics, science and technical subjects (Soon, 1993). Second, educational infrastructure was expanded (Chiang, 1998). Third, government training centres became an important source of skills upgrading where the Government worked closely with enterprises and workers. Drawing on financial assistance, technical expertise and machinery and equipment from the ILO and the United Nations, the Government initially established six training centres by 1968. Since 1978, the Council for Professional and Technical Education chaired by the Ministry of Trade and Industry became the decision making body, aligning education and training with Singapore's projected industrial structure and human resources needs (see Low et al., 1991).

B. In pursuit of competitiveness: High road or race to the bottom?

Productive transformation must take into account external factors, notably competitiveness. While firms must strive to be competitive to ensure their financial health and long-term sustainability, the means used to become and remain competitive deserve scrutiny and must be viewed through the lens of decent work. The Rana Plaza tragedy in Bangladesh in 2013 showed in the grimmest terms the risks entailed when firms take a low-road approach to achieving competitive outcomes – by focusing on cost competitiveness, in the context of unacceptable conditions of work and disregard for workers' health and safety. Far less visible instances of the race to the bottom in pursuit of competitive outcomes abound throughout the world, in both developed and developing countries.

Different approaches to competitiveness

Incentives matter. That is, if executives' pay and shareholders' returns are determined largely by short-term business performance, the balance of incentives may lead firms to focus on generating a short-term boost in profits at any cost, rather than on more sustainable investments that would promote long-term productivity and competitiveness, the benefits of which are likely to take longer to manifest and may not be adequately rewarded. This low-road path to cost competitiveness, with

a narrow focus on short-term profits, carries a high risk of socially and ethically unacceptable outcomes, which, in turn, can ultimately harm firms' and economies' long-term competitive prospects.

At the opposite end of the spectrum, there are many positive examples of a high-road approach being taken to achieve enhanced productivity and competitive outcomes. There are many other positive examples of initiatives, aimed at introducing progressive workplace practices, improving health and safety outcomes, boosting employee morale, raising productivity levels, and focusing on environmentally-sustainable production methods, while also helping to enhance enterprise competitiveness. Promoting decent work at the firm level means avoiding a race to the bottom in search of competitive outcomes and instead finding practical, financially viable ways of achieving competitive outcomes for enterprises alongside good working conditions for employees and a fair distribution of the gains accruing from improvements in productivity and profitability. Workplace cooperation between management and workers, strong social dialogue, improved management practices for human resources, quality, environment and health and safety play a vital role in successfully implementing high-road strategies.

High-road strategies are much easier to pursue for individual firms, particularly small and medium-sized ones, if they are supported by national and sector policy and have access to business development support. For instance, the ILO's *Better Factories Cambodia* programme provides training services to help boost workers' skills, raising their productivity and contributing to enhanced enterprise competitiveness. *Better Factories Cambodia* also monitors factories for discrimination, occupational safety and health, freedom of association and collective bargaining, compensation and working hours, as well as economic performance. Over a decade of performance monitoring shows that improved working conditions have gone hand-in-hand with enhanced competitiveness and better economic results (see box 5.6).[4]

Developed economies display a strong segment of medium-sized enterprises. This segment is often weak or missing altogether in developing economies and deserves special attention and support. The ILO has been supporting national partner institutions in their efforts to boost competitiveness of SMEs and their insertion into higher value-added supply chains. Programmes such as SCORE (Sustaining Competitive and Responsible Enterprises) and SIMAPRO (System for Integrated Measurement and Improvement of Productivity) have been successfully applied in SMEs in a range of sectors from agro-industries (cut flower production in Colombia, asparagus in Peru, fruit export in Chile, sugar in Mexico) to manufacturing (auto-parts in India, China and Indonesia; furniture in Viet Nam), to services (hotels and tourism in South Africa, Mexico and Thailand). Short classroom training in the methodologies for managers and workers followed by factory visits by experts to support the application on the shopfloor have led to significant improvements of a range of key performance indicators. These include better quality and reductions in reject rates for products, higher energy and raw material efficiency, lower accident rates and absenteeism of workers.[5] Partnerships between buyers and suppliers along global value chains and cooperation between the private sector and government are important to make such efforts cost-effective and to achieve scale.

4. See http://betterfactories.org/ [15 May 2014].
5. See ILO 2013b at http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/projectdocumentation/wcms_226486.pdf [18 May 2014].

Box 5.6 Better Factories Cambodia

The US–Cambodia Bilateral Textile Agreement (USCBTA) is an interesting case because the agreement includes a labour provision that explicitly refers to the internationally recognized core labour standards in one of the most economically important sectors in Cambodia. In order to maintain compliance, the agreement states that "the Government of the United States will make a Determination [every year] whether working conditions in the Cambodia textile and apparel sector substantially comply with such labor law and [international] standards."[1] Such determinations were the grounds upon which the United States would grant yearly export quota increases to Cambodia.

The ILO's *Better Factories Cambodia* programme was established to independently monitor Cambodia's workplace practices in the garment sector and report on the factories' compliance with national and international labour standards. To be able to export to the United States, a factory had to opt in to the ILO inspections.[2] The agreement created positive incentives for compliance by rewarding it with increases in the quota for Cambodian textile exports to the United States. In practice, the improvements were achieved and recognized and rewarded each year with increases in quota of up to 14 per cent.

Because the programme reported its findings of factory compliance both to the United States Government and (initially) to all interested stakeholders, including large clothing retail companies that purchased Cambodian-made garments, the factories were incentivized to improve both collectively (to raise the export quota) and individually (to maintain rapport with the firms that ordered garments from them). After 2006, the Royal Government of Cambodia, and the country's garment industry and trade unions requested that *Better Factories Cambodia* continue to operate despite the cessation of both the export quota increases and the retailer reporting scheme.

Based on the extensive factory-level data collected by *Better Factories Cambodia*, the ILO and independent academic researchers have conducted several studies on the impact of the programme on working conditions in the Cambodian garment sector and business competitiveness. The results are striking:

- *Better Factories Cambodia* led to higher compliance, both in factories with a reputation-sensitive buyer and in those without, although factories with reputation-sensitive buyers achieved higher compliance rates than those without.[3]
- Cambodian garment factories that maintained higher levels of compliance had a higher rate of future survival.[4]
- Neak and Robertson (2009) found that the garment sector had the lowest rate of workplace accidents in Cambodia.
- Rossi and Robertson (2011) showed that an improvement in industrial relations (shown by the introduction of a shop steward or liaison officer) was correlated with later improvement in occupational health and safety and overtime policy.
- Robertson (2011) found that increased wages for women in the garment industry improved women's wages throughout Cambodia, both in absolute terms and relative to men's wages.

Based on the success of the *Better Factories Cambodia* programme, the ILO launched the *Better Work* programme that now operates in Haiti, Indonesia, Jordan, Lesotho, Nicaragua and Viet Nam and will soon be launched in Bangladesh. In each case *Better Work* began operations on the invitation of the government, employers and workers organizations.

[1] The full text of the Cambodia Bilateral Textile Agreement is available via http://cambodia.usembassy.gov/. [2] See the history of *Better Factories Cambodia* at http://betterfactories.org/?page_id=5082. [3] Robertson, R.; Dehejia, R.; Brown, D.; Ang, D. "Labour law compliance and human resource innovation: Better factories Cambodia", Better Work Discussion Paper Series (International Labour Organization/International Finance Corporation, Geneva, 2011). [4] Brown, D.; Dehejia, R.; Robertson, R. "Is there an efficiency case for international labour standards?", Better Work Discussion Paper Series (International Labour Organization/International Finance Corporation, Geneva, 2013).

Table 5.2 Levels of FDI per worker and share of working poor and vulnerable employment, by Global Competitiveness Index quintile, latest year for which data are available

Competitiveness ranking (2013/14)	FDI per worker (in 2012 US$)		Percentage of employed		Distribution of countries (%)			
	Mean	Median	Working poor (below US$2)	Vulnerable employment	LDCs	LMIs	EEs	AEs
Top quintile	4744	1154	8.7	33.5	0	0	12	89
2nd quintile	1295	1153	13.8	36.4	0	7	52	41
3rd quintile	625	397	44.5	62.5	11	30	44	15
4th quintile	681	319	40.6	62.8	7	33	41	19
Bottom quintile	153	87	54.1	72.1	66	30	4	0

Note: Based on 134 countries.

Source: ILO calculations based on World Economic Forum, *Global Competitiveness Report 2013–2014*; World Bank, *World Development Indicators 2013*; ILO, *Trends Econometric Models*, October 2013.

At the national level, competitiveness is essential for sustainable economic growth and economic development. National – so called 'systemic' – competitiveness is determined by national and enterprise level factors. They include: (i) the quality of institutions and infrastructure, including energy infrastructure; (ii) the education, skill level and health status of the population and workforce; (iii) the performance of the macro-economy and labour market; (iv) business sophistication and innovation; and (v) the ability of workers and enterprises to adopt new forms of technology.[6] While these factors do not, in themselves, ensure competitiveness, they contribute to the development of more competitive economies. National competitiveness can be assessed on the basis of these factors in conjunction with outcome indicators, such as the ability to attract investment and to produce sustainable increases in economic growth and standards of living.

Economies that are perceived as being more competitive tend to attract more foreign investment, often a key ingredient for gaining access to advanced technologies, increasing productivity and moving up the production value chain, which in turn can raise potential growth rates and foster economic development. The strong, positive relationship between national competitiveness rankings and average levels of FDI per worker is shown in table 5.2. Taking the median FDI per worker figures across countries in each quintile of the World Economic Forum's Global Competitiveness Index, we see that countries in the top two quintiles[7] receive, on average, more than three times as much FDI per worker than countries in the third and fourth quintiles and more than 13 times as much FDI per worker than countries in the bottom quintile.

Two measures of job quality indicate that less competitive economies tend to have a higher share of workers living in poverty (on less than US$2 per household member per day) and a higher share of workers in vulnerable employment. In the least competitive quintile, more than half of all workers are poor and nearly three-quarters are in vulnerable employment, as compared with less than 10 per cent of

6. The World Economic Forum classifies 12 pillars of competitiveness: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size, business sophistication and innovation. Country rankings in the Global Competitiveness Index are based on scores in these areas. *The Global Competitiveness Report* 2013–2014 (Geneva, 2013).

7. The full GCR index includes 148 countries; however, only 134 countries were included in this analysis due to limited data on FDI and/or employment.

workers living in poverty and one-third of workers in vulnerable employment in the most competitive quintile. The differences are even greater if China is excluded from the most competitive quintile. Excluding China, only 0.1 per cent of workers in this quintile are living with their families in poverty and less than 10 per cent are in vulnerable employment.

Much of the observed gap in job quality across competitiveness quintiles is probably due to the fact that more developed economies tend to have higher competitiveness rankings. The most competitive quintile is comprised mainly of advanced economies (AEs), with only two emerging economies (EEs), i.e. China and Malaysia. The second quintile is comprised mainly of advanced and emerging economies, with only two lower middle income countries (LMIs), namely Indonesia and the Philippines. Three least developed countries (LDCs) are included in the third quintile (Cambodia, Lao PDR and Rwanda), with the majority of the other countries in the EEs and LMIs groupings. At the bottom end, LDCs make up two-thirds of the least competitive quintile. These figures show that the perceived degree of national competitiveness is largely associated with countries' level of development. Nonetheless, some LDCs and LMIs have managed to rise in the competitiveness ranks and attract relatively high levels of investments which in turn can foster growth and the acquisition of new capabilities.

As with enterprises, there are high roads and low roads that national economies can take to increase their productivity and boost competitiveness. As emphasized in the Conclusions of the International Labour Conference on Sustainable Enterprises in 2007, the Decent Work Agenda provides a framework for creating an enabling environment for enterprises and for designing appropriate policies to ensure that competitive outcomes are built on a strong and sustainable foundation. International labour standards serve as an important tool for preventing a race to the bottom in search of national competitiveness; however, national legislation to uphold such standards must be adopted and effectively enforced (see Chapters 6 and 7). Robust labour market institutions, underpinned by effective tripartite dialogue between workers, employers and governments, are essential for ensuring that the path to competitive outcomes is pursued in a way that maximizes social welfare. Meaningful social dialogue can effectively become a source of competitiveness, as a more stable and harmonious work environment can help to increase productivity levels, enhanced stability and attract additional investment.

Yet, it is also important to recognize that economies at different stages of development often face different challenges in their efforts to boost competitiveness while also promoting decent work. For policy-makers in countries at lower levels of per capita GDP, focus should be on public investments that will yield long-term productive dividends. This includes improvements in the quality of the educational system and the share of children completing primary and secondary education. It also includes improved transport, energy and communications infrastructure and streamlined administrative processes, which enables enterprises to get products to market at a lower cost and with less wastage. For economies moving to middle stages of development, it is important to get the basics right; but enterprises must also increase their focus on improving their efficiency. Investments in management capacity, in workplace cooperation and in worker training programmes as described earlier can boost employee morale while also improving productivity and profitability in the workplace particularly in SMEs which become critical for broad-based competitiveness at higher levels of development.[8]

8. See ILO (2008).

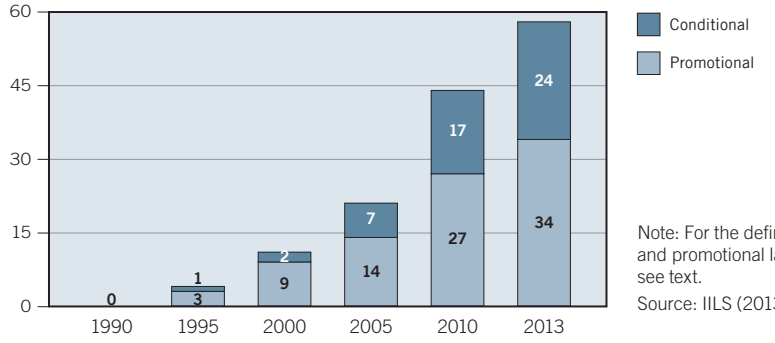
The growing importance of labour provisions in trade and investment agreements as a means to avoid a competitive race to the bottom

A growing number of countries consider labour and environmental provisions a key component of frameworks for bilateral and regional trade as well as investment agreements and unilateral trade preference programmes. This trend emerges clearly in the multiplication of such arrangements that include labour standards clauses, as well as in the growing number of developing countries that are covered by these agreements. In 2005, 21 bilateral trade agreements contained labour provisions; by June 2013, this number had almost tripled, with 58 bilateral trade agreements including labour provisions (figure 5.1).[9] The Generalized Systems of Preferences (GSP) of both the European Union and the Unites States include references towards labour standards, while they differ significantly with regard to the implementation mechanisms.

Labour provisions are proliferating, not only among the agreements concluded by traditional actors, such as the European Union, the United States and Canada. Countries such as Chile, China, European Free Trade Association (EFTA) countries, Japan, New Zealand and Peru (to name but a few) have increasingly included labour provisions in their economic governance (i.e. trade and investment) arrangements. By June 2013, 16 South–South agreements included a labour provision, compared with half of that number in 2005 (figure 5.2).

In the past two decades, the incorporation of broader socio-economic concerns, including labour rights, also gained importance in the field of international investment agreements.

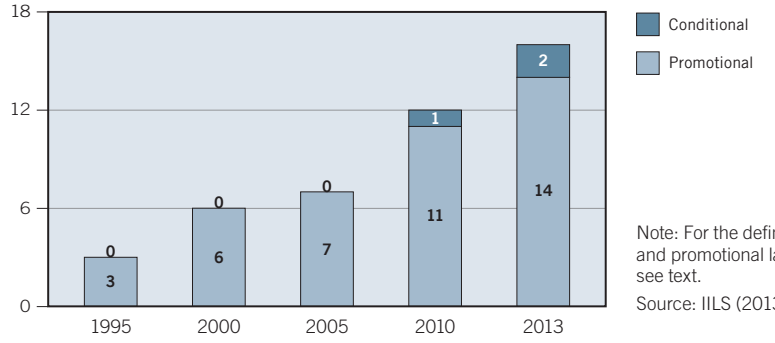
Figure 5.1 Number of bilateral and regional trade agreements that include labour provisions, 1990–2013



Note: For the definition of conditional and promotional labour provisions, see text.

Source: IILS (2013a).

Figure 5.2 Number of South–South trade agreements that include labour provisions, 1990–2013



Note: For the definition of conditional and promotional labour provisions, see text.

Source: IILS (2013a).

9. ILO, 2013. *The social dimension of free trade agreements.*

This policy development in economic governance agreements can be explained by two main factors. First there is the global recognition of the need for sustainable development with progress along all three dimensions – economic, social and environmental – as underlined in the outcome document of the UN Conference on Sustainable Development 2012 (UN 2012). Second, from a human rights perspective, labour provisions have been used to provide an additional effective means of promoting and/or achieving compliance with international labour standards.

There is considerable similarity with regard to the normative content of labour provisions across economic governance agreements. In particular, there is widespread reference to the ILO 1998 Declaration on Fundamental Principles and Rights at Work and its commitment that countries will not lower, waive or derogate from domestic labour legislation to attract foreign trade or investment as well as that labour standards will not be used for protectionist purposes. Views are divided over whether promotional or conditional provisions are most effective and both have increased significantly. In terms of implementation mechanisms, however, different countries rely on different approaches, ranging from technical cooperation activities in labour matters to monitoring to formal dispute settlement mechanisms.

C. Concluding remarks

The evidence presented in this chapter, including the case studies of countries that have successfully upgraded their productive capacity, show that development requires a strategy to diversify the economic base and enhance opportunities to create quality jobs. While the starting positions of different countries need to be taken into account – suggesting that there is no single development path – the chapter documents success stories for countries at all levels of development using a range of approaches to economic diversification, with specific interventions in those sectors which offer the greatest potential. The natural resource constraints and environmental limits faced by all countries can be turned into an advantage by developing and emerging economies by seizing the opportunity for technological 'leapfrogging' and basing their development on the latest and most efficient technology.

These findings shed new light on the important role of government in developing countries. According to conventional wisdom, selective interventions and targeted support would be a source of distortions and economic inefficiency. However, in reality, all policy approaches include a degree of targeting, by design or by default (Chang and Andreoni, 2014).

This chapter reports successful experiences based on careful diversification strategies in the context of gradual trade liberalization consistent with multilateral commitments.

Productive transformation needs to be underpinned by an enabling environment for enterprises including supportive macroeconomic policies. The experiences of several Latin American countries underline the potential of development strategies to foster production diversification in collaboration with the private sector and strengthen the environment for enterprises, while at the same time ensuring that there is sufficient aggregate demand, notably through countercyclical macroeconomic policies. They have also demonstrated success with well-calibrated capital controls to manage volatile capital flows and keep exchange rates both predictable and competitive (Salazar et al., 2014; Ocampo, 2014).

Finally, for productive transformation to be achieved, it is important to focus on quality job creation at the same time. Indeed, it is not possible to achieve economic diversification without active measures to tackle low productivity in agriculture and SMEs, poor working condition traps and high rates of informality. Sustained, strong growth is at risk if social inequality grows, as demonstrated by recent research by the IMF,[10] or rent-seeking behaviour by owners of natural resources or land is allowed to continue unchecked.

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Labour and social protection institutions

6

Recent trends and impact on development

Introduction

As noted in Chapter 5, development is a dynamic process. Economic growth is key to development but, on its own, it is not enough. Policies and institutions are also needed to ensure that the nature of economic growth translates into improved and shared well-being for society as a whole, without leaving segments of the population behind. Well-designed labour market and social institutions are vital in achieving this goal.

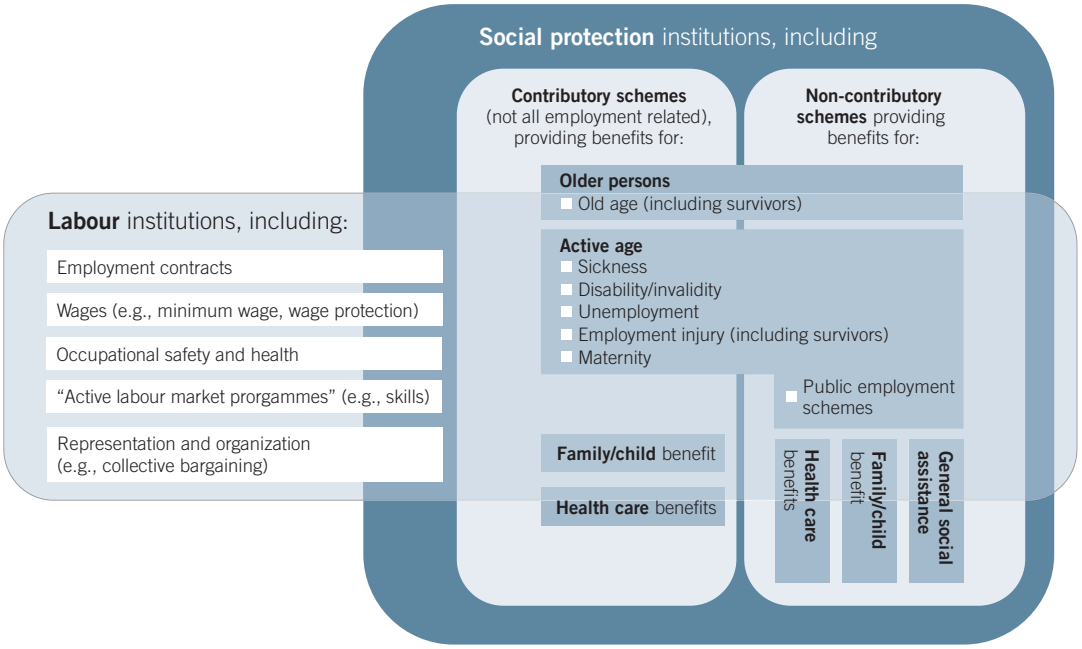
This chapter examines the roles of labour policies and institutions from the perspective of development. It first defines these institutions and presents an overall analytical framework (Section A). The chapter then reviews recent trends in selected labour institutions (Section B). Social protection institutions are covered separately in Chapter 7. Finally, the chapter investigates how labour and social protection institutions can be made relevant to informal workers (Section C). Policy issues which emerge from concrete country examples are also discussed. The chapter concludes with a summary of key findings and policy implications.

A. Institutions and development

The labour market functions within, and is influenced by, a web of market and "non-market" institutions, rules and practices which affect how the labour market works (Berg and Kucera, 2008, p. 11).

For the purpose of this report, the institutions which affect the labour market are grouped into two categories (figure 6.1). The first includes rules and practices which influence the workplace in a direct way through their impact on the behaviour of firms, working conditions and employment. They comprise institutions that govern employment contracts, wages, working time, benefits, occupational safety and health, a broad range of "active" labour market policies and the right of employers and workers to organize themselves.

Figure 6.1 Labour and social protection institutions: An illustrative typology



The second category includes social protection institutions which aim to provide income security and access to health care for the population. Figure 6.1 identifies the scope of social protection in terms of the range of benefits or functions covered and the type of schemes providing these benefits (e.g., contributory or non-contributory). The structure of the labour market, and, notably, the magnitude of formal versus informal employment or atypical forms of employment, shape to some extent the mechanisms needed to make benefits available to different groups. Social protection institutions, in turn, may have significant impacts on labour markets. Their direct relation with the labour market is particularly clear in the case of benefits provided to the working-age population through contributory, employment-based schemes. Unemployment, maternity or employment injury benefits, for instance, are also critical in shaping the way in which the labour market functions through their impacts on income security, work incentives and labour costs. Other social protection benefits (e.g., pension, child benefits and health) also play a role through effects on labour market participation. Overall, the degree of "income security" which is provided through social protection institutions is a significant factor in determining labour market performance and workers' well-being. These issues are discussed in detail in Chapter 7.

There have been two contrasting views about these institutions in terms of how they affect the labour market (Freeman, 2009). According to one view, there is a possibility that the interventions of institutions in the market may distort resource allocation and damage productivity and efficiency. Therefore, even though such institutions have well-intended goals, they may result in net losses for society, for instance in terms of employment. One aspect of this argument is that these institutions may improve job quality for some groups, but at the expense of the overall quantity of employment. There would thus be a trade-off between quantity and quality of employment and, in developing countries with a shortage of jobs, priority should be given to employment volume.

According to the other view, the labour market is imperfect and does not function like other markets because "labour is not a commodity". Labour and

Box 6.1 Developing with democracy: The case of foreign direct investment (FDI)

Development is not just about narrowly defined economic growth, but should be seen as "a process of expanding the real freedoms that people enjoy" as proposed by Sen (1999, p. 3). This broad-based view of development is at odds with the view that suppression of rights or wages, for example, would spur faster economic growth.

One recent review of empirical evidence by Asiedu and Lien (2011, pp. 99–111) concluded that 11 out of 12 relevant studies find an insignificant or – more often – positive effect of democracy on FDI, which can be a key component of economic growth, as discussed in Chapter II.1. A recent study by Kucera and Principi (2014, pp. 1–23) finds that the effect of democracy on FDI is positive, especially in the case of the service sector, based on indicators for democracy from the Freedom House database, such as "free trade unions" and "effective collective bargaining".

However, there are exceptions to this overall positive finding, notably the mining and oil and gas extraction industries. For these industries, there is a negative (though not always statistically significant) association between democracy and FDI. This implies that, while there may be a general positive relationship between democracy and FDI, such a dynamic may play out only in particular industries and countries, perhaps depending on the extent to which countries are reliant on these natural resource industries (Langille, 2009, pp. 47–82).

social protection institutions are essential for making imperfect labour markets function more efficiently and more equitably, to the benefit of the society (Deakin, 2011). The employment effects of these institutions can be positive if they contribute to remedying market failures, and they are particularly helpful in improving the quality of employment for vulnerable groups of workers.

These contrasting views have been addressed in a growing body of empirical work. In this regard, a key conclusion from the empirical evidence is that the effects of labour and social protection institutions crucially depend on how the policies are designed and implemented (OECD, 2013; World Bank, 2013; Berg, forthcoming; Lee and McCann, 2013). Some evidence also suggests that the notion of trade-offs is a false dichotomy that does not aid analysis or policy response (box 6.1).

This report adopts the view that effective labour and social protection institutions are essential for achieving both efficiency and equity goals and broad-based development. Yet, it should be noted that emphasis is placed on the term "effective". Institutions may not function as expected or as intended. Three factors are particularly important (Lee and McCann, 2013):

- *design*: institutions, especially laws, are sometimes designed poorly for reasons including inadequate targeting, lack of necessary institutional details, incoherence in policy formulation or political economy constraints;
- *implementation*: even well-designed institutions and policies require proper implementation mechanisms. This is especially important in countries where implementation structures are weak (for example, due to lack of human and financial resources) or subject to corruption;
- *institutional coherence*: it is important to take into account the interactions that exist between different institutions. For example, rural employment programmes or conditional cash transfers may require different levels of institutional support; and available infrastructure may impede delivery of services.

B. Labour institutions

Labour institutions are intended to influence the workplace in a direct way, especially by shaping the behaviour of firms and the conditions of work and employment. This section reviews several key labour institutions which have been subject to debates in recent years: minimum wages, working time, collective bargaining and employment protection.

Minimum wages

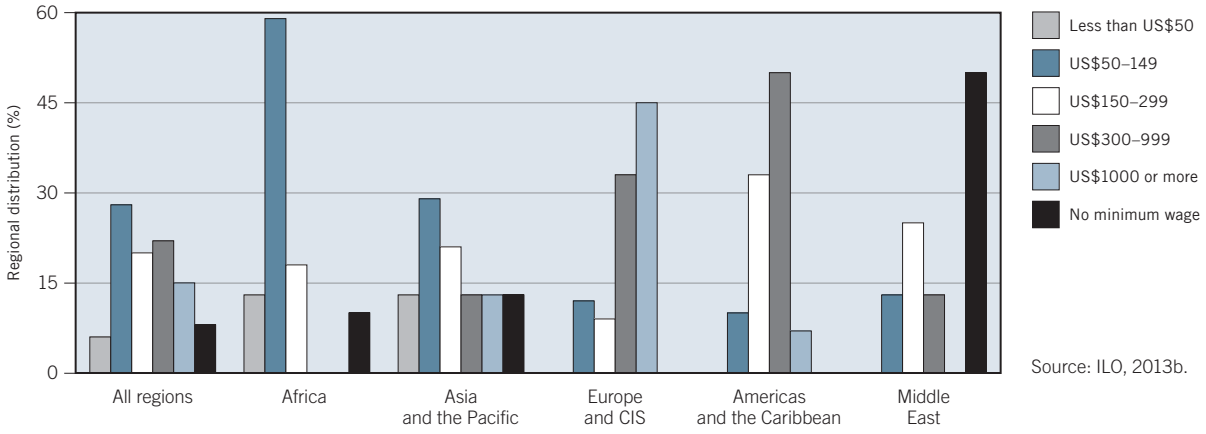
A minimum wage establishes a floor to the wage structure, for the intended purpose of protecting workers at the bottom of the wage distribution (ILO 2008, p. 34). This is an institution which intervenes in the labour market directly. It is a nearly universal institution, with more than 90 per cent of countries maintaining various minimum wage regimes (ILO, 2013b; see also figure 6.2).

Minimum wages have received growing interest and support in recent years (ILO, 2013a), for two important reasons. First, wage inequality has been growing in many countries and working poverty (i.e., workers employed but living in poverty) is on the rise in most countries. Second, there has been an accumulation of recent empirical evidence which points to an overall neutral effect of minimum wages on employment, contradicting earlier theoretical predictions and some studies that claimed a negative impact on employment. These findings have led many analysts and policy-makers to support measures to create or increase the minimum wage (OECD, 2013; ILO, 2010; World Bank, 2013; Betcherman, 2014).

The level of minimum wages varies, largely depending on the level of economic development. Figure 6.2 shows that, as of 2012, minimum wages ranged from less than US$50 per month (close to the global extreme poverty level of US$1.25 per day) to US$1,000 or more (sometimes multiples of that amount: e.g. France). African countries generally have the lowest levels of minimum wages, while European countries have the highest minimum wages.

Beyond the basic level, it is important to evaluate minimum-wage levels compared to average or median wages. Figure 6.3 shows how the minimum–average wage ratio (often known as the Kaitz index) differs across countries.[1] A few

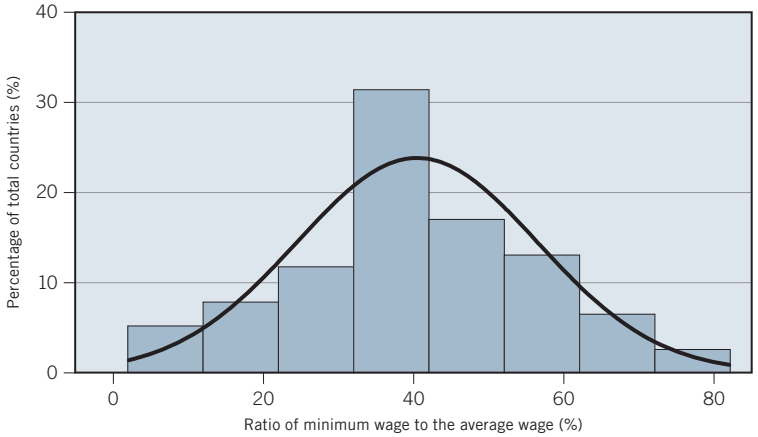
Figure 6.2 Monthly minimum wages, 2012 (% distribution within each region, US$)



Source: ILO, 2013b.

1. Median average wages are ideal for such analysis, but mean average wages are used instead due to data constraints.

Figure 6.3 Minimum wages, 2011 or latest year (as % of average wages)



Source: ILO Global Wage database (77 countries).

important issues emerge. First, there is no universally applicable level of "optimal" minimum wages. The "optimality" of minimum wages depends on country-specific conditions and, importantly, social dialogue (ILO, 2008; ILO, 2014; Lee, 2010; Belser and Sobeck, 2012). However, the majority of countries have minimum wages that range between 40 and 60 per cent of average wages. There is also the question of whether minimum wages can be "too low" or "too high". A significant minority of countries have a very low rate, in a few cases less than 20 per cent of average wages. At such a low rate the minimum wage would not improve the equity of the wage distribution and would be unlikely to prevent working poverty. By contrast, minimum wages set at a level close to average wages could be difficult to enforce and therefore low-paid workers might not benefit, despite being the target group. Evidence shows that both extremes are associated with higher incidence of low pay (Lee and Sobeck, 2012). Each of these issues indicates the importance of good institutional design and consultative processes for the setting of minimum wage levels.

Implementation is another critical dimension of *effective* minimum wages. Even when minimum wages are properly set, they are sometimes poorly implemented or enforced. Recent studies on the implementation of minimum wages in developing countries document the large scale of non-compliance and indicate the possibility that better enforcement alone (without increasing the level of minimum wages) could improve wage conditions significantly (Rani et al., 2013). This issue is discussed in detail in Section C.

Working hours

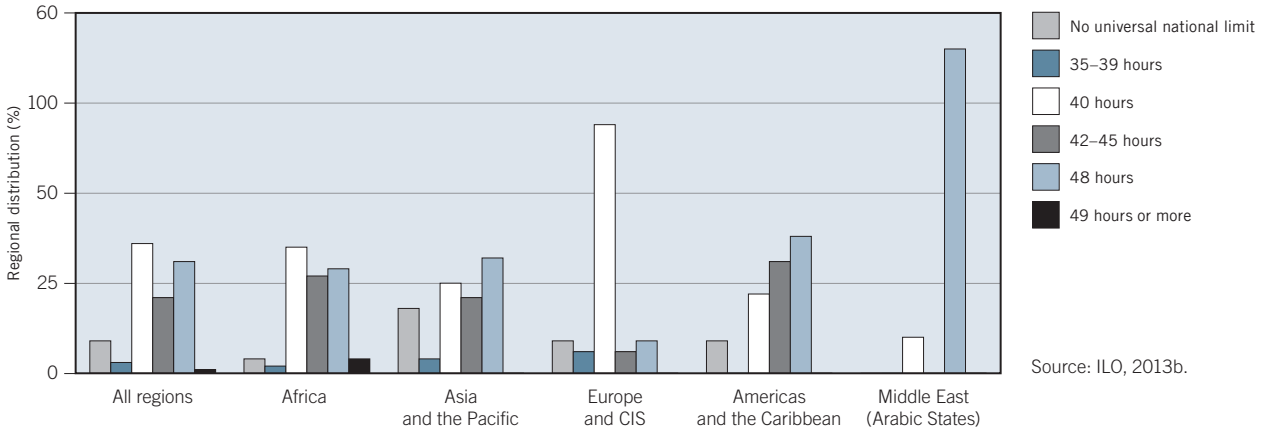
Labour legislation restricting excessive working time is one of the oldest institutions designed to protect the well-being of workers. This includes the regulation of normal hours, overtime work and "unsocial" hours (e.g., night and weekend work). Reduction of working time is also considered to be a primary way of sharing economic progress.[2] The length of working hours has become central to the policy debate in developing countries (Lee and McCann, 2011).

Figure 6.4 provides a global snapshot of working hours regulation. As of 2013, about 40 per cent of countries have set a statutory limit of 40 hours or less as the period defined as normal working hours. While 40 hours or less is a fairly well-established standard in advanced economies, longer normal hours are commonly found in developing countries, with considerable variations between regions. For instance, both Asian and Latin American regions are more likely than the African region to have 48 hours as the statutory normal number of hours.

However, the relationship between economic development and working hours is not straightforward. First, detailed analysis shows that, even with similar income levels, a significant difference exists in working-hour standards (Lee et al., 2007; ILO, 2013b). Higher income does not automatically lead to a reduction in statutory hours. Second, as is highlighted in the case of minimum wages, a stricter standard does not guarantee reductions in actual working hours. Indeed, enforcement gaps are sizeable in many countries, making the relationship between statutory hours and actual working hours uncertain.

In order to examine this relationship, the incidence of "excessive" hours (defined as working more than 48 hours per week)[3] is calculated and related to national income per capita. As discussed above, nearly all countries set their statutory normal hours at 48 hours or less, and it is often assumed that higher income leads to a lower incidence of excessive hours. Figure 6.5 shows that there

Figure 6.4 Statutory limits to weekly working hours (normal hours)

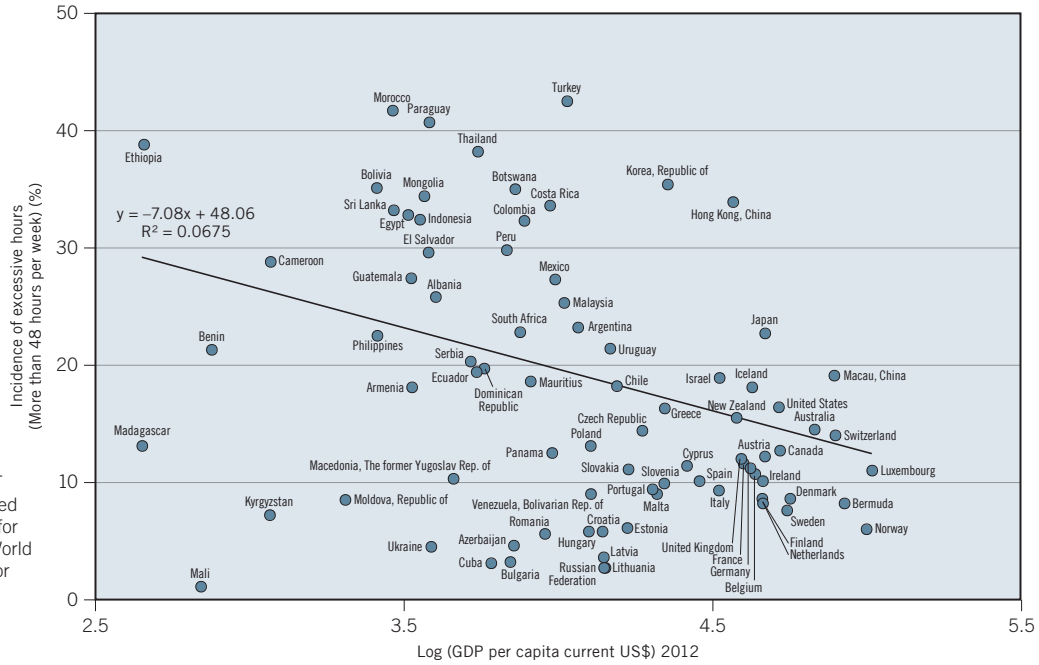


Source: ILO, 2013b.

2. Due to the critical importance of such goals, working time regulation has been understood not to be subject to pure economic considerations (e.g., the EU Directive on working time). However, in recent years, the scope of working time institutions has been broadened to allow workers adequate time to devote to their unpaid work and leisure, especially balancing work and family life. These efforts have been accompanied by firms' growing demand for flexibility in the way that working hours are deployed. Also, some working-time policies (e.g., part-time work) have been developed with a view to boosting employment for under-represented groups, especially women (ILO, 2011; Messenger, 2011; Fagan et al., 2013).

3. The proportion of workers who are working more than 48 hours per week (actual working hours) is calculated from national statistical sources for about 60 countries (see table 3.4 in Lee et al., 2007).

Figure 6.5 Economic development and the incidence of "excessive" working time of more than 48 hours per week, 2012 or latest year (% of total employment)



Source: ILO STAT database (retrieved on 4 April 2014) for working hours; World Bank database for income data.

is a negative correlation between the two variables. However, the correlation is not statistically significant. Indeed, it is clear that, within a similar income group (e.g., the group of countries located at the middle of figure 6.5), the incidence of excessive hours differs considerably (from less than 5 per cent to more than 40 per cent). These results imply that there is no one-to-one relationship between economic growth and working time, but that a wide range of options in terms of institutional design and implementation are available in determining working hours. In this respect, it is also important to note that long working hours have the potential to reduce productivity and firm performance, as is documented by a recent review of empirical evidence (Golden, 2012). In other words, additional hours tend to produce decreasing returns in terms of productivity, which means little productivity gain for the firm.[4]

In short, institutions matter in determining working hours, but their impact depends on how relevant laws are designed, how they are enforced at the workplace, and what negotiation and dialogue are taking place for their adjustment and implementation (ILO, 2011; Lee and McCann, 2011). Again, institutional failures in this respect are not uncommon. In terms of design, a shorter normal-hours standard is sometimes accompanied by lax regulation or even no regulation of overtime hours (which is the situation in certain African countries), which may encourage long working hours through extended overtime. A similar situation can emerge when exceptions are granted with respect to some groups of workers (e.g., those in unregistered small and medium-sized enterprises), which may make up a large share of total employment. Compliance is also an issue when governments have limited capacity and resources available for enforcement, and employers' and workers' organizations are underdeveloped.

4. According to Cette et al., 2011, when average working hours are already long (e.g., more than 2,000 hours per year), a 1 per cent increase in working hours can lead to a decrease of almost 1 per cent in productivity.

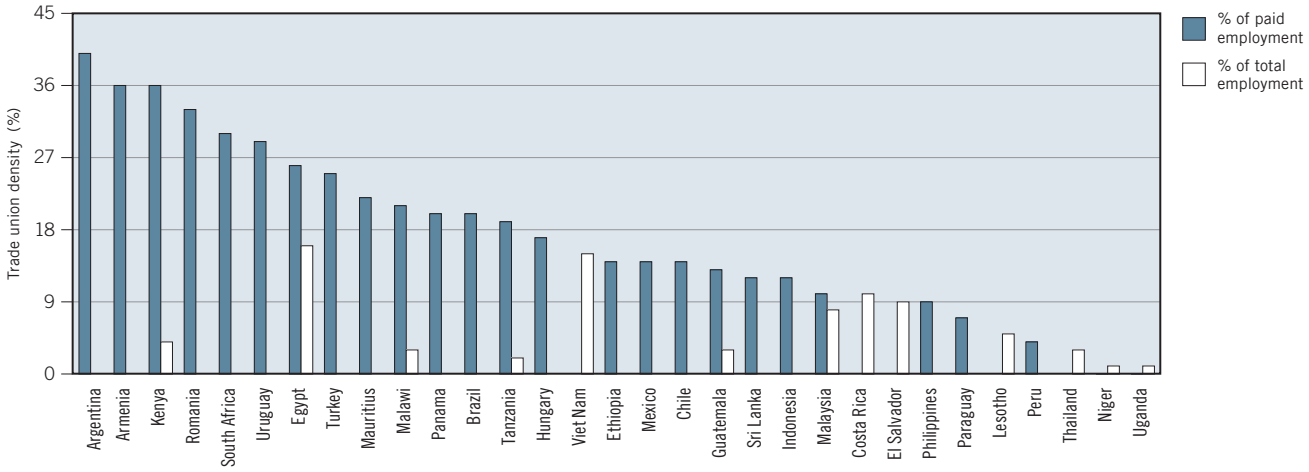
Collective bargaining

Collective bargaining is a specific and powerful mechanism to enable employers and workers to shape the functioning of the labour market. The right to organize is recognized as an integral part of human rights. Nonetheless, there is a debate concerning its economic impacts, including in developing countries. Some argue that trade unions may pursue the interests of a particular group at the expense of others, such as unorganized workers. Others note that collective bargaining has the power to address market imperfections, such as monopsonic hiring power and insufficient information. Furthermore, unions can improve the efficiency of the labour market by allowing workers to express their preferences rather than taking a costly "exit" option (e.g. decision to quit).

It is not an easy task to analyse the impacts of collective bargaining in this respect, due to the complexity of trade union and employer structures and the variety of systems across countries. Recent empirical evidence suggests that, as expected, trade unions tend to increase average wages and, at the same time, reduce wage inequality (Hayter, forthcoming; Lee and Sobeck, 2012). These wage increases do not necessarily mean a proportional increase in labour costs for firms, as the presence of trade unions reduces turnover and increases job tenure, which in turn enhances incentives for training, with potential productivity increases (Aidt and Tzannatos, 2002; Betcherman, 2014; ILO, 2008). Finally, with regard to the employment impact of trade unions, the evidence is not conclusive, as it may depend on the structure of collective bargaining (OECD, 2006; Freeman, 2007) and the types of economic shocks experienced in any given labour market (Betcherman, 2014).

Figure 6.6 presents the latest statistics on trade union membership, which are captured by two indicators: union members as a percentage of employees and as a percentage of total employment. Considering the first indicator of union density, variations between countries are considerable. In some countries, such as Niger and Uganda, unions are relatively rare, but their presence is strong in Argentina, Kenya and South Africa (around 30 per cent or above). However, this indicator may overestimate the real influence of trade unions over the workforce as a whole, as a high proportion of workers in some of these countries are self-employed or not in the formal economy. The second indicator presents union members as a percentage of total employment, which shows that, according to this criterion, unions cover a minority of total workers in some countries. In terms of trends, recent years

Figure 6.6 Trade union density in selected countries, 2010 or latest years (%)



Source: Hayter, forthcoming; ILO Statistics on Trade Unions and Collective Bargaining.

have witnessed a continued decline in union density, which appears to be accompanied by similar changes in employers' organization, although reliable data are scant (see Hayter and Stoevska, 2011; Visser, 2006).

These developments have a number of implications. First, the weakness or underdevelopment of employer and worker organizations may reduce the effectiveness of labour and social institutions as a whole. Especially in the case of labour laws, effective enforcement requires awareness-raising, monitoring and other types of participation from employers and workers. Labour inspection is a key organ of enforcement, but its capacity is limited by insufficient resources in many developing countries. Second, if collective bargaining covers a small share of workers and the majority of workers lack any alternative method of wage negotiation and determination, then minimum wage setting may be the only option to influence wage outcomes. Expectation about minimum wages would grow and the target group of this institution would shift from the lowest paid workers towards the average workers (Lee and McCann, 2013). The result might be the overburdening of minimum wages, creating a continued upward pressure towards average wages. Thus, the issue of strengthening employer and worker organizations should be understood in terms of its complex and broader impacts on labour and social protection institutions as a whole.

Employment protection

Employment protection legislation (EPL) is designed to give employees protection against job loss. EPL governs the initiation of employment contracts as well as firms' ability to terminate contractual relationships, either individually or collectively. It also regulates the use of temporary contracts. Well-designed EPL should balance the need to provide fair treatment as well as income security to workers and firms' need to adjust employment in the face of fluctuations in aggregate demand. As such, EPL can be an important determinant of a country's ability to weather an economic downturn (ILO, 2012, Chap. 2; Cazes et al., 2012).

EPL typically covers three main elements:

(i) individual termination of regular employment;

(ii) collective dismissals;

(iii) hiring of temporary workers.

The first element provides a set of rules on what reasons are valid for terminating an employment relationship (substantial requirements), what procedures are to be followed, how a worker should be compensated for the loss of a job and avenues for redress. The second element covers rules for terminating employment relationships of groups of workers (the definition of what constitutes collective dismissals varies across countries). Given that collective dismissals have broader economic and social impacts, their regulation is meant to strike a balance between the socio-economic costs of collective dismissals (on individuals, enterprises and the community as a whole) and the need for employers to be able to adjust employment.

Employment protection has become a controversial aspect of labour market institutions. According to the economic theory, a consequence of employment protection is that it raises the costs to employers of adjusting the size of the workforce and its composition (Skedinger, 2010). If this happens, EPL may discourage hiring on open-ended contracts and thus may have an impact on aggregate employment

Box 6.2 ILO EPLex database

The main data source for the analysis of EPL regulations in the area of hiring temporary workers is the ILO's Employment Protection Legislation database (EPLex). Data include information on a rich set of provisions for 105 countries over the period 2009–2013.

EPLex covers all main aspects of employment protection regulations, which include:

(a) source and scope of regulation, with information on the categories of workers and enterprises excluded;
(b) contract of employment, which is concerned with the duration of probationary periods and the conditions and limits on fixed-term contracts;
(c) substantive requirements for dismissals;
(d) procedures for individual dismissals, which cover the obligation to give reasons and form of notification;
(e) collective dismissals for economic reasons, including definitions and procedural safeguards;
(f) severance pay;
(g) avenues for redress.

The database allows tracking of legislative changes in employment protection, along with comparative analysis of the current situation across countries. The EPLex database is available at: http://www.ilo.org/dyn/eplex/termmain.home [10 May 2014].

with important implications for welfare and equality. However, this assessment has been widely challenged on the grounds that EPL also provides greater stability in employment relationships, lowering transaction costs of screening and training new personnel (Cazes and Nesporova, 2007) and providing incentives to firms to invest in job training (Almeida and Aterido, 2008). A separate consideration is the effect of EPL on "insiders" versus "outsiders" – that is, workers covered by the EPL rules and those outside the scope of regulation.

Ultimately, the labour market impact of EPL should be an empirical rather than a theoretical question. The latest reviews (Boeri, 2011; OECD, 2013; Betcherman, 2014) suggest that the impact of EPL on employment and unemployment levels is very modest and may be positive or negative. Most recent studies also show that both excessive and insufficient regulation can be equally problematic (ILO, 2012; World Bank, 2013).

With the advent of the global economic crisis, the debates around the role of EPL have intensified. Numerous countries have introduced changes to their EPL, and in the majority of cases these changes signified a decrease in worker protection (notable exceptions are Montenegro, Georgia and Niger). In recent years, there has also been a debate around the role of EPL in labour market duality, which refers to situations where workers with open-ended contracts covered by standard termination rules and other forms of protection rules co-exist with workers on temporary contracts who face greater job instability with lower levels of protection. Numerous observers have argued that recourse to temporary employment has intensified because of the liberalized ability to use such temporary contracts in many countries while maintaining protection levels for workers on permanent contracts, or a so-called "liberalization at the margin" (Boeri, 2011; Boeri and Garibaldi, 2007).

In order to shed new light on this issue, an analysis of the impacts of regulations on fixed-term contracts (FTCs) has been performed. Table 6.1 presents a global picture of how FTCs are regulated, drawing from the ILO EPLex database (see box 6.2 for an overview).

The large majority of countries explicitly regulate FTCs. Most countries that do not have a statutory regulation of fixed-term contracts are common law

Table 6.1 Regulations on fixed-term contracts: A global overview

	FTCs are regulated by law? (Yes, %)	Valid reasons for the use of FTCs are required? (Yes, %)	Maximum number of successive FTCs is specified? (Yes, %)	Mean of maximum number	Limits to the cumulative duration of successive FTCs are specified? (Yes, %)	Mean of maximum duration (months)
Income groups						
LDCs	84.2	36.8	26.3	2.0	42.1	33.0
LMIs	57.9	47.4	15.8	2.0	47.4	49.3
EEs	59.3	55.6	25.9	2.0	66.7	42.0
HIs	63.3	43.3	40.0	2.9	60.0	38.0
Region						
Africa	76.9	38.5	26.9	2.0	46.2	37.0
Americas	30.8	53.8	23.1	2.0	46.2	32.0
Arab States	80.0	0.0	20.0	2.0	40.0	48.0
Asia	58.8	29.4	17.6	2.0	35.3	50.0
EU15	71.4	64.3	64.3	3.0	78.6	30.5
Other Europe	70.0	65.0	20.0	2.5	80.0	48.8
All countries	**65.3**	**46.3**	**28.4**		**55.8**	**40.5**

Notes: The latest year for which data are available is 2013 for 43 countries, 2012 for 30 countries, 2011 for 12 countries and 2010 for ten countries. LDCs – least developed countries; LMIs – low and middle-income countries; EE – emerging economies; HIs – high-income countries.

Source: ILO EPLex database.

countries (e.g., Canada, Bangladesh, Ghana, Singapore, South Africa, Sri Lanka, United States and Zambia). In those countries, there is no legal distinction between fixed-term and permanent contracts and the duration of an employment contract only depends on the will of the parties. As a consequence, fixed-term categories of employment may only be recognized in jurisprudence. Interestingly, the incidence of regulating FTCs does not differ much between LMIs, EEs and HIs (ranging from 58 to 63 per cent), but is significantly higher in LDCs (at 84 per cent).

In most cases, FTCs may be allowed only to address temporary needs, such as the substitution of an employee who is on leave, for seasonal work or the performance of occasional and punctual tasks which do not fall within the normal activities of the employer's business. In several countries (such as Algeria, Peru and Tunisia), FTCs are also allowed in case of an exceptional increase in workload or temporary increase in market demand, therefore including among the valid reasons to use FTCs the completion of tasks which are part of the normal activity of the employer. In Peru, for example, a company facing an increase in market demand may use FTCs with a maximum permitted duration of five years (Jaramillo, 2014). Some countries fully liberalized the use of FTCs for specific categories of workers or specific types of work. In Indonesia, FTCs may be used in companies developing a new activity or an additional product that is still in the experimental stage.

The majority of countries included in the ILO EPLex database (54 per cent) do not set out any limitations on the reasons for concluding FTCs.

Around 26 per cent of LDCs (five out of 19 countries) and 16 per cent of LMIs (only three out of 19 countries) specify a maximum number of successive FTCs. A similar pattern emerges in the case of the maximum cumulative duration of FTCs. Within countries with such restrictions, the duration is shorter in LDCs than in EEs and advanced economies. While the incidence of FTC regulation is more common in low-income countries, the regulations often lack necessary details which may be critical in translating the law into a reality in the workplace.

Box 6.3 Interaction between different elements of regulations on fixed-term contracts

Recourse to FTCs can be limited in two ways; namely, by specifying the valid purposes for using such contracts or by limiting the maximum duration of successive FTCs. One might expect that countries with stricter regulation on the former aspect would not need to resort to the latter type of regulation.

This is, in fact, what correlation analysis suggests (table 6.2). If the sample is confined to countries with relevant regulation, there is a negative correlation between "requiring valid reasons for FTCs" and "maximum duration of FTCs". There is also a positive correlation between "the maximum number of consecutive contracts" and "the maximum duration of contracts".

Table 6.2 Correlation coefficients among dimensions of regulations on FTCs

	Valid reason for FTC use	Maximum number of successive FTCs	Maximum cumulative duration of successive FTCs
Panel A. Correlation coefficients among all countries that have regulations on FTCs			
Valid reason for FTC use	1.00		
Maximum number of successive FTCs	–0.04	1.00	
Maximum cumulative duration of successive FTCs	–0.23*	0.33***	1.00
Panel B: Correlation coefficients among LDCs and LMIs that have regulations on FTCs			
Valid reason for FTC use	1.00		
Maximum number of successive FTCs	0.09	1.00	
Maximum cumulative duration of successive FTCs	–0.50**	0.40**	1.00

Note: * = statistical significance at the 0.10 level; ** at 0.05; and *** at 0.01. See Macis and Monti (2014) for further details.

Source: ILO estimates.

These results suggest that lower-income countries, which often have weak enforcement mechanisms, might favour regulating FTCs along dimensions that are easier to monitor. Thus, they might be more likely to regulate the maximum number or the maximum total duration of successive contracts rather than imposing a set of valid reasons for using FTCs, compliance with which may be more difficult to track.

Table 6.3 Changes in regulations on fixed-term contracts, 2009–2012

Income groups	Number of countries	% of countries with any changes	% of countries increasing strictness of regulation of FTCs
LDCs	19	15.8	66.7
LMIs	14	7.1	100.0
EEs	17	23.5	50.0
HIs	19	5.3	100.0
Total	69	13.0	66.7

Source: ILO estimates; only countries for which data are available for all four years (between 2009 and 2012) are included.

Since the start of the global crisis, there has been growing pressure to adopt more flexible contractual arrangements in advanced economies (ILO, 2012). An opposite trend can be detected in developing countries. Indeed, there seems to be a tendency towards stricter regulation of FTCs in 2012 as compared to the preceding years in LCDs and, more markedly, in EEs. Table 6.3 displays the evolution of FTC regulation between 2009 and 2012 by income category, limited to countries for which data were available for all four years. During the observed period, only nine countries out of 69 (13 per cent) have modified the legislation governing FTCs. Among them, five countries increased the level of employment protection for fixed-term workers by introducing a statutory definition of FTCs (Gabon, Malawi, Morocco and Slovenia) or by introducing a maximum duration of FTCs and limitations with respect to the reasons for which FTCs can be concluded (Montenegro). Three countries reduced the level of protection (Antigua and Barbuda, Romania and Uganda) and only one country (Niger) introduced limitations to renewals of FTCs while increasing their maximum duration.

C. Labour and social institutions and informality

Informal employment presents one of key challenges in achieving broad-based development through labour and social protection institutions. Informal employment remains largely outside labour and social protection institutions, and recent policy efforts which focus on integrating these workers into the existing regulatory system (known as "formalization") have made progress. Indeed, country experiences have shown that policies can be designed and implemented to tackle some critical dimensions of informality in an effective way.

As documented in Chapter 3, informal employment is widespread and even predominant in low-income countries. Informal employment accounts for a significant share of total non-agricultural employment, ranging from 33 per cent in South Africa to 82 per cent in Mali in sub-Saharan Africa; in most of the South and East Asia (excluding China) it constitutes more than 60 per cent of total employment and ranges from 42 per cent in Thailand to 84 per cent in India, and in China, where the data is limited to six urban areas, the share of informal employment is about 33 per cent; in Latin American and Caribbean countries it ranges from 40 per cent in Uruguay to 75 per cent in Bolivia; and in North Africa and the Middle East it constitutes between about 58 per cent in the Occupied Palestinian Territory and 31 per cent in Turkey. In the agricultural sector, the proportions are significantly higher. In Eastern Europe and the Commonwealth of Independent States (CIS) the share of informal employment in total non-agricultural employment ranges from 6 per cent in Serbia to 20 per cent in Armenia (ILO, 2013c). From a global perspective, the most striking feature of informality is perhaps the sheer diversity of the forms it takes, from subsistence farming and survivalist waste picking or street vending to the employment and/or supply of labour to the formal sector as undeclared wage labour or home-based workers.[5] The proportion of informal-wage employees in most developing countries is on the rise, and the latest estimates show that it ranges between 20 and 55 per cent depending on the region (table 6.4).

5. The picture would not be complete without also considering the disingenuous avoidance of labour law through outsourcing and various forms of atypical employment – a process known as "informalization" because it is steadily stripping employment of its traditional guarantees of security, rights and benefits in most developed countries.

Table 6.4 Employment in the informal sector by status in employment (%)

Country	Status in employment				Year
	Employers, own-account workers and MPCs	Contributing family workers	Employees	Total	
Argentina	68.3	2.2	29.5	100.0	2009 (IV)
Armenia	48.2	3.3	48.5	100.0	2009
Bolivia	62.2	12.7	25.1	100.0	2006
Brazil	71.4	2.3	26.3	100.0	2009
China	68.0	6.7	25.4	100.0	2010
Colombia	72.6	7.3	20.1	100.0	2010 (II)
Costa Rica	62.9	3.3	33.9	100.0	2009 (July)
Côte d'Ivoire	66.9	14.5	18.7	100.0	2008
Dominican Republic	89.6	2.7	7.7	100.0	2009
Ecuador	60.8	8.6	30.6	100.0	2009 (IV)
El Salvador	62.7	8.7	28.7	100.0	2009
Ethiopia (urban areas)	81.9	10.1	8.0	100.0	2004
Honduras	62.8	13.3	23.9	100.0	2009
India	47.0	11.2	41.9	100.0	2009–2010
Indonesia (Banten and Yogyakarta)	47.2	11.6	48.8	100.0	2009
Kyrgyzstan	35.2	0.0	64.7	100.0	2009
Lesotho	5.4	1.3	93.4	100.0	2008
Liberia	85.9	8.8	4.9	100.0	2010
Macedonia, The former Yugoslav Republic of	51.3	5.1	43.6	100.0	2010
Madagascar	51.7	30.3	18.0	100.0	2005
Mali	81.9	5.9	12.2	100.0	2004
Mauritius	69.2	8.6	22.1	100.0	2009
Mexico	56.0	8.8	35.2	100.0	2009 (II)
Republic of Moldova	91.0	1.4	7.7	100.0	2009
Nicaragua	61.1	8.5	30.4	100.0	2008
Occupied Palestinian Territory	47.9	14.3	37.9		2010
Pakistan	45.0	10.5	44.1	100.0	2009–2010
Panama	90.6	1.3	8.1	100.0	2009 August
Paraguay	62.8	11.2	26.0	100.0	2009
Peru	71.0	11.0	18.0	100.0	2009
Philippines	36.9	7.6	55.5	100.0	2008
Russian Federation	30.7	2.2	67.1	100.0	2010
Serbia	65.0	2.4	32.6	100.0	2010
South Africa	61.0	2.7	36.3		2010 (IV)
Sri Lanka (excl. Northern Province)	40.8	7.2	52.0		2009
Tanzania, United Republic of	80.3	3.7	16.0		2005–2006
Uganda	61.7	9.8	28.5		2010
Ukraine	9.9	1.9	88.2		2009
Uruguay	70.5	3.5	26.0		2009
Venezuela, Bolivarian Republic of	84.2	1.2	14.6		2009 (I)
Viet Nam	60.7	9.7	29.6		2009
Zambia	53.6	14.5	31.9		2008

Note: MPC = members of producers' cooperatives; In case quarterly data are used, they are specified in the bracket.
Source: Compiled from ILO (2013c).

It has long been assumed in the development literature that "informal employment" is part of the residual workforce and that it would disappear with growth as formal employment is generated. However, despite high levels of growth in many of the developing countries, employment in the formal sector has not been generated at a sufficiently significant rate to absorb those in the informal labour market. The limited available empirical evidence on labour mobility from informal to formal employment shows mixed results. Studies in Latin American countries in the 2000s showed that the mobility between informal self-employment and informal salaried employment was significantly high. They also observed a similarly significant level of mobility from informal salaried to formal salaried employment in Argentina, Brazil and Mexico (Bosch and Maloney, 2010). Bertranou and Casanova (2013) also found a high labour mobility between informal salaried employment and inactivity, mainly among low-skilled women. They also found a high turnover rate for young people both within the formal and the informal sector. Evidence for Turkey showed that there was higher mobility among the informal salaried and that it was fairly limited among the self-employed, which implies a state of lower-tier self-employment (Tansel and Kan, 2012). This evidence is also corroborated in other developing countries, such as in Ghana, where labour mobility from predominantly own-account work or family-based work to formal wage employment is extremely low for men and even lower for women due to the market's limited opportunities for (formal) wage employment. Overall, across all three market segments, the own-account workers are found to be the least mobile and unpaid family workers the most mobile, with wage employees in between. As a result of capital market failure, transitions into own-account work are strongly influenced by the amount of household assets (and also training), though experience of wage employment is associated with lower odds of entering self-employment (Taiwo, 2013).

Tackling informality on two fronts …

Because high levels of informal employment are associated with acute and widespread poverty in the majority of cases, it is not realistic to expect formalization to be accomplished within a short time frame and without substantial policy effort. Nor would it make sense to wait for economic growth to "trickle down" to workers and households currently working in informal conditions.[6]

Instead, progress will require major efforts on two fronts. First, governments should establish programmes and policies to provide better incomes and security to those who are likely to remain in informal situations for a substantial period. In this context is important to design programmes that can provide greater security and social protection to the self-employed as well as to dependent workers. Second, and at the same time, a wider range of measures can be combined to move towards integration of these workers into formal employment.

6. In India, for example, well over 90 per cent of the workforce is estimated to be in informal employment. In 2009–10, however, despite the country's impressive economic growth rates and the rise of a new middle class, the average daily earnings of casual labourers ranged from roughly US$1 for rural females to US$2 for urban males; and about 30 per cent of the working population, especially those in informal wage employment and in own-account work – over 350 million people – lived below the official poverty lines of about half a dollar per person per day in urban areas and significantly less than that in rural areas (Drèze and Sen, 2013, table A.3, part 15 and pp. 190–91).

… first, improving the incomes and security of informal workers …

Policies and initiatives can be designed to place informal workers and their families in a better "starting position" by extending basic social services, income support and social protection to them directly, rather than making access to such vital assistance conditional upon the formalization of their livelihoods (for more on the underlying arguments, see Drèze and Sen, 2013).

Since the 1990s, many governments have embarked on large-scale programmes to improve the income security or welfare of the poor, most of them in the informal sector. Large-scale non-contributory social protection programmes targeted mainly at poor households include employment guarantee schemes and other public employment programmes, as well as cash transfer programmes. The latter often combine income support with skills development and employment and entrepreneurship opportunities for adults in the affected households as well as requirements (conditionalities) that the adults ensure school attendance and certain health measures for their children. Non-contributory old-age pension schemes were also introduced to ensure regular income to former informal economy workers excluded from contributory schemes. These programmes are discussed in detail in Chapter 7.

… including the self-employed …

The self-employed, who include own-account workers and contributing family workers, is a heterogeneous category covering street vending, home-based workers, agricultural workers and many others. The labour and social protection measures that are needed differ across these groups. For those engaged in street vending, labour protection would include: having a designated place of work; an identity card; protection against extortion, confiscation of goods and arbitrary evictions; access to basic infrastructure and subsidized credit, etc. Those in agriculture require access to inputs and insurance, access to basic infrastructure and subsidized credit, and a minimum support price for their products. The mechanism of providing social protection could vary from non-contributory to some level of contributory schemes. Recent experiments with subsidized social security extension as an incentive for formalization seem to have produced mixed results, as illustrated in Uruguay and Brazil, which suggest that the targeting of such schemes is still very much a work in progress (Amarante and Perazzo, 2013; Nagamine et al., 2013). The contexts and outcomes of these initiatives, however, provide useful insights.

In Uruguay, self-employment accounted for 21 per cent of total employment in 2010, with the share of self-employed workers "with premises" being 18 per cent and those without premises being 3 per cent in 2010. While workers in both of these categories earn less than private-sector wage employees, the pay gap in 2009 was about 25 per cent for those with premises and nearly 40 per cent for those without. At the national level, contributory social protection schemes cover a relatively high proportion of the labour force compared to other countries. By law, both employees and self-employed are covered by the pension scheme. For example, in 2011, coverage varied from 68 to 82 per cent of the labour force, depending on the source of information (administrative versus household survey data).

In order to encourage these workers' registration and social security coverage, a special scheme was legislated in 2001, based on a single reduced membership charge consolidating taxes and contributions, which was subsequently eased further by amendments passed in 2007. This "single tax scheme", however, has had

limited success because many of the self-employed simply cannot afford to sign up. Overall, social security coverage actually declined between 2001 and 2010, from 35 to 30 per cent among those "with premises" and from 8 to 3 per cent among those "without premises"; and only 23 per cent of covered self-employed workers were registered under the single tax scheme by 2010. By contrast, the coverage of private sector wage employees increased from 70 to 77 per cent over the same period.

In December 2011, the Government responded by launching another single tax scheme targeting self-employed micro-entrepreneurs and family enterprises for households whose income was below the poverty line. The main features of this scheme are its progressive rates of contribution (from 25 per cent of the full rate on joining to 100 per cent after 36 months) and conditionality on children's attendance at school, regular medical check-ups and participation in free training programmes. While clearly promising, this scheme has not been in operation long enough to allow meaningful evaluation (Amarante and Perazzo, 2013).

In 2009, Brazil's 19 million self-employed workers accounted for over 20 per cent of the labour force, but only 17 per cent of them were formally registered and paying social security contributions. Under legislation[7] that took effect that year, "self-employed micro-entrepreneurs" became eligible for simplified registration and for social security, medical care and maternity leave subject to payment of a contribution amounting to 11 per cent of the minimum wage (reduced from 20 per cent, and reduced again to 5 per cent in 2011) and flat-rate taxes amounting to about US$2.50. As an additional incentive, they are issued with a certificate that facilitates their access to markets and low-cost loans (a crucial feature in the light of the severe credit constraints characteristic of self-employment in developing countries). By the end of 2012, some 2.7 million workers were registered under this programme, 1.5 million of whom had paid social security contributions at least once in the course of that year. While this is arguably a better outcome than that achieved in Uruguay, one of the questions raised by Brazil's scheme is its long-term financial sustainability. For both schemes, in fact, the challenge is to strike the right balance between sustainability, affordability and effective targeting, while minimizing substitution effects in regard to both disguised wage employment and self-employment previously covered by other schemes (Nagamine et al. 2013).

… and second, facilitating transitions to formal employment

The transition to formal employment entails benefits such as written contracts and provision of wages in line with minimum wage regulations, which provide some stability and income security at work. A number of Latin American countries have, in the past decade, undertaken major efforts to bring informal workers under such protections. In Brazil and Argentina, mechanisms included strengthening labour inspection, simplifying the registration process for informal firms, reducing taxes for small and micro-enterprises and increasing access to social protection (Maurizio, 2014; Bertranou et al., 2013).

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7. It is essential that the "micro entrepreneurs" are registered in the "Registro de Empresas Mercantis" (Register of Companies) or "Registro Civil de Pessoas Jurídicas" (Civil Registry of Legal Entities). To qualify for a "micro entrepreneur" there is a ceiling of an annual gross revenue smaller than R$ 360.000,00 and for small businesses the ceiling is an annual gross revenue greater than R$ 360.000,00 and smaller than R$ 3.600.000,00. More details on this scheme could be found at http://www.planalto.gov.br/ccivil_03/Leis/LCP/Lcp128.htm and http://www.planalto.gov.br/ccivil_03/Leis/LCP/Lcp123.htm#art25p

Similarly, a number of countries have extended minimum wage coverage to workers in both the formal and the informal sector. Even in countries where minimum wages do not cover informal wage workers, there is evidence that shows some positive spillover effects, which have led to increases in wages in the informal sector.[8] The impact on the informal sector appears to be correlated with the level of the minimum wage relative to median wages. If the ratio is very low, the wages are likely to be below market wages and thus have no impact. If the ratio is high, it will not be binding in the informal sector.[9]

Where countries have achieved a good mix of accompanying policies, including capacity building to inform workers and employers, reinforced labour inspections, tougher sanctions and worker empowerment through individual complaints procedures and active trade union participation, minimum wage policies have had impressive effects on informal wages (Krein and Manzano, 2014). Brazil, in particular, has a federal minimum wage that applies to all wage earners (i.e., 100 per cent coverage) and it has maintained a relatively stable compliance rate of about 80 per cent despite increasing the level of its minimum wage from 63 to 76 per cent of the median wage over the 2000s. The crucial role of labour inspection in Brazil's balanced policy approach to compliance has been documented as well (Pires, 2008). Compliance still tends to be much lower for those in informal employment, among females, low-skilled and agricultural employees.

A study on compliance with minimum wages and other labour law provisions in Chile also documents the particular vulnerabilities of women, workers from minority groups, uneducated workers and those employed in small enterprises or rural areas, all of whom are typically overrepresented in informal employment (Kanbur et al., 2013). The study shows that the incidence of minimum wage violation among covered workers averaged 20 per cent over the period 1990–2009. From 2006, however, stronger enforcement, coupled with a reduction in the relative level of the minimum wage, produced a sharp drop in the rate of non-compliance, from 29 to 15 per cent between 2006 and 2009. Interestingly, this study also shows that a 25 per cent increase in the number of labour inspections appears to have achieved a striking reversal of the rising trend in other labour law violations as well (namely, conclusion of a written contract, pension entitlement and working time limits).

Well-designed minimum wage policies can thus help to raise incomes among workers excluded from the formal labour market, even though their primary focus is on formal wage employment. The evidence – again from Brazil – suggests that labour inspection and trade union participation can improve compliance with minimum wages. The case for improving inspection and enforcement is strengthened by recent evidence that over half of Brazil's informal small-scale urban entrepreneurs are opportunity driven (Williams and Youssef, 2014).

The extent to which labour and social protection institutions can successfully improve conditions for informal workers and/or facilitate transitions to formality

8. This is called the "lighthouse" effect in the literature and studies discussing this effect include Fajnzylber, 2001; Carneiro and Henley, 2001; Lemos, 2009 for Brazil; Maloney and Núñez, 2001 for Colombia; Gindling and Terrell, 2004 for Costa Rica; and Chun and Khor, 2010 for Indonesia.

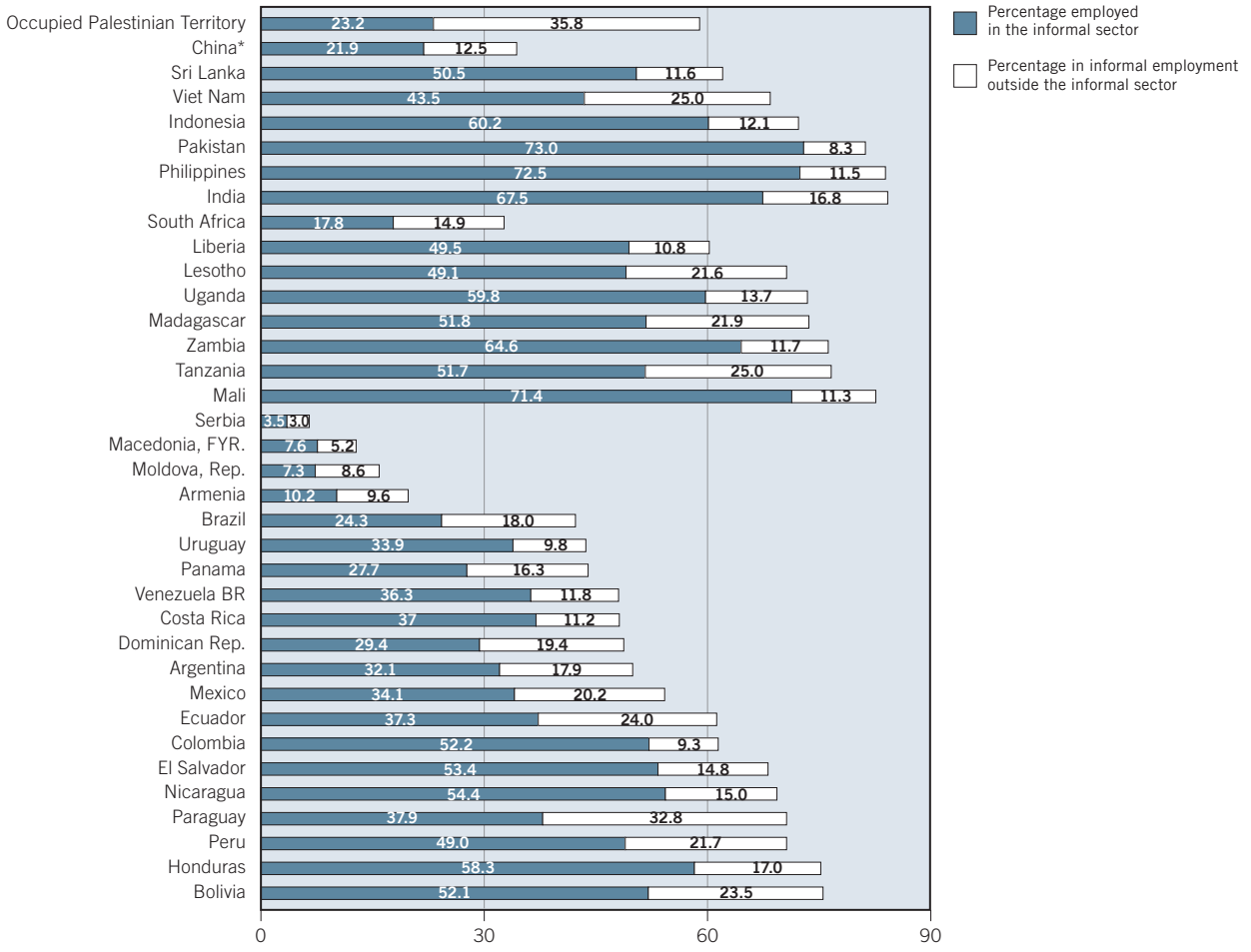
9. Recent comparative research has produced new evidence on minimum wage policies and compliance in a number of developing countries (Rani et al., 2013). The study shows that the rates of compliance with minimum wages ranged from 49 per cent in Indonesia to 95 per cent in Viet Nam, but these rates largely reflect the relative levels at which minimum wages are set (see figure 7a in Rani et al., 2013). In all of the countries except Mali, Mexico and Viet Nam, minimum wages are set at more than 60 per cent of median wages (i.e., at a relatively high level compared to most developed countries).

depends on careful policy design and implementation. An example of recent experience illustrates the risk of unanticipated consequences if policies are not well-designed for the context. In Ukraine, many workers choose comparatively low-paid formal employment in public or privatized enterprises for the sake of the extensive non-monetary benefit packages they provide while simultaneously taking up better paid informal employment on the side (Commander et al., 2013). This trade-off between relative wage levels in formal versus informal employment, on the one hand, and the range and subsidization of benefits enjoyed by some formal employees on the other can characterize some transition economies with inherited employment-based social protection systems. Social benefits are thus found to play an "attaching" role, thereby also influencing the relative shares of informal and formal employment.[10]

There are also a number of well-documented cases in which businesses avoid a range of regulations by staying small. A study on South Africa found small and medium-sized enterprises to be in broad compliance with legislated labour standards (e.g., on safety and health) but not with the binding rules set by collective agreement under the country's system of Bargaining Councils (Bischoff and Wood, 2013). These binding rules cover minimum wages, overtime and the payment of contributions to Council-administered benefit funds. Small enterprises refrain from expanding their formally registered workforce beyond a certain threshold for fear of attracting the attention of trade union inspectors; they meet their extra labour needs by using unregistered workers, thereby self-limiting their own growth and lapsing further into informality. Many of the firms interviewed said they would comply with the Bargaining Council agreements if they were caught and issued with a compliance order. This suggests that better enforcement, rather than eroding labour standards, could make a difference.

10. In Ukraine, between 2003 and 2004, 6 per cent of the formal employees in the research sample moved into multiple job-holding, and 4 per cent into purely informal employment; 45 per cent of those in multiple job-holding shifted into purely formal employment, and 20 per cent into purely informal employment. Meanwhile, over the same two-year period, informal employment increased from 13 to 17 per cent of total non-agricultural employment, and from 19 to 24 per cent of the total employment including agriculture (not counting own-consumption agriculture).

Figure 6.7 Components of employment in the informal economy as percentage of non-agricultural emplyoment (latest year available)



Notes: Horizontal lines separate geographical regions. The countries are presented in ascending order of empoyment in the informal economy within each geographical region.

* Data for China cover six cities, including Fuzhou, Guangzhou, Shanghai, Shenyang, Wuhan, and Xi-an.

Source: ILO (2013c).

D. Concluding remarks

Recent years have seen mixed developments in labour institutions. Institutions relating to minimum wages and social protection have been strengthened across a range of developing countries, but collective bargaining shows a declining tendency. Trends in employment protection are also mixed, with some sign of stricter regulation over fixed-term contracts.

This is important because effective institutions can contribute to boosting development and hence job quality is also a development issue, which should be carefully considered in the post-2015 debate. Even in low-income countries there is often room for improving job quality which can then create a virtuous circle between incomes, decent work and development.

The evidence also shows that the conventional idea of a trade-off between the quantity and quality of jobs is either incorrect or significantly overstated. This is in line with the findings of the World Bank's *World Development Report 2013: Jobs*

(and Betcherman, 2014) but at odds with studies based on stylized internationally comparable indicators, such as the World Bank's Doing Business Indicators, which are called into question by recent evidence and meta-analyses of earlier studies.

These positive potentials of labour institutions are often not fully realized in developing countries for various reasons, including poor design and implementation, limited enforcement capacity and lack of coordination with macroeconomic and other policies.

Finally, these challenges are felt particularly strongly in countries with massive informal employment. Recent country experiences indicate that, while the principle of formalization is the desired goal, pragmatic and innovative measures that tackle some of the most harmful dimensions of informality can achieve real progress in the short term.

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7 Social protection, living standards and economic development

Overview of trends and assessment of policies

Introduction

This chapter examines the role of social protection from the perspective of economic development.[1] In particular, similar to Chapter 6, it examines the possible links between social protection on the one hand, and living standards and economic growth (key dimensions of development) on the other. In addition, while the next chapter looks at income distribution *within* the labour market, this chapter investigates the role of social protection as a key dimension of *secondary distribution*.

Section A presents how a number of developing countries have started to implement some elements of their social protection systems through a mix of schemes and institutions. Section B documents "policies in action", with a focus on income security for the main age groups (children, working age and older persons) and access to health care. Importantly, the section provides examples of how social protection coverage can expand in the context of limited fiscal space.

Section C examines the critical question which cuts across the report, namely the possible interactions between social protection and economic development. The focus is first on links with living standards and its various dimensions, notably poverty, health, education and employment. Both short-term and long-term impacts are explicitly considered in the analysis. Second, the chapter analyses the macroeconomic impacts of social protection, notably with respect to productivity, aggregate demand and sustainable economic growth. The section pays particular attention to the importance of proper design and implementation of mechanisms of social protection. Finally, Section D discusses policy implications drawn from the analysis.

1. The definition of social protection for the purpose of this report is provided in Chapter 6.

A. Social protection in developing countries: Emerging trends in spending and coverage

The extent to which social protection contributes to development depends, among other things, on the scope[2] and coverage of the system. The purpose of this section is to document emerging trends in this respect.

At the beginning of the twentieth century, only a few countries, mainly in Europe, provided any social protection benefits, notably for pensions, health and work-related injury. Currently, all countries around the world have social security programmes anchored in national legislation for at least one contingency out of the total of nine contingencies specified in ILO Convention No. 102. In 2012, 28 of the 125 developing countries for which information is available had comprehensive social protection systems. The remaining 97 countries did provide protection but not necessarily for some of the main risks or contingencies that the population may face (see figure 7.1).

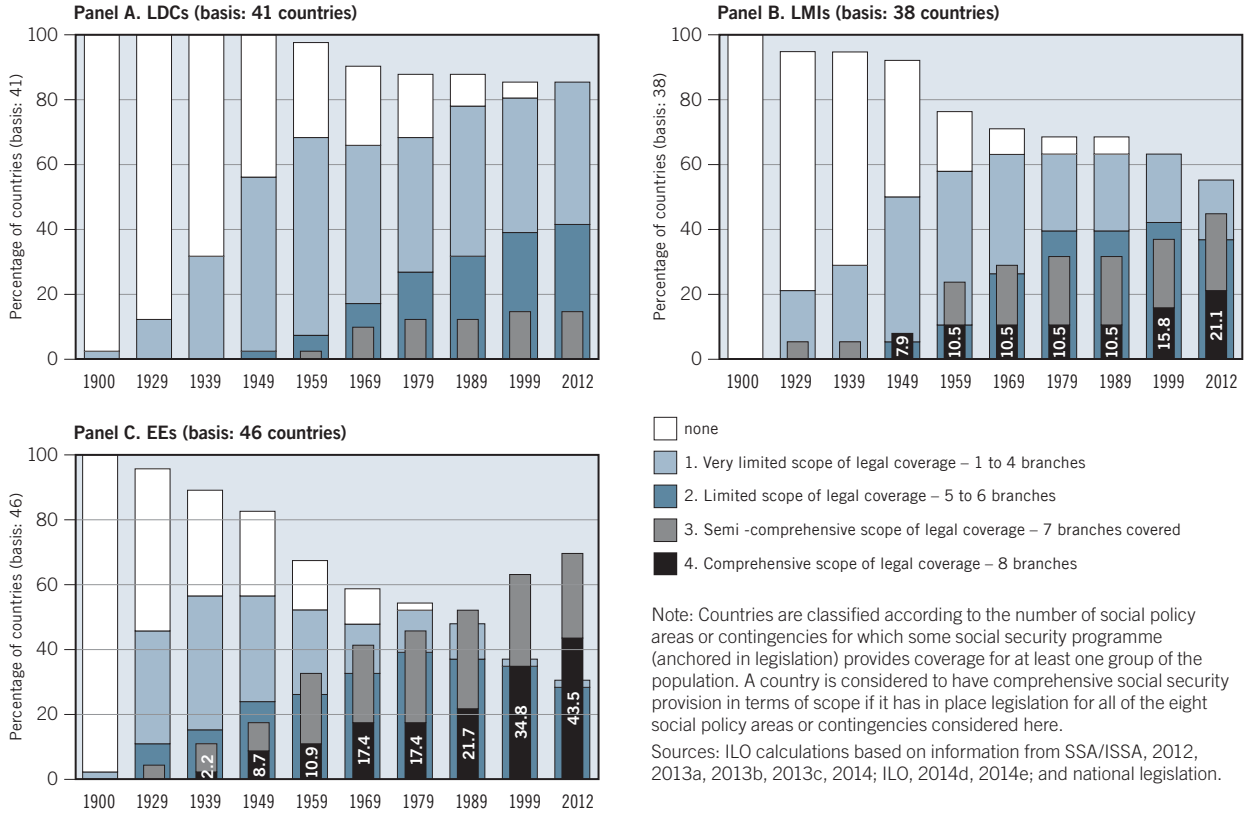
In least developed countries[3] (LDCs) and lower middle and low income countries (LMIs), a limited number of contingencies are covered by statutory provisions and a small number of people benefit from them. By contrast, more comprehensive systems are in place in emerging economies (EEs). Among LDCs, social protection usually concentrates on employment injury, old age, disability and survivors[4]. None of these countries provide protection in case of unemployment. Also, only a few countries cover the risk of sickness or ensure even basic income security for children or families with children. The most common situation in LMIs can be characterized as lying somewhere between EEs and LDCs, typically not providing unemployment or family benefits (and sometimes sickness benefits). Yet, four LMI countries (Albania, Armenia, Moldova and Mongolia) have a relatively comprehensive system.

A rising trend in spending on social protection is evident in the majority of developing countries …

Figure 7.2 reveals a rising trend in real expenditure on social protection[5] at all levels of development.[6] In 2011/12, developing countries spent, on average, 6.2[7] per cent of GDP on social protection, compared with 3.8 per cent in 1995.[8] During the same period, in LDCs, spending on social protection as a percentage of GDP rose from 1.9 per cent in 1995 to 3.6 per cent in 2011/12. The rise in LMIs was from

2. The scope of social protection is measured by the number of social security policy areas or contingencies for which there is relevant legislation that is actually enforced. It gives an overview of "where we are", although this indicator does not, by itself, provide information about the proportion of the population covered or improvements in the quality and level of benefits. The framework of contingencies is specified in the relevant ILO international labour standards (notably Convention No. 102, Social Security (Minimum Standards) Convention, 1952 and Recommendation No. 202, The Social Protection Floors Recommendation, 2012). Details can be found in ILO, 2014a annexes I and II.
3. For details of the country groups see Appendix A in Chapter 1.
4. For definitions of contingencies see Annex I in ILO 2014a.
5. Throughout this chapter, social protection spending refers to government spending on social protection.
6. Trends refer here to index values (1990 = 100) of real public social protection expenditure per capita expressed in constant US$.
7. The figure of 6.2 per cent is the global estimate weighted by total population in 2012 (based on UN population prospects, 2012 revision). When weighted by GDP per capita, the global estimate is significantly higher, at 9.5 per cent in developing countries (4.3 per cent in LDCs, 8.0 per cent in LMIs and 10.7 per cent in EEs).
8. There is limited reliable data in 1990, in particular for LDCs and LMIs.

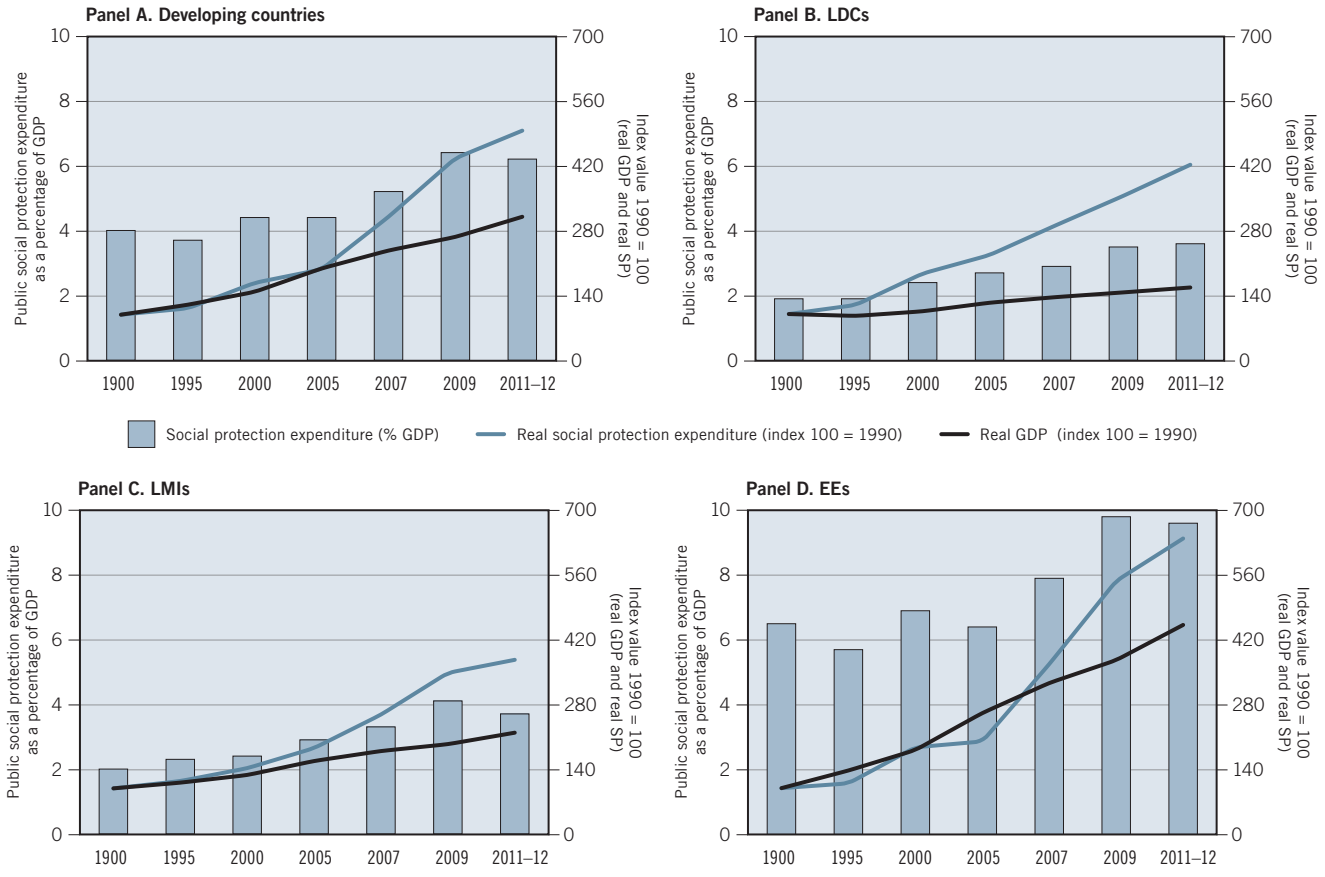
Figure 7.1 The emergence of social protection systems over the past 100 years in developing countries



Note: Countries are classified according to the number of social policy areas or contingencies for which some social security programme (anchored in legislation) provides coverage for at least one group of the population. A country is considered to have comprehensive social security provision in terms of scope if it has in place legislation for all of the eight social policy areas or contingencies considered here.

Sources: ILO calculations based on information from SSA/ISSA, 2012, 2013a, 2013b, 2013c, 2014; ILO, 2014d, 2014e; and national legislation.

Figure 7.2 Trends in government spending on social protection, 1900 to 2011–12



Source: ILO Research Department based on ILO, 2014b; IMF, 2013a, 2013b; UN ECLAC, 2014a; ADB, 2014; and national sources.

2.3 per cent in 1995 to 3.7 per cent in 2011/12 and, in EEs, from 5.7 per cent in 1995 to 9.6 per cent in 2011/12 (or 12.9 per cent excluding China). In 2012, EEs represented 42.6 per cent of the population of developing countries and accounted for a massive 83.3 per cent of public spending on social protection in developing countries.

In EEs, economic growth has facilitated the extension of social protection by broadening the revenue base of governments and creating space for strengthening administrative capacities. In addition, using lessons learned from previous crises, some Latin American countries (Argentina and Brazil, in particular) and Asian economies (such as China and Thailand), have expanded fiscal space to deliver social protection.

Despite their more limited fiscal space and institutional capacities, LDCs and LMIs have engaged in a progressive development of certain elements of the social protection system. Progress has been particularly fast with respect to health care and pensions in certain countries. In Rwanda, coverage of Community-Based Health Insurance reached 91 per cent in 2010,[9] up from 73 per cent in 2006 – resulting in a rapid decrease in maternal and child mortality. In Lesotho, Nepal and Timor-Leste, older persons above a certain age are now entitled to a non-contributory pension. The Programa Subsidio de Alimentos in Mozambique provides income security for vulnerable households, many of which include older persons and children (Cunha et al., 2013). Public employment programmes have been launched in Ethiopia, Malawi and Niger, with particular focus on rural areas.

There are also cases of extension of social protection beyond health and pensions. Viet Nam aims to cover the whole population through health insurance and has introduced an unemployment scheme (Bonnet et al., 2012a). In Cabo Verde, the Government is committed to achieving universal social security coverage, combining a gradual extension of contributory social insurance with the delivery of basic non-contributory benefits.

… which continued after the eruption of the global financial crisis

Almost three-quarters of the 128 developing countries with information show a significant increase in both real social protection expenditure and total government expenditure between 2007 and 2009 (figure 7.3). This is particularly evident in China and India, where there has been demonstrable expansion over this period and structural reforms of their social protection systems are still ongoing since 2009.

In India, the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA[10]) provides an important example of how social programmes can be used as countercyclical devices. Thanks to the programme, urban migrant workers who lost export-oriented jobs were able to rely on stable wage income being generated among their families in their rural places of origin. The continued functioning of the MGNREGA ensured the survival of the rural population by providing an additional source of income for those who had previously relied on remittances from urban migrant workers (figure 7.4).

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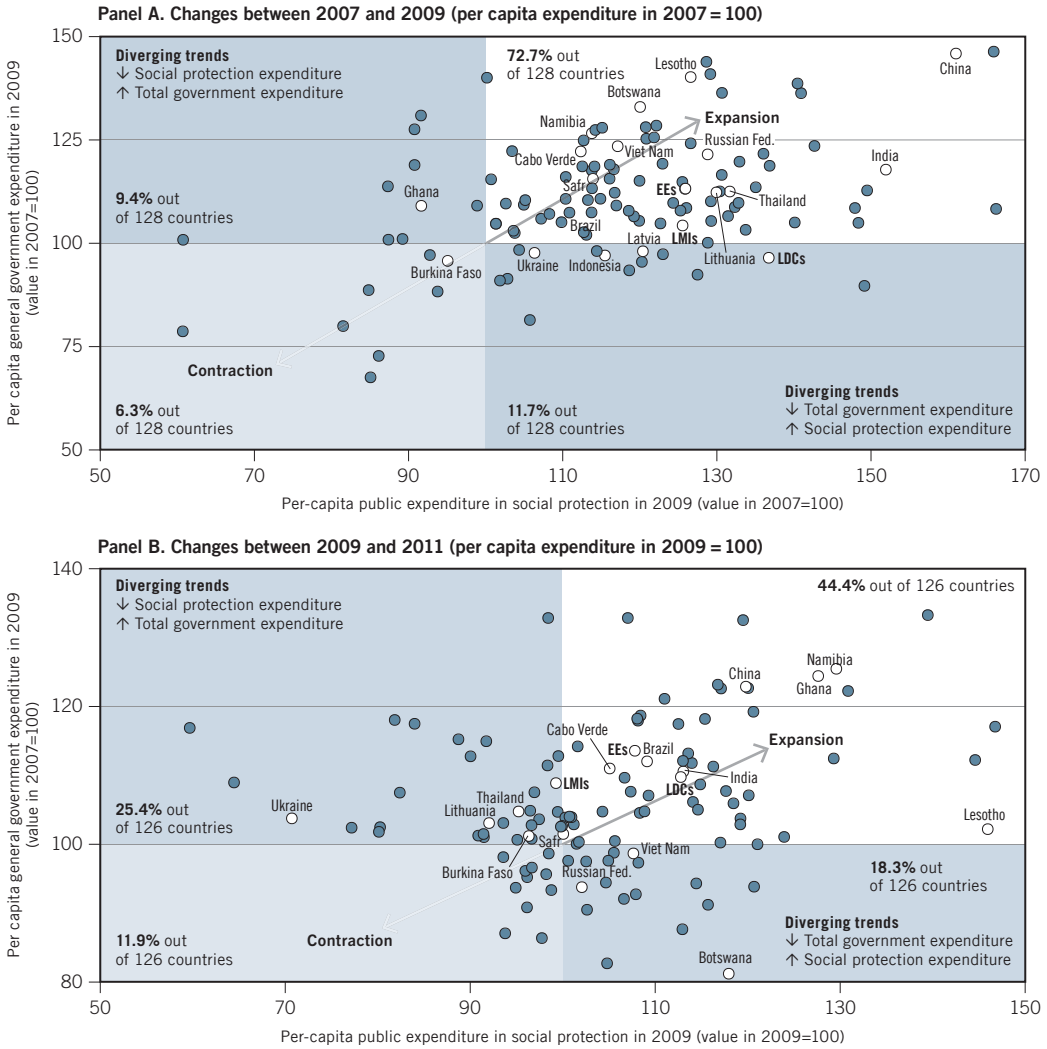
9. Rwanda National Health Insurance Policy (Ministry of Health, 2010); Global Extension of Social Security (ILO Social Protection Department Platform on Social Protection); Rwanda Country Profile, 2013; *Sharing Innovative Experiences: Successful Social Protection Floor Experiences* (ILO - SU/SSC (UNDP) - National experts, 2011).

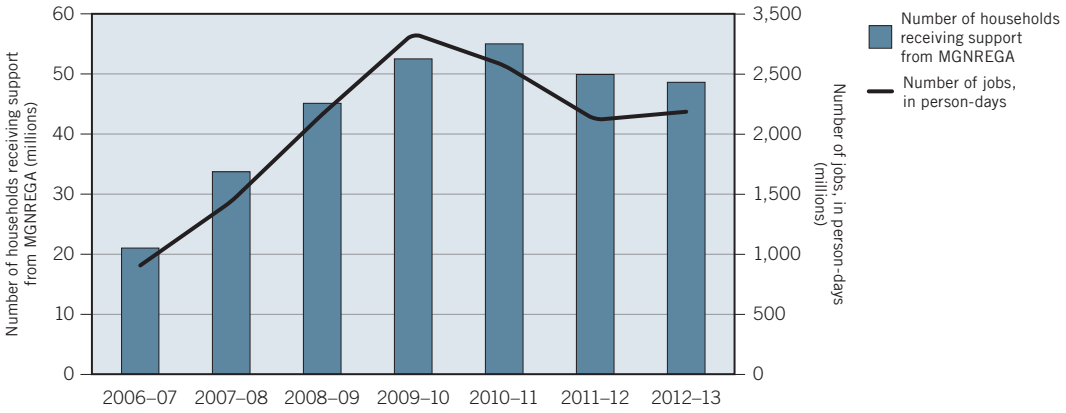
10. Established under the corresponding Act (the National Rural Employment Guarantee Act: NREGA) in 2005.

Figure 7.3 Per capita general government expenditure and per capita public social protection expenditure, at constant prices 2005 US$



Source: ILO, 2014a, 2014b; ILO; IMF, 2013b; UN ECLAC, 2014a; ADB, 2014; and national sources.

Figure 7.4 Number of households and jobs receiving support from MGNREGA (in millions)



Source: ILO Research Department based on www.nrega.nic.in [accessed 13 May 2014].

B. Social protection policies in action: Innovations and gaps

In 2012, it was estimated that less than 20 per cent of the working age population and their families in developing countries had access to comprehensive social protection systems. In EEs this estimated proportion was 42 per cent, and in lower income groups of countries it was less than 2 per cent. The incomplete coverage of social protection was mainly due to the significant number of labour market participants that do not correspond to the status of "formal employee" typically covered by social insurance (such as own-account workers, family employment, domestic or rural workers).

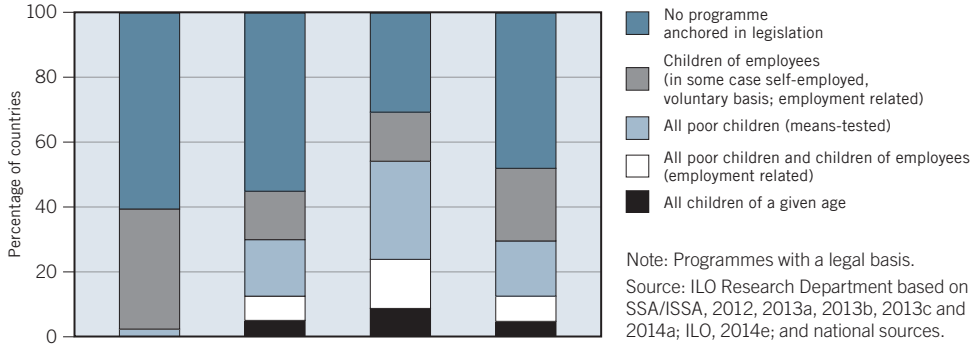
The objective of this section is to provide an overview of the state of coverage by social security benefits at different stages of the life cycle and social health protection[11], in line with the approach adopted by ILO Recommendation No. 202.[12] Particular attention is devoted to cases where social protection was effectively extended, through contributory and non-contributory mechanisms[13], despite the limited fiscal and institutional capacity that often prevails in developing countries. The section points to a significant number of country innovations in this respect.

Innovations include, first, an increase in the number of countries with cash transfers for families with children…

More than half of the countries in the developing world, but less than 40 per cent of LDCs, provide, by law, some form of child or family benefit (figure 7.5).[14] Public expenditure on benefits for children or families with children (including main

11. When possible gaps in coverage are assessed in terms of i) social protection benefits provided compared to the minimum ILO social security standards, as set out in particular in the Social Security (Minimum Standards) Convention, 1952 (No. 102); and ii) basic income security and access to health care as provided in the Social Protection Floors Recommendation, 2012 (No. 202).
12. The Recommendation on Social Protection Floors, 2012 (No. 202) calls upon states to i) achieve universal coverage with at least minimum levels of protection through the implementation of social protection floors, and ii) progressively ensure higher levels of protection. National social protection floors should comprise basic social security guarantees that ensure effective access to essential health care and basic income security that allows life in dignity, throughout the life cycle; these should include: access to essential health care, including maternity care; basic income security for children, providing access to nutrition, education, care and any other necessary goods and services; basic income security for persons in active age who are unable to earn sufficient income, in particular in cases of sickness, unemployment, maternity and disability; basic income security for older persons. Complementing pre-existing standards, Recommendation No. 202 sets forth a life-cycle, integrated and coherent approach to social protection, puts forward the principle of universality of protection through progressive realization in terms of benefits and persons covered, and addresses prioritization and sequencing with due regard to the unprotected, including workers in the informal economy and their families. It thereby aims at ensuring that all members of society enjoy at least a basic level of social security throughout their lives, and establishes poverty, vulnerability and social exclusion as priority contingencies, with the clear objective of poverty reduction as soon as possible. It calls for systems that are country-led, aligned to national circumstances and include the participation of all stakeholders. In an innovative way, it contains guidance on monitoring for countries to assess progress in moving towards enhanced protection and to improve the performance of national social security systems (ILO, 2014a).
13. Schemes can be classified in two major groups, according to their financing mechanisms: contributory schemes and non-contributory schemes. In contributory schemes the contributions made by beneficiaries (and their employers) determine entitlement to benefits. Non-contributory schemes normally require no direct contribution from beneficiaries or their employers as a condition to benefit entitlement. Non-contributory schemes are usually financed through general taxation or other state revenues.
14. Being understood here as either: a periodical payment in cash, to ensure some level of income security and so facilitate access to nutrition, health, education and other basic services for children; or as the provision to or in respect of children of food, clothing, housing, holidays or domestic help; or a combination of both – but in any case, as a right stated by law.

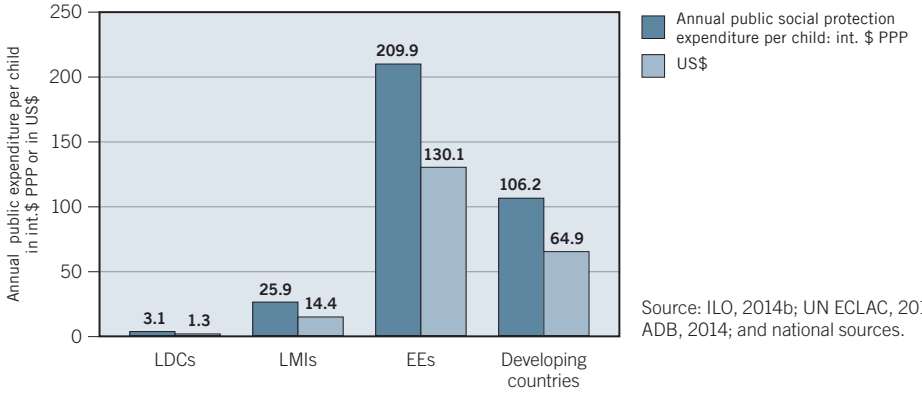
Figure 7.5 Percentage of countries with cash benefit programmes for children in 2012–13



Note: Programmes with a legal basis.

Source: ILO Research Department based on SSA/ISSA, 2012, 2013a, 2013b, 2013c and 2014a; ILO, 2014e; and national sources.

Figure 7.6 Public social protection expenditure per child (excluding health and education)



Source: ILO, 2014b; UN ECLAC, 2014a; ADB, 2014; and national sources.

conditional cash transfers) represents 0.05 per cent of GDP in LDCs, 0.15 per cent in LMIs and 0.4 per cent in EEs.[15] Eastern European countries such as Latvia, Lithuania, Romania and Serbia already have universal benefits for children in place. In recent years, most Latin American and Caribbean countries have implemented programmes covering a large proportion of children and families, which in most cases combine employment-related benefits with non-contributory benefits (including conditional cash transfers) anchored in legislation. The low level of expenditure in LDCs and LMIs (mainly in Africa and Asia, figure 7.6) reflects a situation where contributory programmes, when they exist, are limited to a minority of the population. Moreover, non-contributory programmes tend to be either non-existent or only at the pilot stage.

In the case of conditional cash transfers, the aims are to help alleviate the poverty of the beneficiaries, to support and improve access to health services and education, to preserve and promote human development, and to enhance the functioning of the labour market in order to create conditions for poverty reduction in the long term. Some of these programmes include measures to improve access to employment for adults (e.g. the Chile Solidario programme). In countries such as Brazil and Honduras, the programmes cover more than one-quarter of the population (figure 7.7 and box 7.1).[16]

15. In absolute terms (see figure 7.6), the annual expenditure per child is less than 110 $ PPP (65 US$) in developing countries. On average, the level of expenditure is far lower in LDCs (3.1 $ PPP) than in EEs (210 $ PPP).

16. In Brazil, around 29 per cent of the population benefited from Bolsa Família in 2013. In Honduras, more than 35 per cent benefited from Programa de Asignación Familiar (PRAF) or Bono

Box 7.1 The rise of cash transfer programmes in developing countries

The emergence of cash transfer programmes targeted at children and low-income households can be considered as one of the main policy innovations in recent years in developing countries. Other major innovations include employment guarantees such as the MGNREGA programme in India, discussed below. Many of these programmes are part of an integrated approach that addresses not only income insecurity, but also access to nutrition, health, education and care, either explicitly, through conditional cash transfer programmes, or implicitly, through universal or targeted programmes.

The Child Support Grant (CSG) is an important instrument of social protection in South Africa, reaching over 10 million children each month.[1] This is an example of gradual expansion being achieved through successive changes in the criteria for eligibility (with an increase in the age limit from 7 to 18 years since 1998), and adjustments in the income threshold to take consumer price increases into account and improve equity.

In Argentina, the increase in formal employment after 2003 made it possible to many families to enrol in the social security system (Salvia, 2011). In response to the economic slowdown resulting from the global economic crisis, the Government decided to launch a universal and integrated programme of social assistance for children – the Asignación Universal por Hijo (AUH). The AUH provides income transfers (a monthly benefit initially set at US$47 and raised to US$72 in September 2012) to families with children aged under 18 years and which had been excluded from the contributory system.[2] Coverage of children and youth (by AUH and other programmes) increased from 37 per cent in the early 2000s to 86 per cent in 2009.[3]

The Bolsa Família programme in Brazil covered 13.9 million households in 2012 (in comparison, fewer than 5 million households benefitted from earlier assistance programmes in 2001). Since the launch of the programme in 2003, 22 million people have been moved out of extreme poverty. In 2013, the monthly benefit ranged from R$32 to R$306, depending on the socioeconomic status of each family. The programme uses a single data registry[4] at the national level, which facilitates coordination with other social programmes and improves targeting. In mid-2011, the Plano Brasil Sem Miséria ("Brazil Without Misery Plan") was launched with a view to improving the assessment of people in extreme poverty. It was indeed estimated that 16 million people living in extreme poverty were still not covered by existing programmes.[5] As a result, according to the Ministry of Social Development, from June 2011, 791,000 new families were located, registered and included in Bolsa Família.

In Uruguay, family allowances (Asignaciones Familiares) were introduced in 2008 as an extension of the contributory allowances that had been in place since the 1940s. The new programme is non-contributory and more likely to reach vulnerable groups. An important feature of the Uruguayan social protection system is that contributory and non-contributory transfers are integrated; both are provided by a single institution, the Banco of Previsión Social (Filgueira and Hernández, 2012). The effectiveness of the Asignaciones Familiares is illustrated by the fact that poverty rates declined from over 34 per cent in 2006 to 13.7 per cent in 2011 (Caristo, 2012).

… second, efforts to provide income security to the unemployed and underemployed, notably through employment guarantee schemes…

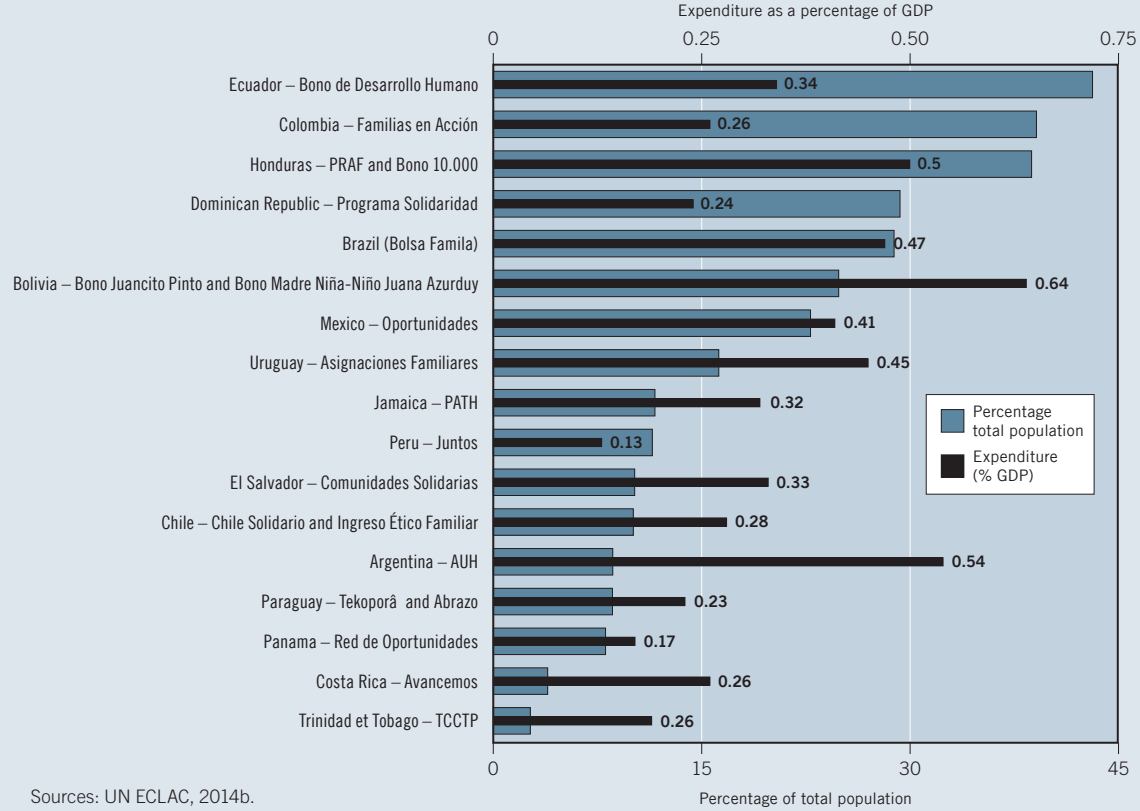
In 2011, public spending on social protection benefits for people of working age[17] ranged from 0.4 per cent of GDP in LDCs, to 0.9 per cent in LMIs and 2.9 per cent in EEs (including general social assistance).[18] Many of the schemes targeting people of working age are contributory. In most cases they are funded from social security contributions and they tend to cover a minority of workers. However, there is a growing range of programmes that are non-contributory and thus are funded from general government taxes and other revenues. These include, for

10.000 Educación, Salud y Nutrición in 2011 (UN ECLAC, 2014b).

17. Social protection benefits for those of working age include unemployment, employment injury, disability or sickness and maternity benefits, and also more general arrangements under a range of titles, ranging from general social assistance to conditional or unconditional cash transfers.

18. General social assistance represents almost half of expenditure in LDCs, 40 per cent in LMIs and 38 per cent in EEs. Less than 0.1 per cent of GDP was spent on unemployment benefits (0.16 per cent in EEs).

Figure 7.7 Cost and coverage of the main conditional cash transfer programmes in Latin America



Sources: UN ECLAC, 2014b.

[1] The CSG, introduced in 1998, is the largest and fastest growing social assistance programme in post-apartheid South Africa (DSD, SASSA and UNICEF, 2012). In 2012, taking all social assistance programmes together (old age, child and disability grants), the number of beneficiaries reached close to 30 per cent of South Africa's population – one of the highest figures among emerging and developing countries (SASSA, 2014; ISSA, 2013). [2] The AUH incorporated beneficiaries of Plan Jefas y Jefes de Hogar Desocupados (PJJHD) and the Family Plan, extending the benefits to protect children aged under 18 of the unemployed and informal economy workers, domestic workers and vulnerable workers earning less than the minimum wage. [3] Between 2010 and 2011, in addition to the 4.3 million children already covered by the other schemes (contributory family allowance and income tax rebate), the AUH reached 3.6 million children (ANSES, 2011; ILO, 2012a; Bertranou and Maurizio, 2012a). [4] The municipalities provide social services and play an important role in identifying potential beneficiaries. The programme also provides financial incentives for municipalities to keep their databases up to date. [5] Despite the progress in the implementation of social protection programmes in recent years, according to the 2010 Demographic Census there are still 16 million people living in extreme poverty.

instance, the employment guarantee scheme (MGNREGA) in India and Ethiopia's Productive Safety Net Programme.

Less than 40 per cent of developing countries have some form of social protection in case of unemployment (figure 7.8). The figure is 10 per cent in LDCs, 35 per cent in LMIs and 70 per cent in EEs. Only 19 per cent of the labour force is entitled by law to periodic unemployment benefits (contributory or non-contributory) in case of job loss in developing countries. The percentage of the labour force entitled to unemployment benefits ranges from almost zero in LDCs, to 11.3 per cent in LMIs and 30.2 per cent in EEs. In practice, in 2012, only 5.9 per cent of the unemployed – compared with 4.7 per cent in 2000 – effectively received unemployment benefits, most of them in EEs.

Recent developments are characterized by the emergence of various forms of protection to provide income security and safeguard human capital in case of unemployment and underemployment. This includes the extension of unemployment insurance, the development of social assistance programmes and employment guarantee schemes (box 7.2).

Box 7.2 Coping with unemployment and underemployment in developing countries

Unemployment is often one of the last social risks covered as part of the process of extending the scope of social protection in developing countries. However, a number of developing countries introduced or significantly expanded coverage of unemployment benefits or implemented schemes that tackle underemployment in a developing country context.

Mauritius and Viet Nam have launched contributory unemployment benefit programmes.[1] In Brazil, unemployment insurance has been extended to domestic workers, small-scale fishermen, workers rescued from forced labour and workers involved in the Bolsa Qualificação (training scholarship). In South Africa, unemployment insurance was extended to domestic workers in 2003.

In 2008, a number of countries with operational unemployment programmes adopted additional measures as a direct response to the global economic crisis. For example, in Chile, the rules of the scheme were adapted to give easier access for workers from sectors hit by the crisis. Argentina extended coverage to include youths and increased the duration of cover, as did Brazil, Latvia and Uruguay.

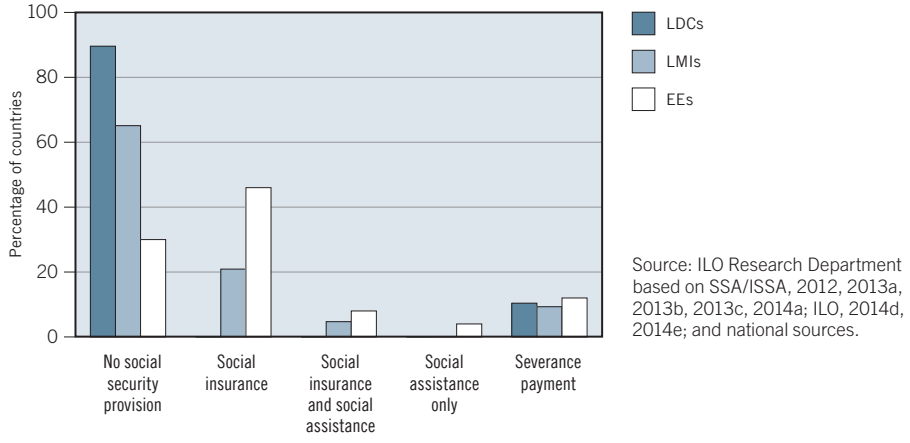
In recent years, a number of developing countries have introduced large-scale public employment programmes (employment guarantee in the case of India) in order to reach underemployed workers in the context of high levels of informality. These programmes are typically non-contributory. They include the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) in India. There are also programmes that combine cash transfers with support for skills development, as in South Africa and the Benazir Income Support Programme in Pakistan.

Unlike other public employment programmes, the MGNREGA, introduced in 2005, provides a legally guaranteed right. The MGNREGA is one of the more historic pieces of legislation in independent India. It is based on two interlinked concepts. First, it ensures livelihood security to rural residents, by providing at least 100 days of guaranteed wage employment in a year to every household whose adult members volunteer to do unskilled manual work. Second, it mobilizes surplus labour in the countryside, to unleash productive forces and generate more economic growth in the rural areas. Importantly, these features are complemented by a rights-based approach, whereby employment is seen as the right of the citizen and must be delivered by the state, otherwise a cash transfer must be provided. The number of households that were provided employment under the scheme peaked at 55 million in 2009/10 and was close to 49 million in 2012/13. Even at its peak, expenditure on the programme accounted for less than 1 per cent of GDP; it currently accounts for around 0.3 per cent of GDP. Evidence on the impact of the programme is discussed in Section C.

Ethiopia has also implemented a large programme – the Productive Safety Nets Programme (PSNP) – which combines public works with food and cash benefits, although it does not provide a legal guarantee. The PNSP currently reaches over 7 million people. Its main objectives are to smooth consumption and protect the assets of chronically food insecure households by providing them with predictable and adequate transfers of cash and/or food. The programme also aims to build community assets, such as roads, soil and water conservation structures and schools, through labour-intensive public works. The latter represents the "productive" component of the PSNP.[2] Between 80 and 90 per cent of PSNP participants participate in public works. They are paid for up to 5 days per month, for up to six months per year. The median amount received per household over a five-year period is around US$200, representing the equivalent of approximately 10 to 40 per cent of annual basic food needs, defined in terms of Ethiopia's national poverty line (World Bank, 2013).

[1] Planned before the global crisis, their implementation turned out to be beneficial in coping with its repercussion (Bonnet et al., 2012b).
[2] A direct (unconditional) transfer is provided as well to people who, in addition to being chronically food insecure, are unable to work either temporarily or permanently (people with disabilities, orphans and people who are sick, elderly, pregnant or lactating).

Figure 7.8 Percentage of countries providing unemployment benefit, by type of programme



Source: ILO Research Department based on SSA/ISSA, 2012, 2013a, 2013b, 2013c, 2014a; ILO, 2014d, 2014e; and national sources.

… third, coping with gaps in maternity protection…

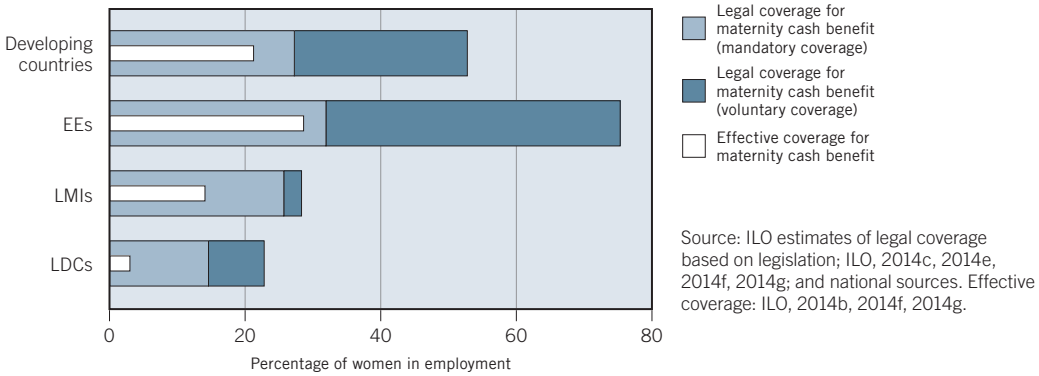
Maternity protection includes providing cash benefits to protect against lost income during maternity leave and ensuring access to health care. Figures 7.9 and 7.10 relate only to the cash benefits component of maternity protection. Recent developments will, however, provide examples of programmes addressing both healthcare and income components of maternity protection.

As far as income security is concerned, 26 per cent of women in employment in developing countries benefit from mandatory legal coverage providing eligibility (by law) for cash maternity benefits (figure 7.9). Voluntary coverage is available in a number of countries, mainly for the self-employed, but is usually not translated into practice. If voluntary coverage is included in the figures, the total proportion of employed women who are legally covered is 53 per cent. In practice, just above 21 per cent of women in employment are effectively covered for such benefits if pregnant (mainly those who contribute to an existing scheme or, in rare cases, are eligible for non-contributory benefits).

There is a correlation between maternity protection coverage and maternal mortality (figure 7.10). Similar correlations can be observed for other indicators of access to maternal care (such as between the proportion of live births assisted by skilled health staff and maternal mortality or prenatal mortality).[19]

Various options for improving protection during maternity are illustrated by some recent innovations. In 2011, Jordan established a new maternity benefit branch covering workers in the private sector, financed by employer contributions. A number of countries have recently implemented non-contributory programmes that provide a combination of income security and access to maternal care to women not covered by traditional maternity protection. In Argentina, the new Universal Birth Allowance expanded coverage of the existing Universal Child Allowance to unemployed women and other disadvantaged women. In 2011, 22 per cent of births in Argentina were covered by this extension[20] (Aleksynska

Figure 7.9 Maternity protection: Percentage of women in employment eligible for maternity cash benefits

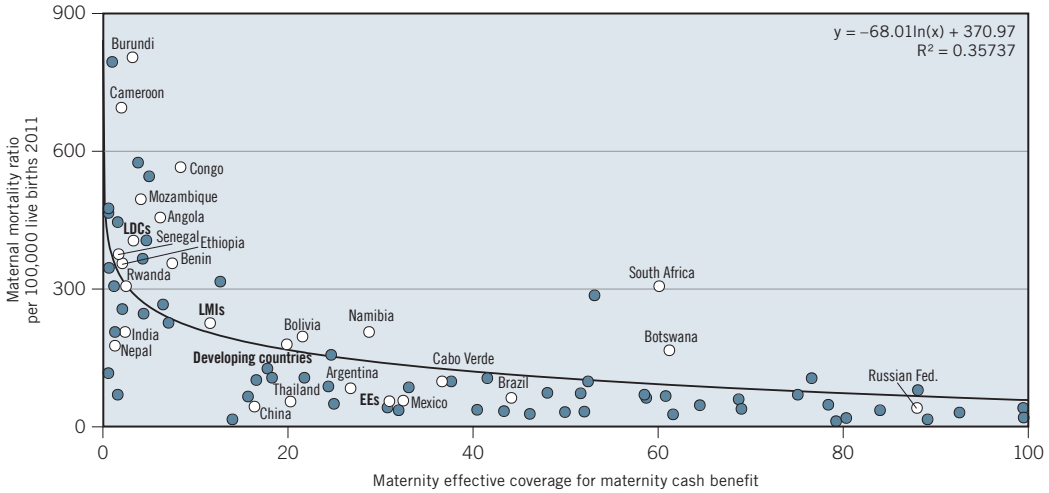


Source: ILO estimates of legal coverage based on legislation; ILO, 2014c, 2014e, 2014f, 2014g; and national sources. Effective coverage: ILO, 2014b, 2014f, 2014g.

19. See in particular Gomby and Pei (2009), which provides empirical evidence of the benefits of proper maternity protection. Based on an analysis of 17 OECD countries, Winegarden and Bracy (1995) find that "the benefits of paid maternal-leave programmes would seem to be unconditionally positive with lowering infant mortality, and also positive with respect to raising female labour-force participation". Tanaka (2005) examines child health outcomes for 18 OECD countries and finds that "paid leave significantly decreases infant mortality, while other leave has no significant effect".

20. Based on data from the Dirección Nacional de Programación Económica, Subsecretaría de Políticas de la Seguridad Social, Secretaría de Seguridad Social sobre la base de datos de la ANSES in *Social Security Bulletin 2012*, *Boletín Estadísticode la Seguridad Social* (2nd Trimester) (available at: http://www.trabajo.gov.ar/left/estadisticas/bess/informe.asp [accessed 24 May 2013]).

Figure 7.10 Correlation between percentage of women in employment covered by maternity protection and maternal mortality rate



Source: ILO estimates of effective coverage: ILO, 2014b, 2014f, 2014g. Data on neonatal mortality: WHO, 2014.

et al., 2013). In India, the new Conditional Maternity Benefit, fully funded by the Ministry of Women, is being piloted in 53 districts. Its main objective is to improve the health of pregnant women, lactating mothers and infants by providing cash benefits and care. During this pilot phase the programme is expected to cover 1.38 million pregnant and lactating women. Similarly, in 2008, Bangladesh implemented the Maternity Allowance Programme for Poor Lactating Mothers, with the main target groups being vulnerable and rural low-income pregnant mothers.

… fourth, addressing gaps in protection for people with disabilities…

In most developing countries (especially LDCs and LMIs), existing provisions for social protection in the case of disability[21] provide benefits either through social insurance as the only type of programme (51.9 per cent of countries) or through employer liability (8.4 per cent). In other words, only people who have made a minimum number of contributions are protected. This is the current situation in more than 75 per cent of LDCs.

Less than 10 per cent of developing countries (16.3 per cent of EEs) provide any degree of protection independently of employment history for people with disability. Among EEs, Namibia, Mauritius, most European and CIS countries (including Azerbaijan, Kazakhstan, Latvia, Lithuania, Russian Federation and The former Yugoslav Republic of Macedonia) cover all people with disabilities through social insurance and non-contributory, non-means tested benefits. Some LMIs provide at least a basic level of income security to all people with disabilities (Armenia, Bolivia, Moldova and Mongolia, for instance). Most Latin American countries (such as Argentina, Brazil, Costa Rica, Ecuador and Uruguay) have schemes covering poor people with disabilities, in some cases as part of conditional cash transfers, in addition to those entitled to contributory social insurance.

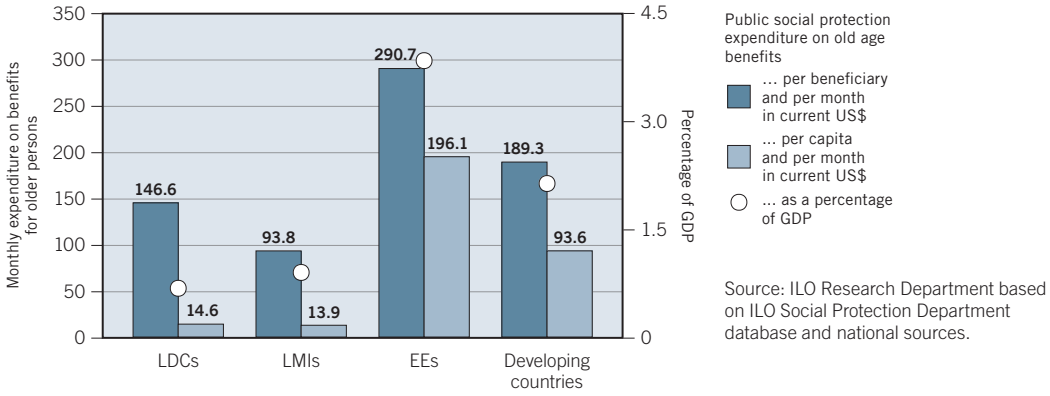
21. According to global estimates, more than 1 billion people in the world live with some form of disability (15 per cent of the world's population), of whom nearly 200 million experience considerable difficulties in functioning. Between 785 million and 975 million of them are of working age (15 years or older) and most live in developing countries (WHO and World Bank, 2011).

In South Africa, the coverage of the disability grant was recently extended by raising the means testing threshold. In December 2013, the programme covered more than 1 million people with disabilities (SASSA, 2014). In several countries, measures to extend the coverage of pension insurance to more groups of the population (e.g. self-employed and domestic workers) have included coverage for disability. Paraguay recently extended pension insurance coverage (including disability, OASDI[22]) to independent workers – but only on a voluntary basis.

… fifth, new avenues for providing income support to the elderly…

Benefits for the elderly represent on average 2 per cent of GDP, ranging from 0.7 per cent of GDP in LDCs[23] to 3.9 per cent of GDP in EEs (figure 7.11). In LDCs and LMIs, benefits are concentrated on a few beneficiaries. In many EEs, most elderly people are eligible to old-age benefits (Brazil and China are examples, as presented below).

Figure 7.11 Expenditure on old-age benefits in developing countries, latest available year



Source: ILO Research Department based on ILO Social Protection Department database and national sources.

The share of older people receiving an old-age pension increased from 22.7 per cent in 2000 to 44.2 per cent in 2010. There are significant country disparities: in LDC, 16 per cent of older people received an old-age pension, compared with 26 per cent in LMIs and 70 per cent in EEs.[24] Despite the limited proportion of contributors, the proportion of elderly people receiving a pension is relatively high in some developing countries – which may be explained by the development of non-contributory pension programmes (box 7.3).

There is a correlation between old-age pension coverage and labour force participation in old age. An additional important dimension is the level of benefit provided. In some countries, levels of benefits are lower than $1.25 PPP a day, e.g. in Swaziland and Thailand. Such levels result in relatively high labour participation rates among elderly despite high levels of coverage (figure 7.12).

22. Old-age, survivors, and disability insurance.
23. Mainly on pensions for former employees in formal employment.
24. The magnitude of the informal economy determines to a large extent the coverage of contributory schemes. Fewer than one adult out of four in developing countries or 22 per cent of the working-age population contribute to an old-age pension scheme (less than 4 per cent in LDCs, close to 10 per cent in LMIs and close to 40 per cent in EEs).

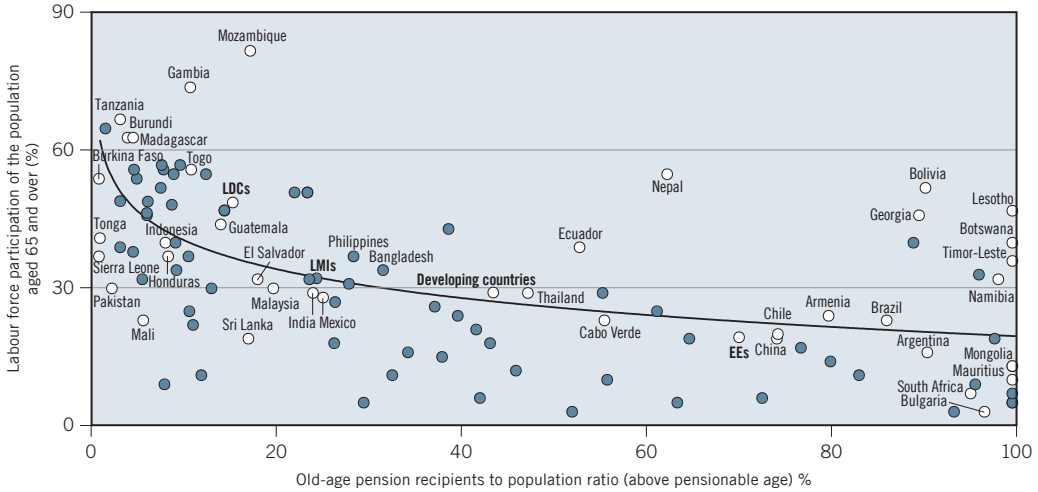
Box 7.3 The role of non-contributory pensions

Typically, EEs have relatively comprehensive pension systems in place. These systems combine contributory schemes (in some cases partially subsidized or adapted to cover non-regular workers) and non-contributory schemes – as is often the case in advanced economies. This is, for instance, the case in China. As part of the extension strategy of social security coverage, the Government decided in 2012 to expand to all the Chinese population the new rural pension scheme, which had been piloted in 2009, and the social pension insurance for urban residents, which had been piloted in 2011. At the end of 2013, 850 million people, nearly 75 per cent of the population aged 15 and above, were covered under the four pension schemes in place, of which 498 million were covered under the two new schemes, accounting for 59 per cent of the total number covered (ILO, 2014a).

In lower income groups of countries, in the absence of a significantly developed contributory basis, non-contributory pensions tend to be the main or the only pensions available.[1] For example, in Lesotho an old-age pension was introduced in 2004, providing a monthly benefit of 300 maloti (US$30) to all persons aged 70 or over and not in receipt of another pension (HelpAge International, 2014). Pensions in Nepal were introduced in the late 1990s, and were gradually extended to more elderly people by lowering the age criteria – people over the age of 70 are now covered. The Democratic Republic of Timor-Leste implemented a support allowance for the elderly in 2008, covering people aged over 60.

[1] Non-contributory pensions exist in 48 per cent of developing countries: 20 per cent of LDCs, 54 per cent of LMIs and 69 per cent of EEs. Most non-contributory pensions are either means-tested (52 per cent) or pension tested (28 per cent). Only 15 per cent are universal available for all persons above the eligible age (HelpAge, 2014 and national sources). The cost varies from 0.1 per cent of GDP in Bangladesh (means-tested old age allowance covering 30 per cent of the population above eligible age providing a low level of benefit) to 1.8 per cent of GDP in Lesotho. The level of pension provided varies widely within this sub-group of LDCs from 3.9 USD monthly in Bangladesh or 8.1 USD in Nepal to 130 USD in Western Samoa (HelpAge, 2014, ILO, 2014a).

Figure 7.12 Correlation between the proportion of older persons receiving a pension and the labour force participation rate among persons aged 65 and above



Sources: ILO Research Department based on ILO Social Protection Department database and ILO statistics (Economically Active Population (EAP) estimates).

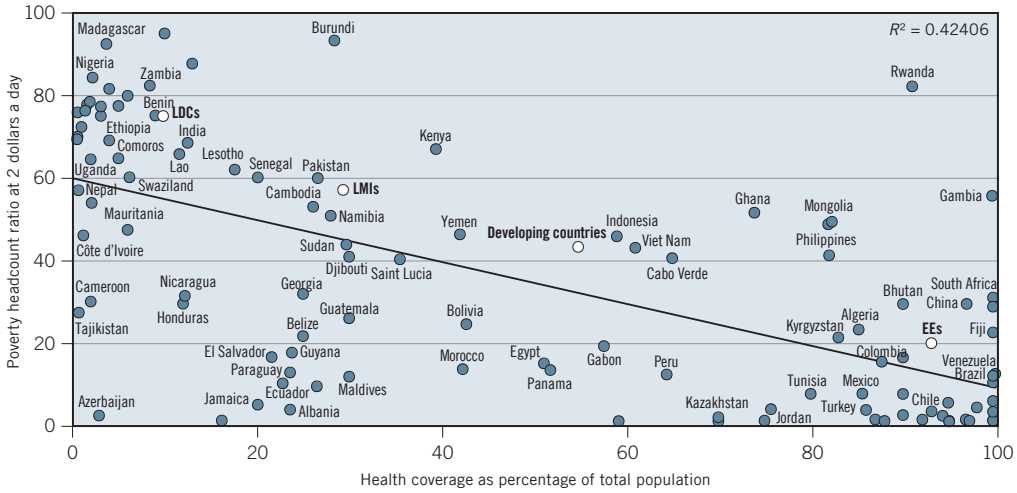
In Bolivia, for instance, more than 50 per cent of those aged 65 years or older still work, despite the universal pension system. This provides some indirect evidence that pension payment levels are low (less than US$30 monthly). Thus, in Lesotho, Nepal and Swaziland, non-contributory pensions were successfully extended to most of the old-age population. The low benefit levels may have helped reduce poverty, but not enough to allow older persons to retire fully from the labour market.

… and, finally, important recent extensions in health protection.

Existing health systems cover close to 55 per cent of the population[25] in developing countries, on average, but coverage is less than 10 per cent in LDCs and 30 per cent in LMIs. The most significant gaps in coverage are found in the countries with the highest poverty levels (figure 7.13). In 2011, the per capita public expenditure on health per year was US$229 in developing countries, ranging from US$46 in LDCs (which is below the minimum level recommended by the World Health Organization[26]), to US$81 in LMIs and US$436 in EEs (WHO, 2014).

In a little over three years, China has managed to extend access to basic health care to more than 95 per cent of its population (ILO, 2012b). The aim of the reform – which has cost about US$133.5 billion – is to achieve universal healthcare coverage by 2020. The extension of health coverage in China has required action in multiple dimensions of social health protection: human resources, infrastructure, medicine (availability and economic aspects) and legislation. In the early 2000s, it was mainly those working in urban areas that benefitted from health insurance coverage, under a formal employer–employee relationship. In 2003 and 2007, the Government launched two schemes to extend coverage to rural populations and to non-working urban residents. The healthcare budget was increased by 30 per cent annually between 2008 and 2011. A large proportion of these resources were invested in staff training and in the enhancement of local health services. The Government also invested heavily in building the infrastructure.[27] Basic medicines are now sold at the same price across the country. The new system is aimed especially at people with no resources, no ability to work and no one to support them (in China, these are known as the "Three No" people). Local governments now

Figure 7.13 Social health protection coverage and poverty



Source: Poverty: World Bank, 2014a; ILO Key Indicators of the Labour Market (KILM).
Social health protection: ILO 2014a, 2014b.

25. This includes social insurance as well as public health system providing healthcare services for free or at limited cost.
26. The WHO recommendation for public health expenditure in order to provide basic health services in low-income countries is estimated as US$51 per person per year in 2012; US$60 per person per year in 2015.
27. The Government invested CN¥63 billion in rural areas to support the construction or improvement of over 2,200 county-level hospitals, some 6,200 central township clinics and 25,000 village clinics. CN¥4.15 billion was also invested in urban areas to support the construction and improvement of almost 2,400 community healthcare centres.

fully cover the individual health insurance contributions of this group. The rapid extension of health insurance in China can also be attributed to the 2010 Social Insurance Law.

In Indonesia, the Government aims to have every Indonesian covered by health insurance by 2019,[28] under a new scheme called the Jaminan Kesehatan Nasional (JKN). The implementation has just started (in 2014), following the enactment of the National Social Security System Act in 2004 and the Social Security Providers Act in 2011. Nearly US$1.6 billion was allocated to cover premiums for the poor in 2014. Around 65 per cent of the country's 240 million people, including 86 million categorized as poor, are covered by some form of regional or national health programme and are automatically entitled to comprehensive coverage under the JKN. The roll-out of universal health coverage in Indonesia raises some challenges and concerns, notably with regard to inadequate funding, which could undermine the quality of care.

In Turkey, health insurance covers 95 per cent of the population, and 76 per cent of Turkish citizens are satisfied with healthcare services (World Bank, 2014b). This is the result of the comprehensive Health Transformation Programme adopted in 2003. The four health insurance schemes that existed previously were merged into a universal programme. Participation in the scheme is fully subsidized for the poor and partially subsidized for the near poor. Key health indicators such as life expectancy and child and maternal mortality have improved. Turkey's level of public health spending (5.1 per cent of GDP) is comparable with that of other countries at similar levels of development.

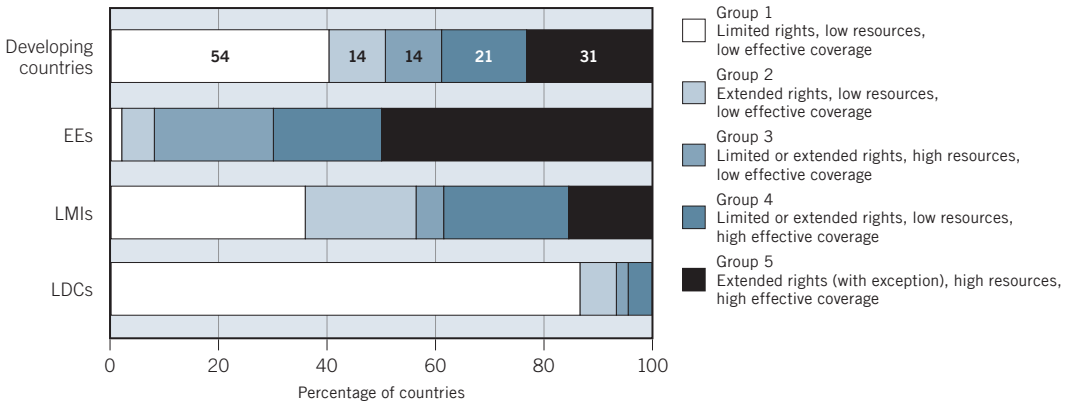
A typology of countries' social protection strategies

One way to analyse the overall social protection systems and strategies used by different countries is to consider the three following interrelated dimensions (see Appendix A for detailed definitions): (i) a country's statutory commitment to social protection as a right[29]; (ii) the national resources invested in social protection to give effect to statutory commitments; and (iii) the effectiveness of implementation, in terms of coverage and level of benefit provided (which depends on efficient and effective use of resources). The typology results from the combination of these three dimensions. Figure 7.14 presents five groups, based on 134 (out of 145) developing countries for which required information is available. Group 1 is located at the lowest stage of development of a social protection system, while group 5 at the highest level of social protection among developing countries. Some information on the composition of these groups is provided below.

28. Integrated Regional Information Networks (IRIN) (available at: http://www.irinnews.org/ [accessed 14 January 2014]).

29. A country's commitment to social protection as a right is measured through the observed stage of development of the legal foundations of the national social protection system and, to some extent, by comparisons with minimum values indicated in the Social Security (Minimum Standards) Convention, 1952 (No. 102) or with the ultimate goals of income security in the recent Social Protection Floors Recommendation, 2012 (No. 202).

Figure 7.14 A typology of countries' social protection strategies: Variation by income groups



Source: ILO Research Department. Specific sources are presented

Group 1
Very limited or limited rights – low resources – low coverage (54 countries)

- In this group, statutory commitments are limited and tend to be restricted to small groups of the population (usually those in formal employment). The low level of resources invested in social protection means there is also a significant coverage gap (both in extent and level).
- About 40 per cent of developing countries (28 per cent of the population) belong to this group. Close to 90 per cent of LDCs are in this first group, mainly from Africa (72 per cent of African countries) and Asia (40 per cent of Asian countries). In those countries, the majority of the population live in rural areas (55 per cent) and 60 per cent live from agriculture. The sector makes a comparatively limited contribution to GDP (22 per cent). Close to 64 per cent of the population live below the poverty line, and a similar proportion are working poor and/or are in vulnerable employment (62 per cent).
- The share of employment in industry is limited at 10 per cent (with a contribution to value added of 27 per cent; 11 per cent from the manufacturing sector). Investment level is the lowest of the five groups, at 23.7 per cent, compared with close to 30 per cent of GDP in group 5 (representative of the higher stage of development of social protection systems).
- Total government expenditure as a percentage of GDP is limited (30 per cent on average), which may constrain the allocation of resources towards social protection.

Group 2
Extended rights – low resources – low coverage (14 countries).

- This group represents 26 per cent of the population. A relatively wide scope of statutory commitments cannot be translated into high levels of effective coverage, mainly due to low resource allocations. A number of countries in this category have developed relatively strong legal foundations, or have inherited them from the past (Togo and the Democratic Republic of Congo, for instance). Yet economic downturns, structural adjustments and/or policy changes have eroded the resource base for social protection.

- Poverty is widespread (65 per cent of the population on average and 47 per cent of workers live on less than US$2 a day). The contribution of the agricultural sector to GDP is still relatively high and the industrial sector remains underdeveloped.

Group 3
Limited (35%) or extended (65%) rights – high resources – low coverage (14 countries)

- In this group, which represents 10 per cent of the countries but only 3 per cent of the population, there exist the legal foundations required for a relatively wide range of social security contingencies, and the level of resources allocated to social protection is above average. However, the proportion of the population covered by social protection remains limited.
- This group includes many EEs, such as Colombia, Gabon, Panama and Peru, where the informal economy is large. Poverty rates are among the lowest for developing countries, but inequality is high: the Gini coefficient is above 0.45 post transfers[30], compared with less than 0.40 in developing countries on average. While those in formal employment enjoy a wide range of relatively generous benefits, a large part of the population remains uncovered.
- There is a strong need for social protection to reach out to those in the informal economy, possibly through strengthening of contributory programmes and development of non-contributory programmes.

Group 4
Limited (28%) or extended rights (72%) – low resources – high coverage (21 countries)

- Countries that have limited statutory commitments and low resource allocation for social protection can still have good outcomes in terms of coverage in selected areas. This is usually thanks to the existence of provision for benefits which, although at a basic level, have either universal outreach or are effectively targeted by other means at large sections of the population.
- Close to 95 per cent of countries in this group are either EEs or LMIs. For example, Georgia, Seychelles, Tajikistan and Uzbekistan have well-established non-contributory benefits (and redistribution measures) that provide basic levels of support for the majority of the population. The incidence of poverty is relatively low (16 per cent of the population live on less than US$2 a day, although the proportion of working poor is higher, at 18 per cent) and inequality is the lowest compared with other groups (the Gini coefficient is 0.37), but government expenditure on social protection is comparatively high (39 per cent of GDP).
- The challenge in these countries is to increase the level of benefits rather than extending coverage.

30. After accounting for social protection payments.

Group 5
Extended rights (with exceptions) – high resources – high coverage (31 countries)

- Representing nearly a quarter of the 134 countries and 39 per cent of population, this group is mainly composed of EEs (80 per cent), with the six remaining countries being LMIs. This group includes countries from Central and Eastern Europe (e.g. Bulgaria, Latvia, Lithuania, and Russian Federation), Asia (e.g. China, Mongolia and Thailand), Latin America (e.g. Argentina, Bolivia, Brazil and Mexico) and Africa (e.g. Algeria, Mauritius, Namibia, South Africa and Tunisia).
- This group as a whole has a higher level of investment (close to 30 per cent of GDP), a higher contribution of industry to the total value added (35.5 per cent) and a smaller share of agriculture in total output (7.6 per cent of GDP).
- The poverty rate is relatively low (below 13 per cent) and the share of employees is high, at around 75 per cent.
- In these countries, the key challenges are efficiency and effectiveness. There is a need for careful monitoring of whether the resources invested result in sufficiently adequate outcomes.

This typology categorizes countries according to different stages of development of their social protection system. It allows groups of countries that are homogeneous regarding the state of their social protection systems to be compared on the basis of other important dimensions – poverty, employment and productivity – as illustrated in the next section.

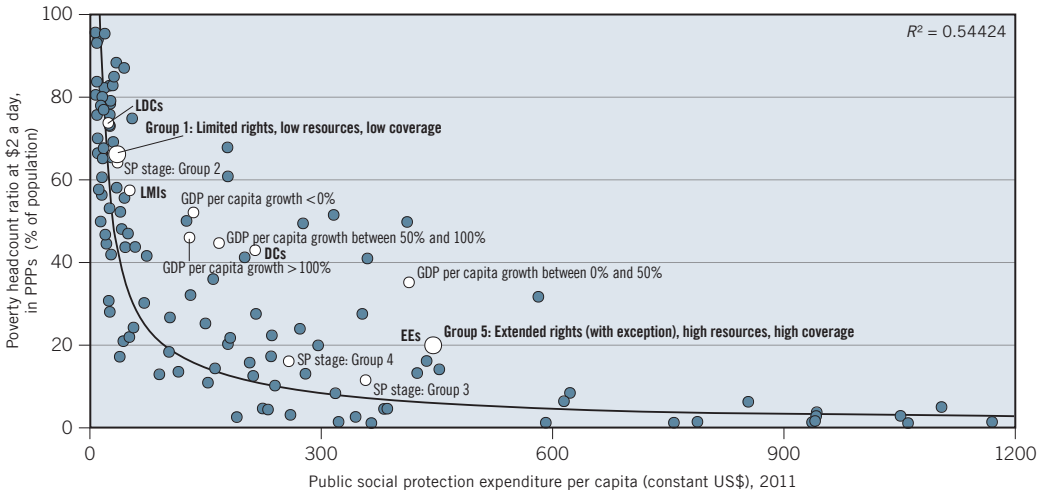
C. Social protection and development

The purpose of this section is to assess the possible impacts of social protection on development. First, if the necessary conditions are in place, social protection can contribute to better health and education outcomes, in turn enhancing individuals' capability. These are the long-term impacts of social protection. Second, social protection can also provide a useful short-term device. Cash transfers (or labour incomes in the case of employment-generation schemes) represent an injection of new demand, which may be necessary in the face of economic shocks. Obviously, the extent to which these two effects are realised depends on the specific funding arrangements and design features of social protection, such as the availability of implementation institutions, tackling the risk of welfare dependence and ensuring an adequate degree of equity.

Evidence suggests that well-designed social protection can, first, help tackle poverty and inequality …

One of the main objectives of social transfers in developing countries is to reduce poverty and vulnerability. This has a direct effect on the level and variability of consumption of the poorest, while also contributing to improving health outcomes and skills development. There is a large literature assessing the poverty reduction effectiveness of these programmes (ILO, 2010b, 2010c). The findings from these studies suggest that most programmes have made a significant contribution to

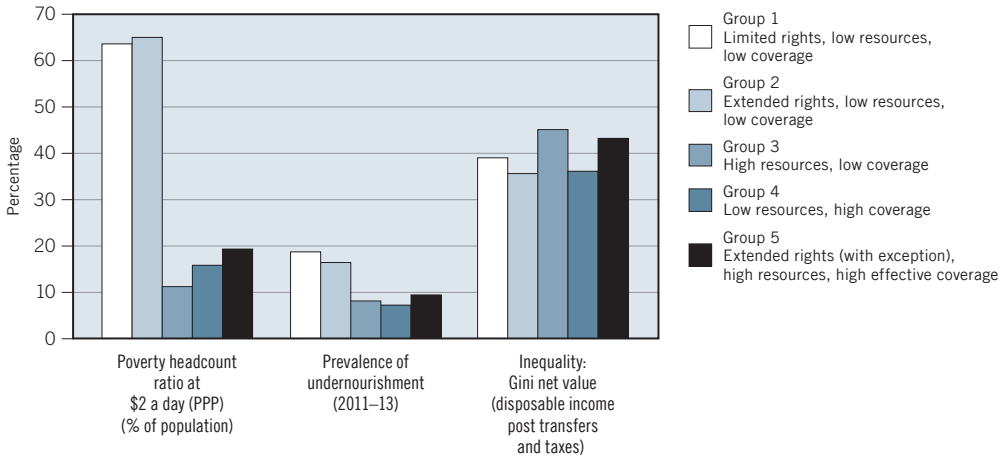
Figure 7.15 Correlation between per capita expenditure on social protection and poverty rates



Note: Weighted by total population.

Source: Poverty: World Bank, 2014a; ILO Key Indicators of the Labour Market (KILM). Social protection: ILO 2014a, 2014b.

Figure 7.16 Poverty and inequality indicators among the five groups of countries (typology)



Note: Weighted by total population.

Source: Poverty: World Bank, 2014a; ILO Key Indicators of the Labour Market (KILM). Social protection: ILO 2014a, 2014b. Employment: ILO, *Trends Econometric Models*, January 2014.

reducing poverty and vulnerability through the insurance of at least a minimum level of income security among beneficiaries. The monetary cash transfer provided by such programmes is usually too small, by itself, to have a significant effect.[31] What is essential is to provide non-monetary benefits (such as employment services, access to housing and support to exercise basic rights) along with monetary transfers.

Figure 7.15 shows that there is an association between higher public expenditure on social protection and poverty alleviation. This is further illustrated in figure 7.16, which shows that countries with more developed social protection systems tend to enjoy lower levels of poverty and working poverty than is the case in

31. Selected programmes presented in this section represent some of the mechanisms in place. Non-contributory programmes, widely represented as part of the illustrations and the subjects of numerous studies, actually represent only a limited share of total investment in social protection, in particular when compared to the resources represented by contributory schemes.

Box 7.4 Examples of social protection and poverty reduction in action

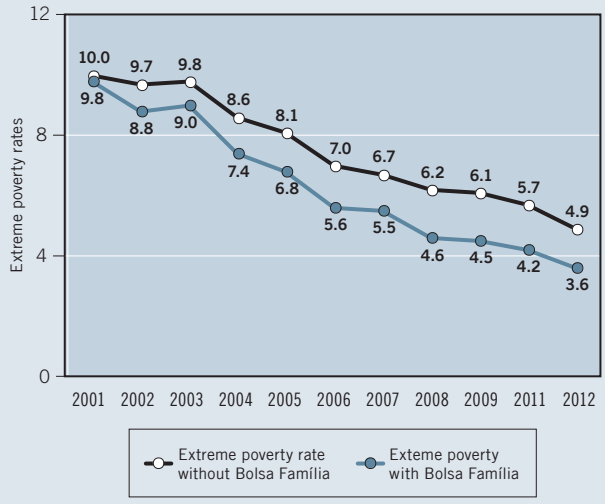
In Argentina, the implementation of the Asignación Universal por Hijo (AUH) contributed to reducing the number of households with children in extreme poverty by 3.4 percentage points in 2010 and by a further 3.5 percentage points in 2012 (ODSA, 2013). The AUH has addressed the most acute problems of poverty and indigence in households with children under 18 years of age but has had no major impact in the labour market in terms of a decrease in the labour force or employment to population ratios (Bertranou and Maurizio, 2012b).

In Brazil, the proportion of Brazilians living on less than R$70[1] decreased from 9.8 per cent in 2001 to 3.6 per cent in 2012 (figure 7.17). It is estimated that the Bolsa Família programme helped to reduce poverty by 36 per cent in 2012 (Neri et al., 2013a). The combination of high efficiency in spending, adequate targeting and access to key basic services provides the main explanation for the effectiveness of the programme (IPEA, 2012; Soares et al., 2010). Beneficiaries get priority access to a raft of services and support – beyond education and health – such as housing and more recently vocational training and job intermediation services.

In Mexico, in the absence of the human development programme Oportunidades, it is estimated that food poverty would be 9.6 per cent higher than the level reported in 2008. Without the combined contributions of all the major social programmes (Oportunidades, PROCAMPO, Adultos Mayores and Becas), poverty would be 13.5 per cent higher than it is today (CONEVAL, 2009). Despite the low level of benefit provided, Oportunidades has been instrumental in achieving poverty reduction.[2] Coordination of the programme is the responsibility of the social development ministry, which successfully promotes the intersectoral and intergovernmental character of its implementation, supported by a well-established mapping and selection process.[3]

In India, a longitudinal survey of 1,064 rural households found that 12 per cent of the households experienced rising incomes because of the MGNREGA scheme as more of their members were able to access wage work (Engler and Ravi, 2013). Another study[4] suggested that the programme generated substantial gains in money incomes for poor rural households (Ghose, 2011) estimating that "MGNREGA may have increased the combined wage income of the rural poor by around 20 per cent in 2009–10 and hence should have reduced the incidence of rural poverty by anywhere between 12 and 16 percentage points in that year alone." Real wages for casual work in rural India (but also in urban India) have increased significantly in the recent period and the gender wage gap has declined (figure 7.18), with MGNREGA playing the major role in stabilizing the rural wage floor, reducing gender wage gaps (Bordoloi, 2011) and providing a better bargaining situation for the rural population.[5]

Figure 7.17 Estimated impact of Bolsa Família programme on extreme poverty (2001–2012, %)



Source: Neri et al., 2013a. Note: Poverty line is taken at R$70 at constant 2011 prices.

Figure 7.18 Real wages for rural casual work (1999–2012)

Note: The figure includes rural casual work other than employment associated with public works.

Source: ILO based on NSSO surveys for wage data and Consumer Price Index for Agricultural Workers (CPIAL) for price deflators.

[1] Official criterion of extreme poverty. Data at 2011 prices, adjusted for inflation throughout the series. [2] Its effect would be even more striking without the unfavourable environment for sustainable enterprises in certain parts of the country. [3] The process of mapping and inclusion occurs in three phases: (i) classification of districts into five categories, according to an index of economic and social marginalization; (ii) definition of households within each municipality by the statistical method; and (ii) checking with the community if the list of selected names reflects the reality of the location (Soares et al., 2007; Bastagli, 2009). [4] Based on small sample surveys in six districts in three states. [5] Between 1999 and 2005, pre-MGNREGA, nominal wages in the rural economy grew at an average annual rate of 2.7 per cent. Post-MGNREGA, the average wage almost quadrupled to 9.7 per cent between 2006 and 2009. And between January 2010 and May 2011, annual nominal wage growth averaged almost 18.8 per cent (Ministry of Rural Development, 2012).

countries where social protection is limited (as defined in the typology presented in the previous section). Almost 64 per cent of the population in group 1 (lowest levels of social protection) live on less than US$2 a day, compared to less than 20 per cent in group 5 (highest level of social protection).

Importantly, figures 7.15 and 7.16 and illustrations from specific countries show that there is significant cross-country variation in terms of the extent to which social protection may curb poverty. Box 7.4 provides examples of how social protection may help to reduce poverty, highlighting the key role of adequate policy design and implementation mechanisms. In addition, figure 7.16 shows that social protection, on its own, may not always be sufficient to tackle income inequalities. Complementary policies are therefore called for and these will be examined in detail in Chapter 8.

… second, boost human development and individual capabilities …

Positive contributions of social protection to employability, higher productivity and decent work arise, inter alia, from (i) better access to food and improved health and nutritional status; and (ii) improved school attendance.

Various studies illustrate the linkages between social protection, on the one hand, and health and education on the other. In Brazil, there is evidence that the incidence of low weight at birth among families receiving Bolsa Família is nearly 1 percentage point lower than among non-recipients of similar characteristics (Santos et al., 2013). Similar results were also observed in most countries implementing conditional cash benefits as well as for beneficiaries of large-scale employment generation programmes (such as Ethiopia's Productive Safety Net Programme, or Bangladesh's Challenging the Frontiers of Poverty Reduction/Targeting the Ultra Poor Programme).

Taking a longer term perspective, better nutrition coupled with better housing conditions are directly related to the prevention of diseases which positively impacts key indicators such as mortality and life expectancy (Mazzola, 2012, Rasella, D. et al., 2013). Additional findings suggest that there will be medium and long-term positive effects on employability and productivity.

Some programmes directly target school enrolment and school attendance through conditions attached to cash transfers. Others have a more indirect effect through ensuring at least a basic level of income security which facilitates school attendance. This is notably the case of child benefits (Child Support Grant in South Africa, for instance) as well as other programmes providing predictable cash transfers to poor families. The quality of education and the transition from school to work are also important. Evidence for Brazil, India and South Africa illustrates changes in terms of school enrolment and attendance. And studies on Mexico provide some indications about longer term outcomes.

In Brazil, the Bolsa Família programme conditionalities associated with the services foreseen in the design of the overarching Brazil Without Misery programme have yielded improvements in education and health. In the case of education, there is evidence that the programme contributes to increased school attendance and increased rates of progression (Januzzi and Pinto, 2013; IFPRI, 2012) and reduces the number of students having to repeat a year of schooling (Oliveira and Soares, 2013a).

Mexico's Oportunidades programme shows direct effects (in terms of school attainment and performance) as well confirming expected outcomes regarding increased access to decent employment in the longer run (see the third point below).

Between 1990 and 2012, a significant reduction, from 26.6 per cent to 19.2 per cent, in the educational backwardness of young people aged six to 15 was observed (CONEVAL, 2012). A corresponding improvement in school performance was observed, with the improvement in mathematics for scholarship trustees increasing by 10 percentage points between 1998 and 2003 (SEDESOL, 2012).

Despite the lack of explicit conditionalities associated with health and education objectives, non-conditional programmes also contribute to promoting human development. In India, evidence from MGNREGA indicates an increase in the trend of workers sending their children (especially girls) to school, due to the assured income. In Odisha and Andhra Pradesh, young people have accessed MGNREGA work placements to help pay for their tuition and other requirements during tertiary education (CERD, 2010). Similarly, the Child Support Grant in South Africa shows positive developmental outcomes in the form of improved school attendance and also longer term benefits of mitigating the detrimental effects of poverty on children in the early years of life[32] (Leibbrandt et al., 2010; Hall and Wright, 2011).

Positive effects on schooling can also be observed from programmes where children are not the primary target group but clearly benefit from the regularity and predictability of the cash transfer. In Namibia and South Africa, recipients reported using their social pension benefits to pay grandchildren's school fees (ILO, 2010c).

… third, support productive employment …

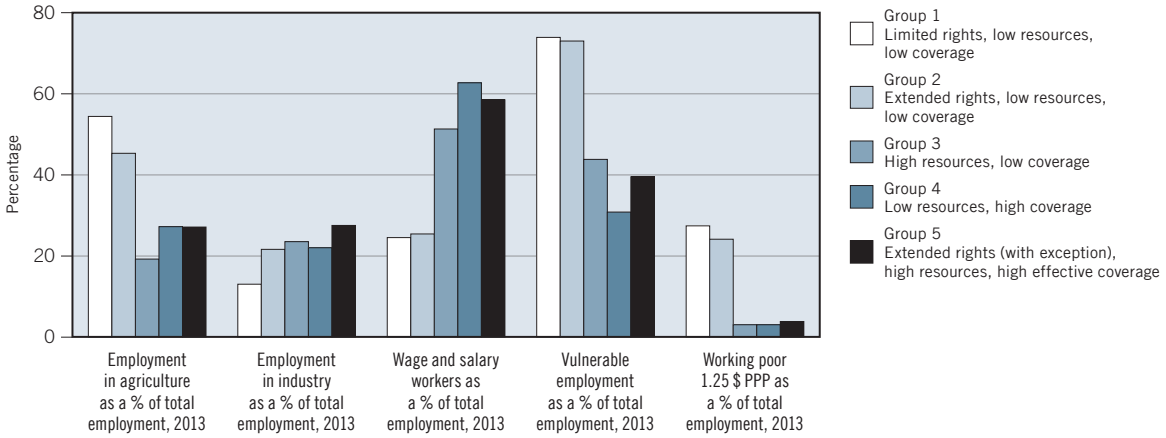
By allowing jobseekers time to find a job that matches their skills, unemployment protection systems can make labour markets more efficient. Figure 7.19 shows those factors that are positively related to the stage of development of social security systems, with backward and forward links between economic growth, employment and social protection. The decrease in agriculture and relative increase in industry as a share of total employment tend to be associated with greater opportunities for wage employment, which in turn broadens the contribution base, and thus serves to extend social protection. In the recent period, social protection policies have also developed approaches to address the situation of those in occupations with low coverage. The rural pension in Brazil, the recent extension of pension and health coverage in rural China and examples of inclusion of domestic workers in contributory schemes for unemployment, maternity and pensions are all examples of such approaches.

Figure 7.19 also shows a significant decrease in the average proportion of the working poor and workers in vulnerable employment along with the development of social protection systems. Studies of Oportunidades have concluded that young people aged between 15 and 25 benefiting from the programme have higher employment levels, and higher income from work, compared to non-beneficiaries (SEDESOL, 2012). Youth who participated in the programme for at least six years and who completed a primary or secondary level of education, experienced an increase in their wages by 12 per cent and 14 per cent, respectively, compared to non-beneficiaries (SEDESOL, 2012).

The impact of social transfers on the utilization of productive capacity raises the common concern of market distortions and some disincentives to work. Recent studies examining the incentive effects of income transfers tend to find,

32. Patel et al., 2013.

Figure 7.19 Recent changes, resources and coverage of social protection by employment indicators, 2013 (%)



Source: ILO Research Department based on previously defined typology and ILO, *Trends Econometric Models*, January 2014.

on the whole, few unintended adverse effects. On the contrary, there is evidence that transfers facilitate improved resource allocation among poor households, support more productive decisions instead of adverse coping strategies and, in the case of employment-generation programmes, may result in increased productivity and expanded production (ILO, 2010c). That said, obstacles to the creation and expansion of sustainable enterprises, inadequate governance and corruption as well as skill mismatch problems may considerably reduce the effectiveness of social protection programmes.

… increasingly in combination with training and skill development activities …

Unemployment benefits avoid the need to accept the first employment opportunity that presents itself, hence preserving human capital and improving job search strategies. Evidence suggests that the reception of a regular cash transfer can, in and of itself, have an impact on labour market participation, even in the absence of training or complementary intervention. In South Africa, receipt of a social protection transfer at household level has been found to have a significant impact on the job search process, by covering the cost (and risk) of investment in job search activity (McCord, 2011). The provision of social protection can itself stimulate investment in skills formation with various impacts regarding skills development depending on levels and type of social protection benefits available (such as pension and unemployment benefits).

Increasingly, social protection programmes contain training/skills development or asset accumulation as part of their objectives and design. This may create an incentive to participate in training. Considering public employment programmes, the main impact of such programmes appears to be greatest among females, prompting increased female labour participation rather than significant increases in employment of those already unemployed (box 7.5).

Box 7.5 Examples of social protection programmes that integrate skills development activities

Studies suggest that social protection can help to cushion the impacts of the economic crisis on the labour market, while nurturing the economic recovery. In Argentina, the Jefes y Jefas programme – now part of the AUH – provided social protection and skills development during the crisis in 2002. The programme integrated public works with training, for a total cost of 1 per cent of GDP (or 4 per cent of the national budget). The total number of beneficiaries reached 2.4 million when including all beneficiaries from training programmes (Kostzer, 2008). Studies suggest that the Jefes y Jefas programme helped to reduce the unemployment rate by 2.5 percentage points during the recovery phase that started in 2003 (Galasso and Ravallion, 2003).

By contrast, the Central Region Infrastructure Maintenance Programme in Malawi did not address local demand and enterprise credit constraints, thereby affecting its effectiveness. The value of capital transfers as well as skill levels were insufficient to allow significant change in productivity and the activities did not survive in the absence of local demand and in the face of droughts (McCord, 2011; DFID, 2004). Similarly, evaluations suggest that the limited success of the Trabajo por Uruguay programme may have been due to the fact that the type of skills provided did not respond to labour market needs (Reuben et al., 2008).

It is important to assess the effectiveness of programmes within a sufficient time frame. The Chile Solidario programme combined social protection with conditionalities in terms of engagement in activities to promote employability and skills. An evaluation of the programme during the first two years of implementation found no evidence that participation in the employment programme translated into improved employment outcomes (Galasso, 2011). However, over time, some positive employment effects were identified (Hoces de la Guardia et al., 2011). In 2011, Ingreso Ético Familiar significantly increased the number of transfers from the Chile Solidario, encouraging the integration of beneficiaries into the labour market.[1]

The link between labour market measures and social protection has been reinforced since 2008 as part of the responses to the most recent financial and economic crisis (Bonnet et al., 2012b; Aleksynska et al., 2013). Linking social benefits to participation in training programmes was an approach adopted in Brazil, where additional vocational training was supplied to beneficiaries of income transfer programmes. The National Programme for Access to Technical Education and Employment (PRONATEC), adopted for the period 2011–2014, had an objective of creating 8 million additional vocational training opportunities by 2014, including for youth and beneficiaries of income transfers. By April 2014, 6.3 million persons had already benefited from the PRONATEC (Brazilian Government, April 2014).

[1] First results indicate an increase of 9 per cent in women's participation and a higher proportion of working adults among families benefitting from the programme (Henoch and Troncoso, 2013).

… and, finally, reduce the supply of child labour.

Economic motivations behind child labour extend to non-income factors, and often emerge as responses to vulnerability among poor households. Transfers to households with children or young people might not be enough to achieve larger social policy goals, such as the elimination of child labour and school dropout. To this end, greater integration and coordination of the various programmes and policies are necessary, taking into account all the risks and vulnerabilities facing individual households according to their family composition.

However, evidence indicates that income transfer programmes are effective in reducing the supply of child labour, also reducing the number of young people who are neither in employment nor in education or training (Oliveira and Soares, 2013b). The positive effects of the Bolsa Família programme in reducing the probability that young people will neither study nor work have been confirmed. The programme reinforces the school attendance of young people aged 15–17 years, the

critical age for entering the labour market through the school–work combination. The programme prevents work from taking the place of school, without necessarily replacing work with school, especially in urban areas (Silveira et al., 2013). In rural areas, where high participation of working youths contrasts with low school attendance, there is a significant decrease in the likelihood of young people only working rather than combining education and work.

At the macroeconomic level, social protection can nurture economic growth under certain conditions

Enhancing productivity

The extension of social protection, documented in earlier sections, has gone hand-in-hand with productivity growth and higher per capita income in developing countries (figures 7.20 and 7.21). Economic performance was stronger in countries that devoted a growing amount of resources to social protection (group 5 as defined in the typology presented in this chapter and in Appendix A) than in their country counterparts which offered low social protection (group 1 in the typology).

Of course, the statistical associations presented in figures 7.21 and 7.22 do not necessarily mean that social protection was the cause of the improved economic performance. Causation can go in both ways. Moreover, at similar levels of social protection, there are some significant cross-country differences in economic performance (i.e., the correlation is not always verified).

However, the fact is that the extension of social protection which has been recorded in developing countries has generally not damaged economic performance. And there are reasons why it may have contributed to improved performance.

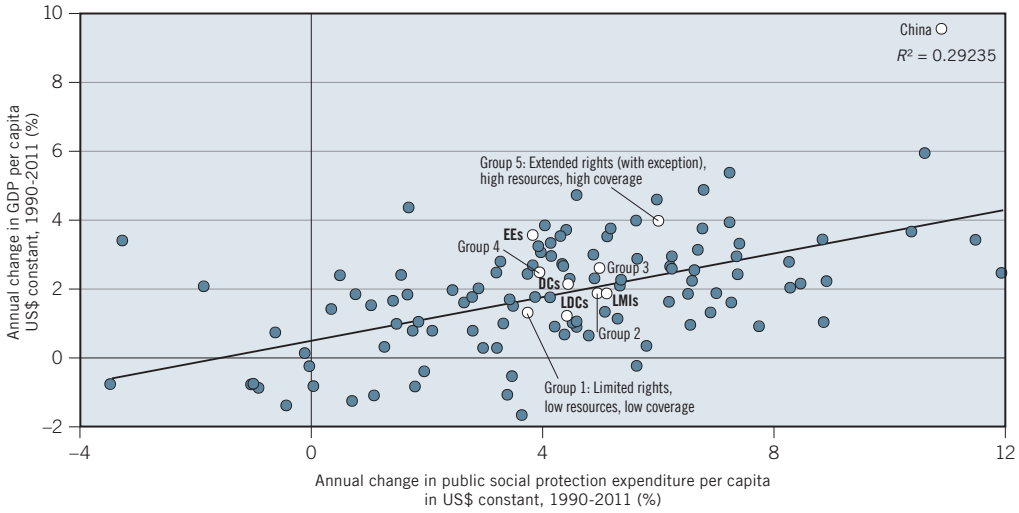
First, an obvious positive economic impact arises when social protection is combined with improved skills, as mentioned above.

Second, and more fundamentally, social protection creates the space for more "productive decisions". Ensuring income security and smoothing household consumption can protect people from poverty and from being forced to resort to harmful coping strategies in order to make ends meet. A basic level of

Figure 7.20 Correlation between changes in spending on social protection and productivity growth, 1991–2011 (%)

Source: ILO Research Department based on ILO 2014b; ILO Key Indicators of the Labor Market (KILM); and World Bank 2014a.

Figure 7.21 Correlation between changes in spending on social protection and per capita economic growth, 1991–2011 (%)



Source: ILO Research Department based on ILO 2014b, World Bank 2014a.

income security is an important precondition for workers' ability to accept economic and entrepreneurial risks, which can facilitate productive investments. The regularity, predictability but also the adequacy of transfers can enable households labouring under credit and liquidity constraints to reallocate their productive resources and, eventually, accumulate and protect their assets. In Bolivia, the consumption of rural beneficiaries of the social pension Bono Dignidad (now Renta Dignidad) rose by twice the amount of the benefit. Similar results were observed in Mexico and in relation to Brazil's rural pension and Namibia's social pension (ILO, 2010c).

Third, there may be a direct productivity impact of public employment programmes. If properly implemented, the creation of durable rural assets, water management and watershed development may boost agricultural productivity. Studies for India tend to confirm the positive direct effects of social protection on agricultural productivity, although these may not necessarily be fully attributable to the MGNREGA (IDYWC, 2010). A recent large empirical study of 40 sample villages with diverse socio-economic and environmental conditions showed that MGNREGA works are generating multiple environmental and socio-economic benefits which have, in turn, led to improved water availability and soil fertility, resulting in increased crop production, increased employment generation and reduced migration (Esteves et al., 2013).

Supporting domestic demand

Social protection can have substantial impacts on household consumption, productive investment and the revival of local markets[33] and the rural economy. The size of the impact depends, among other factors, on the scope and extent of social protection systems as well as specific design features of the programmes, notably the extent to which programmes are linked with employment, labour market participation and training.

This is illustrated by analyses of the demand impacts of Brazil's Bolsa Família and India's MGNREGA. According to some studies, increasing expenditure on Bolsa Família by 1 per cent of GDP would lead to almost 1.8 per cent higher output and 2.4 per cent higher household consumption (Neri et al., 2013b).

In the case of MGNREGA, a study conducted in Karnataka in 2010–11 showed that the multiplier effects of the programme ranged between 3.1 and 3.6, depending on districts (quoted in MoRD 2012). A detailed study in Gujarat found a multiplier of two (i.e., a 1 per cent increase in expenditure on the programme would lead to 2 per cent higher output) (Hirway et al., 2009).

Social protection strengthens the prospects for growth and employment generation and vice versa. A positive economic performance with decent employment generation boosts incomes and broadens the tax basis for financing additional social protection, employment promotion, and infrastructure and human capital development policies.

Boosting sustainable economic growth

It is important to assess the overall macroeconomic effects of social protection beyond the specific impacts of individual programmes on local demand and output. In principle, the macroeconomic effects can go both ways. On the one hand, social protection can contribute to broader domestic sources of economic growth. It can also fulfil a counter-cyclical role, and indeed many developing countries reinforced social protection as a response to the global crisis. On the other hand, social protection should be funded from social contributions or general taxation, which should also be taken into account in any macroeconomic assessment.

To some extent, this is an empirical issue. Table 7.1 shows simple correlations, controlling for country-specific fixed effects.[34] For developing countries as a whole, results show that there is a significant correlation between investing in social protection (taking into account the level of investment) and economic growth in the short term. The finding is that a 1 per cent change in social protection expenditure per capita would lead to a 0.35 per cent change in GDP per capita. When distinguishing between EEs, LMIs and LDCs, results indicate that the elasticity of GDP per capita with respect to social protection expenditure per capita increases when moving up the income ladder (from 0.25 in LDCs to 0.5 in EEs).

33. Indirectly, by sustaining aggregate demand, local markets are stimulated in the short term and intended positive effects on global employment are expected from the effect on aggregate demand (and associated production levels). Spillover effects of social transfers have been reported in small and self-contained local economies. In Namibia and South Africa, many grocery stores were opened in even the smallest villages in response to the increased demand generated by the social pension programme (ILO, 2010c).

34. Results are obtained by regressing the log of GDP per capita on the log of social protection expenditure per capita, allowing interpretation of the estimated coefficient as an elasticity.

Table 7.1 Correlations between social protection expenditure and economic growth, 1990–2012

	Log GDP per capita in constant 2005 US$			
		(only LDCs)	(only LMIs)	(only EEs)
Log social protection expenditure (per capita)	0.353***	0.245***	0.353***	0.477***
	(0.027)	(0.038)	(0.039)	(0.047)
Constant	5.741***	5.482***	5.678***	5.568***
	(0.113)	(0.102)	(0.158)	(0.274)
Observations	887	287	276	324
R^2	0.515	0.374	0.551	0.646
Number of countries	136	45	41	50
R^2 overall	0.820	0.670	0.536	0.424
R^2 (including fixed effects)	0.977	0.9508	0.9313	0.9008

Notes: Standard errors, indicated in parentheses, are cluster robust. *** denotes that the coefficient is statistically significant at less than 1 per cent level.

Source: ILO Research Department estimates based on World Bank, 2014a and ILO, 2014a, 2014b.

These results confirm the role of social protection as an automatic stabilizer in response to crises. Studies show that social protection could contribute to cushioning the effects of the global economic crisis, provided that (i) a solid institutional and implementation capacity was already in place at the time of the crisis; and (ii) the scope of social protection would be broad enough to have a significant impact beyond the group of people directly benefiting from social protection programmes (ILO, 2010a).[35]

Further analysis has been carried out in order to examine the role of social protection as an "automatic stabilizer" (table 7.2). The analysis accounts for the ups and downs of the world economy (which are captured by the period fixed effects in table 7.2). The estimates indicate whether a country that enhanced social protection during a five-year period would grow faster over the following five-year period. According to the estimates, this is the case in EEs (see the first row of table 7.2). By contrast, in LDCs and LMIs, where the scope of social protection is limited, the coefficient is statistically insignificant – suggesting no detectable impact of social protection on economic growth. Still, as illustrated through many examples from LDCs and LMIs in the previous section, despite the empirical finding that there is no positive growth effect for these groups, some countries that started to implement elements of social protection systems experienced positive and tangible effects on the beneficiaries of their social protection programmes in terms of poverty reduction or income maintenance.

More generally, the quality of social protection institutions and implementation mechanisms matters. This is illustrated in table 7.3, which shows how the size of the impact of social protection on economic growth depends on (i) the quality of government institutional capacity and (ii) political stability and the absence of major violent events. The table contains information on the estimated differential impact of social protection on economic growth for countries that perform well with respect to these two factors relative to all other countries. In both EEs and

35. Sections A and B of this chapter show that social protection systems tend to be more comprehensive (in terms of coverage and related levels of spending) in EEs and LMIs compared with LDCs. In addition, the increase of the multiplier effect from less to more developed countries is also the result of more effective channels for impact propagation.

Table 7.2 Estimates of the impact of social protection on economic growth, 1995–2012

	Average GDP per capita growth (p)			
		(only LDCs)	(only LMIs)	(only EEs)
Average social protection expenditure per capita growth (p-1)	0.021 (0.022)	0.007 (0.030)	–0.002 (0.047)	0.080*** (0.027)
Average GDP per capita growth (p-1)	0.319*** (0.084)	0.250* (0.135)	0.461*** (0.091)	0.286*** (0.099)
Period fixed effects	Yes	Yes	Yes	Yes
Constant	Yes	Yes	Yes	Yes
Observations	328	111	106	111
R^2	0.130	0.225	0.191	0.143
Number of countries	116	39	37	40

Notes: Standard errors, indicated in parentheses, are cluster robust. The impact of social protection expenditure per capita growth on economic growth is based on an estimation of the following equation: $y_{i,p} = \beta_0 + \beta_1 y_{i,p-1} + \beta_2 sp_{i,p-1} + \varepsilon_p + \varepsilon_{i,p}$, where subscript i denotes countries and p refers to the time period. The regression is run on averages of social protection expenditure per capita growth and GDP per capita growth (both in constant US$ terms) for four periods (p): 1995–2000, 2000–05, 2005–10 and 2010–12. In the regression, a time lag is introduced, so that average economic growth in the current period ($y_{i,p}$) is related to average social protection expenditure growth ($sp_{i,p-1}$) in the preceding period. In addition, the regression controls for past growth performance ($y_{i,p-1}$) and period fixed effects (ε_p). *** denotes that the coefficient is statistically significant at less than 1 per cent level, ** at less than 5 per cent level and * at less than 10 per cent level.

Source: ILO Research Department estimates based on IMF, 2013a; ILO, 2014a, 2014b.

Table 7.3 Estimates of the impact of social protection expenditure on economic growth in countries with high-quality institutions, 1995–2012

Indicators for institutional quality	Differential impact for top 50% of countries with respect to institutional quality			Differential impact for top 25% of countries with respect to institutional quality			Differential impact for top 10% of countries with respect to institutional quality		
	LDCs	LMIs	EEs	LDCs	LMIs	EEs	LDCs	LMIs	EEs
Government effectiveness		++	++			+			
Political stability and absence of violence					++			+++	+++

Notes: +, ++, +++ (–,––,–––) indicate a positive (negative) estimate of β_2, significant at less than the 10, 5 and 1 per cent level, respectively, where β_2 is defined in the equation specified below. +, ++ and +++ (–, –– and –––) hence indicate whether the impact of social protection expenditure growth is relatively more positive (negative) in countries with high institutional quality compared with other countries. An empty cell indicates lack of significance.

Estimates of impacts are based on the following equation:

$y_{i,p} = \beta_0 + \beta_1 y_{i,p-1} + \beta_2 (sp\_gdp_{i,p-1} \times g_{i,p-1}) + \beta_2 sp\_gdp_{i,p-1} + \beta_2 g_{i,p-1} + \varepsilon_p + \varepsilon_{i,p}$ where the average annual percentage point change in social expenditure as share of GDP in period p (where periods are defined as in the notes of table 7.2) is used as independent variable. This equation introduces an interaction effect with a dummy variable ($g_{i,p-1}$) that indicates whether a country is in the top 50 (25, 10) per cent of countries in terms of government effectiveness, or political stability and absence of violence, respectively. This variable is constructed on the basis of indices for government effectiveness and political stability from the World Bank, 2014c. It is included separately, as well as in interaction with the social protection expenditure variable. The coefficient estimate β_2 indicates whether the impact of social protection expenditure growth on economic growth in countries with a high quality of institutions is significantly larger than in other countries. Such a result would then indicate that high institutional quality helps to enhance the impact of social protection on economic growth.

Source: ILO Research Department estimates, based on IMF, 2013a; ILO, 2014a, 2014b; World Bank, 2014c.

LMIs, both factors are important. The positive impact of social protection expenditure growth on economic growth, which was identified for EEs as a whole, seems to be driven by countries with good governance. These results suggest that social protection systems or substantial elements of these systems can potentially have a positive impact in countries of any income group, provided the country follows principles of good governance translated into well-functioning institutions to support the process of development.

D. Concluding remarks

As documented in the chapter, developing countries have made progress in building up their social protection systems. Over the past 20 years, while per capita income more than tripled in developing countries, per capita social protection expenditure increased by a factor of five. Social protection spending remained, however, relatively low, at 6.2 per cent of GDP in 2010–12 and it is estimated that currently less than 20 per cent of the working age population and their families in developing countries have effective access to comprehensive social protection systems. Nearly all of them live in emerging economies. However, interesting initiatives have also been recorded in lower income developing countries. Indeed, most countries in Eastern and Southern Africa and Asia have limited social insurance traditions, and yet they have extended coverage mainly through non-contributory programmes, such as in Ethiopia, India, Namibia, Rwanda, South Africa and Thailand).

Non-contributory programmes, as part of integrated social protection systems, play an essential role in countries where informality and poverty prevail. However, the benefits provided are usually lower than those provided by contributory schemes. Thus, as economies develop, it is important to move to a balanced mix of contributory and non-contributory benefits, with a significant share of people covered by schemes financed through employer and worker contributions. The development of such successful "mixes" is based on gradual inclusion within contributory schemes, in particular social insurance. It is also facilitated by inter-ministerial coordination. Latin America, Eastern European and CIS countries extended coverage through this mix of contributory and non-contributory schemes.

The chapter shows that, if well designed and supported by adequate implementation mechanisms, social protection can help to meet poverty reduction targets while also supporting the economic development process as described in Chapter 5. In this regard, it is especially important to conceive social protection in conjunction with policies that promote a supportive environment for decent work and enterprise creation and expansion. This highlights the importance of complementarity between social protection and labour market institutions (highlighted in Chapter 6) as well as job creation measures. Uruguay's "single tax" social protection scheme for the self-employed, which facilitates formal entrepreneurship, is an interesting case in point. Strengthening the link between labour market measures and social protection through providing additional incentives for benefits recipients, including jobseekers, to receive training and undertake work can be important too. In Brazil, vocational training programmes are now offered to beneficiaries of income transfer programmes.

The chapter devotes attention to the funding of social protection. This is a key issue, especially in developing countries where the incidence of informal employment is high, thus limiting the ability to fund broad-based social protection through social contributions. This too is an area where progress has been made, notably through proper design and recourse to general taxation as well as government revenues from natural resources. In Bolivia, a universal non-contributory pension has been launched with funding from general taxation and revenues from oil and gas exports. Similarly, Timor-Leste recently extended social protection with funding from taxes paid by foreign extraction companies.

The extension of social protection, together with measures to facilitate transitions to formal employment, can be particularly effective in broadening the tax base, thereby making room for incentives to productive investment and economic growth, which, in turn, facilitates further extension of social protection and improved decent work opportunities. This is why it is crucial to include social protection, as one of the pillars of the Decent Work Agenda, in the post-2015 development agenda.

Appendix A

A typology of countries' social protection strategies

This typology categorizes countries according to different stages of development of their social protection system. It allows groups of countries that are homogeneous regarding the state of their social protection systems to be compared on the basis of other important dimensions – poverty, employment and productivity.

The typology of countries is built on three sets of indicators reflecting:

(i) countries' commitment for social protection as a right: measured through the observed stage of development of the legal foundations of the national social protection system and, to some extent, by comparison with some of the minimum values indicated in Convention No. 102 or with the ultimate goals of income security in line with the recent Recommendation No. 202;

(ii) resources or investment in social protection to give effect to countries' commitment; and

(iii) the effective implementation of these rights (in terms of coverage and level of benefit provided) through an efficient and effective use of resources.

The **degree of statutory commitment to social protection** can be examined through three indicators:

(a) the range of social policy areas (contingencies) covered under the existing social security system – if a country covers more than five policy areas, it is considered to have a relatively strong statutory commitment;

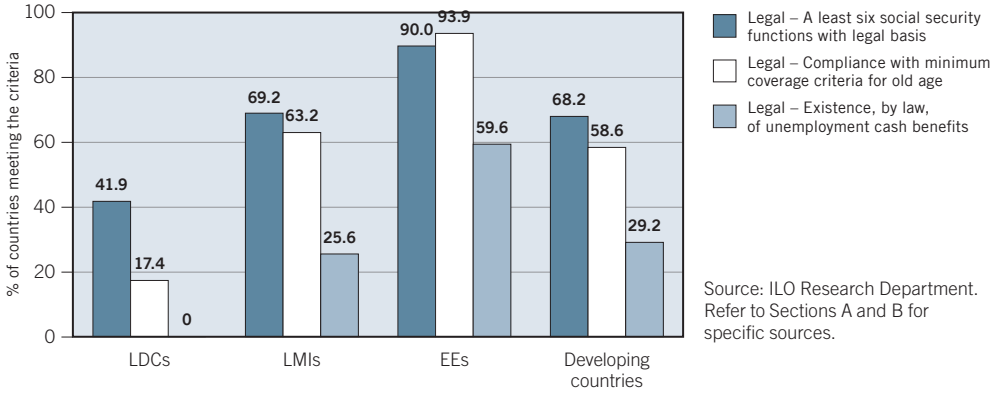
(b) the extent of legal coverage[36] for old age, disability and survivors' benefits in comparison to the minimum level of coverage as indicated in Convention No. 102 ("the persons protected shall comprise ... prescribed classes of economically active population, constituting not less than 20 per cent of all residents");

(c) the existence of periodic unemployment benefit.

A comparative overview based on this assessment framework is provided in figure 7.A1. Around 42 per cent of the LDCs have at least six of the eight selected policy areas covered by law, and the ratio is much higher in LMIs (70 per cent) and EEs (90 per cent). The incidence of meeting the minimum standards regarding social security coverage for older persons is rather low, at 17 per cent, in LDCs but high, at 94 per cent, in EEs. As indicated earlier, unemployment benefits are non-existent in LDCs, exist in a limited number of countries in LMIs (25 per cent) and are more common in EEs (60 per cent).

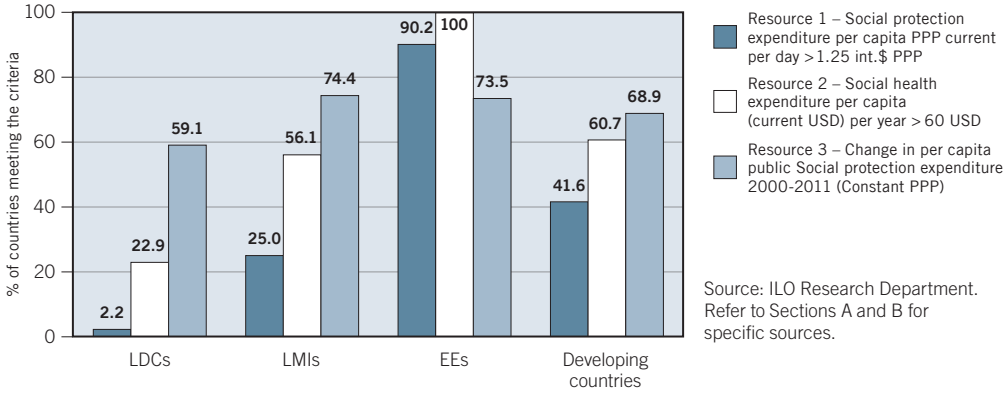
36. Estimates of the extent of legal coverage use both information on the groups covered by statutory schemes for a given social policy area in national legislation, and available statistical information quantifying the number of persons concerned at the national level.

Figure 7.A1 Level of statutory commitment according to the level of income groups, latest available year



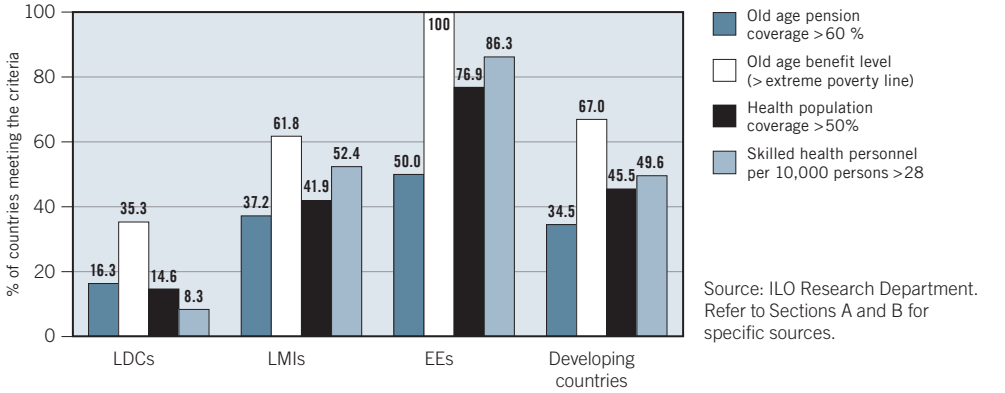
Source: ILO Research Department. Refer to Sections A and B for specific sources.

Figure 7.A2 Resources invested to give effect to countries' commitment by level of income groups, latest available year



Source: ILO Research Department. Refer to Sections A and B for specific sources.

Figure 7.A3 Results (effective implementation): Criteria met by level of income groups



Source: ILO Research Department. Refer to Sections A and B for specific sources.

Another important aspect is the scale of **resources invested in social protection** to give effect to countries' statutory commitments. Three measurements can be considered for the sake of analysis:

(a) Public social security expenditure (including health care) which is expressed in current international dollars PPP on a per capita and per day basis allowing for a comparison with the international poverty line of 1.25 international dollars PPP per day. Data available for 137 countries use various multinational databases, such as the IMF's *Government Finance Statistics* (GFS) (IMF, 2013b), ILO *Social Security Inquiry* (ILO, 2014b), UN ECLAC's public expenditure database and ADB's regional statistical tables;

(b) Annual health expenditure not financed by out-of-pocket[37] per capita (per year) expenditure compared to the minimum level of health expenditure recommended by WHO;[38]

(c) Growth in public social protection expenditure per capita between 2000 and 2011 expressed in constant prices 2005, with a threshold of 50 per cent (i.e., "good performer" if the growth rate exceeds the proposed threshold). The results are shown in figure 7.A2 with a similar pattern to the case of statutory commitment.

The **effectiveness of implementation** is measured through two dimensions: health-care and old-age pension, which are the two largest social security policy areas in terms of resources invested in social protection. For each, an indicator of the extent of effective coverage is complemented by an indicator examining the quality of coverage (level).

In the case of old age, the selected indicators are:

(a) the effective coverage for older people, measured as the proportion of the population above statutory pensionable age receiving an old-age pension (contributory or non-contributory). This criterion is met if the coverage is equal to 60 per cent or more;[39]

(b) a combination of two indicators to assess the quality of coverage: the amount of social security expenditure spent on benefits for older persons per capita and per day compared to the 1.25 international dollars PPP per day and the proportion of the population aged 65 and over not in the labour force.
This criterion is met if expenditure per capita and per day is superior to 1.25 international dollars PPP or, otherwise, if the labour force participation rate of the population aged 65 and over is below 30 per cent.

Coverage and quality of social health protection are measured through:

(a) the effective coverage as a proportion of total population compared to the minimum value indicated in Convention No. 102, Art. 9 ("The persons protected shall comprise: ... (c) prescribed classes of residents, constituting not less than 50 per cent of all residents)"; and

(b) a proxy indicator of health professional staff density, measured as the relative difference between specific country staff density levels and the benchmark of 23 physicians, nurses and midwives per 10,000 population recommended by WHO.[40] The results (figures 7.A1, 7.A2 and 7.A3) show substantive progression along with income growth.

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37. Equivalent to the expenditure per capita on health-care expenditure financed either from general government revenues or from pre-paid private insurance by employers or NGOs).
38. The High Level Taskforce on Innovative International Financing for Health Systems suggested in 2009 that, in order to ensure coverage with a relatively limited set of key health services, low-income countries would need to be spending an average of $60 per capita each year on health by 2015.
39. In order to take into account the significant increase in the proportion of older persons covered, a limited number of countries comply with a second criterion based on this expansion (a proportion of old-age pensioners multiplied by five over the past ten years).
40. WHO estimated that countries with fewer than 23 physicians, nurses and midwives per 10,000 population generally fail to achieve adequate coverage rates for selected primary health-care interventions as prioritized by the Millennium Development Goals framework (WHO, 2006; WHO, 2012). Countries with densities lower than this are defined as having a critical shortage of health workers.

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Does income distribution matter for development?

8

Trends in labour share of income and their economic impacts in developing countries

Introduction

The relationship between income distribution and growth has frequently given rise to heated debates. According to conventional wisdom, changes in income distribution generally do not require policy action. In some instances, policy interventions aimed at tackling changes in income distribution are seen as creating "distortions", which result in losses in economic efficiency. In particular, the common version of the so-called "Kuznets curve"[1] tends to be understood to imply that growing inequality is inevitable at early stages of economic development. This would be followed by decreasing inequality at later stages of development. In this context, changes in income inequality are caused by economic growth, with few or no feedback effects from inequality to growth and development.

However, this view has been questioned by a growing body of empirical studies (e.g., Ostry et al., 2014). Some studies show that inequality is not an unavoidable feature of economic growth, irrespective of income levels. Other studies go further to suggest that reducing inequality may support economic growth (Lavoie and Stockhammer, 2013). This evidence suggest that developing countries should pay attention to income distribution and consider adopting effective policy measures that combine equity and growth.

Income distribution has many different dimensions in which various factors are at play. So far, the policy debate has tended to focus on personal income distribution (i.e., how total income is distributed among individuals in a given country). Another important dimension of inequality is functional income distribution (i.e., the way in which total income is distributed between the two main

1. The Kuznets curve refers to an empirically observed relationship between inequality and economic development in which inequality increases at the early stage of development and then begins to decrease at a certain level of income. It originated from Nobel laureate economist, Simon Kuznets (1955).

productive factors, namely capital and labour).[2] The proportion of total income which goes to labour is termed the labour share of income and the proportion that accrues to capital is called the capital share. In the case of advanced economies, a secular declining trend of labour share has been observed (ILO, 2013). However, the trends in labour share of income in the developing world and their economic implications are not well understood.

This chapter tries to fill in this important knowledge gap by looking at the labour share of income in developing countries. This is not an easy task. Indeed, the scarcity of data makes even the discussion of simple trends across countries difficult. In addition, the wider prevalence of self-employment in developing countries, particularly subsistence and informal self-employment, blurs the line between labour income and capital income. This chapter attempts to address these statistical and analytical difficulties and examines two critical issues.

First, the chapter analyses the trends in functional income distribution over the past two decades across a large number of medium- and low-income countries. Additionally, self-employment income is taken into account using national accounts data from both groups.

Second, the chapter assesses the economic impacts of observed trends in income distribution. In high-income countries, three macroeconomic effects are usually considered: a consumption effect, an investment effect and a competitiveness effect (ILO, 2013). This chapter examines whether these impacts are also present in developing countries.

The chapter is organized as follows. It first reviews the current understanding of income distribution and shows that inequality matters more than has been assumed in recent economic thought (Section A). It also highlights the importance of labour share of income in determining personal income distribution. The chapter then describes the (unadjusted) labour share of income across different levels of economic development and geographical areas (Section B). Given the large incidence of self-employment that typically prevails in developing countries, the chapter also discusses how to adjust the labour income by incorporating the income of the self-employed (Section C). This paves the way for an analysis of the macroeconomic effects of changing income distribution based on an estimated macroeconometric model (Section D). Finally, policy implications are discussed (Section E).

2. For instance, the *Economist* recently observed that "labour is losing out to capital" ("Labour pains", 2 Nov. 2013). Available at: http://www.economist.com/news/finance-and-economics/21588900-all-around-world-labour-losing-out-capital-labour-pains [30 Apr. 2014].

A. Why is it important to look at trends in the share of labour in total income?

An inverted U-shaped relationship between income inequality and income levels has been widely accepted following Kuznets, 1955. According to this stylized fact, inequality would widen as developing countries achieved higher levels of income until a certain threshold is reached. Beyond that threshold, inequality would shrink as income levels continued to grow.[3] This relationship, which is known as the Kuznets curve, has been taken to suggest a cautious approach to policy intervention. Indeed, any direct policy attempts to deviate from the Kuznets curve would come with a cost in terms of lost economic output. Instead, it has been argued that policies should focus on reducing inequality of opportunities rather than directly tackling income inequalities.

A similar "non-interventionist" view has also dominated economic thinking over functional income distribution. Standard macroeconomic models have long assumed that the distribution of income between capital and labour was constant. Therefore, it was assumed that wages would increase in line with labour productivity (ILO, 2013). In this view, policy interventions in favour of either capital or labour would either be ineffective or would entail economic losses.

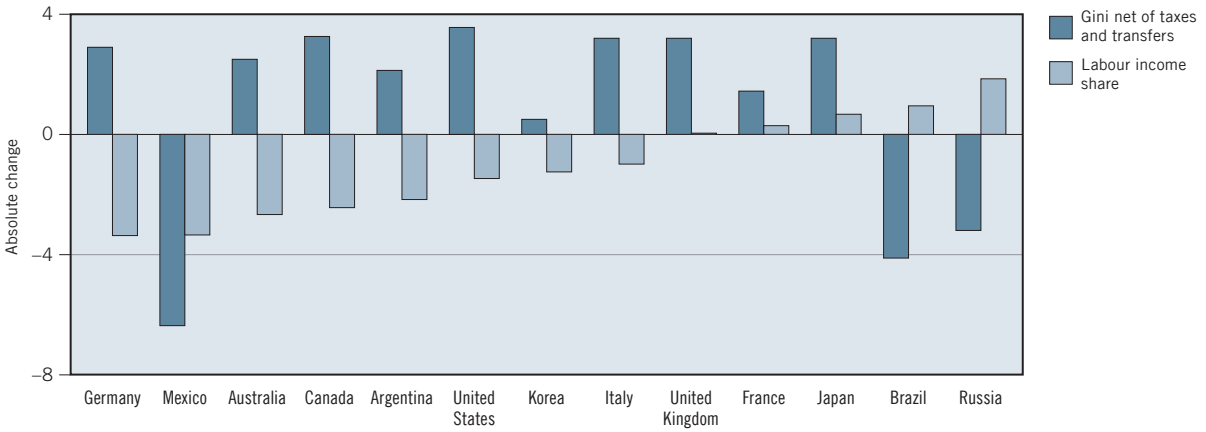
These two views, especially when combined, have discouraged policy-makers from taking active policy action to influence income distribution. However, recent empirical evidence challenges both views and thus questions the conventional wisdom advocating policy neutrality. First, the relationship between personal income distribution and growth is not clear-cut as depicted in the Kuznets curve (e.g., ILO, 2008; Banerjee and Duflo, 2003; Barro, 2008; Berg, forthcoming). More recent empirical evidence has turned the relationship upside down. For instance, an IMF study (Ostry et al., 2014) concluded that "lower net inequality seems to drive faster and more durable growth" and "redistribution appears generally benign in its impact on growth" (pp. 6–7). This means that causality may actually run in the opposite direction to conventional wisdom: inequality can damage economic growth.

At the same time, it has long been known that the assumption of stable labour shares of income lack empirical support. Indeed, a commonly observed trend in high-income countries is a persistent, secular decline in the labour share of income (EC, 2007; IMF, 2007; OECD, 2012; ILO, 2010, 2013). There is currently intense debate over the underlying causes of this trend, which include demographic and technological changes, globalization and financialization, as well as changes in labour market institutions. In the meantime, recent studies have examined the extent to which the downward changes in the labour share of income have negative impacts on different components of aggregate demand (consumption, investment and net exports) and, therefore, on economic growth (ILO, 2013; Lavoie and Stockhammer, 2013). These disaggregated studies show that there are instances where widening inequality in the distribution of income between capital and labour can hurt economic growth.

It is also important to examine the links between changes in the labour share of income and changes in income distribution among households. In theory, the relationship between the two is not clear-cut, for various reasons (UNCTAD, 2012). First, while labour income accrues to individual workers, capital income

3. However, this common interpretation is at odds with Kuznets' original arguments, which put more emphasis on political and institutional changes in reducing inequality. See Lee and Gerecke, 2013.

Figure 8.1 Changes in labour share of incomes and in personal income distribution (Gini index) in selected countries over recent periods



Note: This figure shows the changes in the Gini index of the distribution of income after taxes and transfers, and in the labour share of income (unadjusted for self-employment income). The time period over which the changes are computed depends on data availability. Changes in Gini are computed using five years as an average for the following countries: Argentina: 1993–1997, 2003–2007; Brazil: 1995–1999, 2005–2009; Canada: 1986–1990, 2006–2010; France: 1996–2000, 2006–2010; Germany: 1996–2000, 2006–2010; United States: 1984–1988, 2004–2008. For certain countries with missing data points, the change is computed using two points: Australia: 1995, 2010; Italy: 1994, 2010; Japan: 2005, 2009; Republic of Korea: 2006, 2011; Mexico: 1992, 2010; Russian Federation: 2008, 2010; United Kingdom: 1995, 2010.

Source: Authors' own calculation based on data from the United Nations Statistics Division.

(i.e., the difference between total income and labour income) is not evenly distributed among individuals and households. In addition, household income consists of both wages and non-wage incomes, with the latter including capital income and "mixed income" (such as revenues from self-employment). Finally, household incomes include both earnings realized through market activities (paid employment, self-employment income, interest income and dividends, etc.) and incomes resulting from social transfers, minus taxes paid.

However, recent studies find a close relationship between changes in the labour share of income and changes in income distribution among households (see Jacobson and Occhino 2012, Schlenker and Schmid 2013). For instance, Picketty (2014) shows that profits and incomes from savings and financial investments tend to accrue to high-income households. As a result, a fall in the labour share of income would be associated with a widening of income inequality among households. This is illustrated in figure 8.1, which shows that a decline in the labour share of income tends to be associated with increase in the Gini index of income inequality among households. And, conversely, higher labour share of incomes tend to be associated with lower levels of income inequality among households. This pattern is widely observed in both developed and developing countries for which data exist.

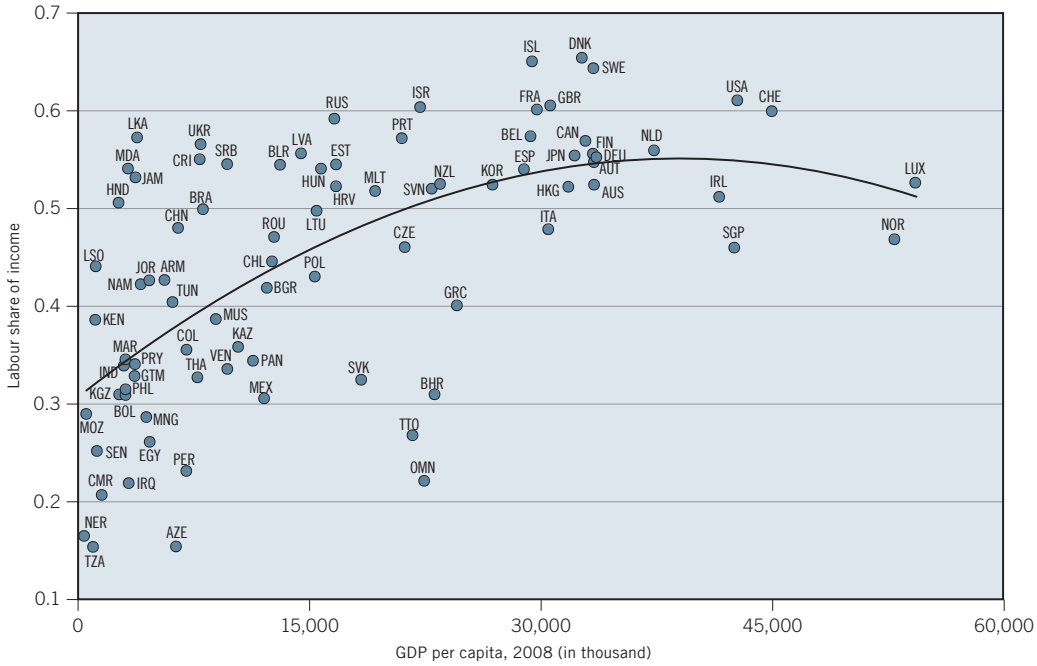
B. Trends in the labour share of income in developing countries

The share of compensation of employees in total income tends to grow with economic development

It is helpful to begin our analysis with the compensation of employees as a percentage of total income, which is often referred to as "unadjusted" labour share of income, as it does not reflect the incomes of the self-employed (see Section C and box 8.2).[4] Figure 8.2 shows how the unadjusted labour share of income varies across countries. It tends to be higher at higher levels of per capita income, and tends to fall slightly beyond a certain threshold (around US$40,000 or above). It is, on average, 26 per cent in LDCs, 37 per cent in LMIs, 42 per cent in EEs and 48 per cent in high-income countries (see Gollin, 2002 for a similar analysis).

The positive cross-country correlation between the unadjusted labour share of income and per capita income levels reflects two main factors. First, composition effects play a critical role. It is widely known that, with income growth, the incidence of wage and salaried employment tends to increase (see Chapter 3 in this report). For the countries considered in Figure 8.2, the incidence of wage and salaried employment accounts for 10 per cent in LDCs, compared with 50 per cent in LMIs, 67 per cent in EEs and 85 per cent in advanced economies.[5] The increase in the incidence of wage and salaried employment and the associated decline in the

Figure 8.2 The unadjusted labour share of income and GDP per capita in 2008



Note: The labour share of income is measured as the ratio of compensation of employees to GDP at factor cost in 2008. GDP at factor cost is measured as GDP at market prices, minus the difference between taxes, less subsidies for production and imports.

Source: Authors' own calculation based on data from the United Nations Statistics Division; China: National Bureau of Statistics; *Penn World Tables*.

4. This is measured as (employees' total compensation)/(GDP - taxes less subsidies for production and imports), using national account data.

5. These estimates are based on the *limited* sample of countries for which labour share of income data are available. See Chapter I.2 for a description of patterns in self-employment in developing countries.

number of self-employed are also related to the readjustment in sector shares away from agriculture and towards manufacturing. Although agriculture accounted for 23 per cent of GDP in LDCs in 2008, this share drops to 15 per cent in LMIs and 8 per cent in EEs.[6]

The second factor concerns wage levels. The literature on structural transformation (e.g., the so-called Lewisian turning point) implies that the increasing share of employees, combined with urbanization/industrialization and the resulting tightening of the labour market, tends to create upward pressure on wages (Chapter 5). On average, wages are 13 times higher in advanced economies than in LMIs, and 5.6 times higher than in EEs. Salaried work often goes hand in hand with a stabilization of the employment relationship, the implementation of labour regulation and wider scope for collective bargaining (Hayter, 2011).

EEs and LMIs countries have gone up the income ladder in the past decade …

The catch-up process has tended to accelerate in recent years, with developing countries growing at a faster rate than advanced economies (Chapter 2). LDCs have been growing at the fastest pace. LMIs and EEs have followed similar paths, although EEs grew slightly faster than LMIs. In 2008, the average per capita income in the richest 10 per cent of countries was 90 times higher than in the poorest 10 per cent of countries, compared to 99 times higher in 2000. Since the crisis, the catching-up process seems to have accelerated, largely reflecting the weak economic performance of advanced economies (see Figure 8.A1 in Appendix).

… and yet, the incidence of compensation of employees in total income has not increased in line with the income per capita growth

One issue regarding functional income distribution in developing countries is whether fast growth of per capita income over the past decade has translated into an increase in the unadjusted labour share of income – as suggested by figure 8.2. There are grounds for expecting such a pattern. With economic development comes a transformation of the productive structure of the economy, from agriculture to manufacturing (Chapter 5). When this sectoral shift generates a similar change in employment from self-employment to salaried work, it can be expected that the share of compensation of employees in total income will increase.

However available data suggest that this expected pattern has not occurred in the majority of cases. During the period 2000–2008, out of the 43 developing countries for which information exists, 35 countries experienced positive growth in their per capita income. Of those 35 only 15 countries witnessed an increase in the share of compensation of employees. With the exception of Latvia, the Republic of Moldova, Mozambique and the Russian Federation, per capita income growth has not translated into a higher share of compensation of employees.[7] It is also important to note that even in the minority of countries that witnessed an increasing trend in the unadjusted labour share of income, the growth rate is relatively slow compared to that of per capita income.

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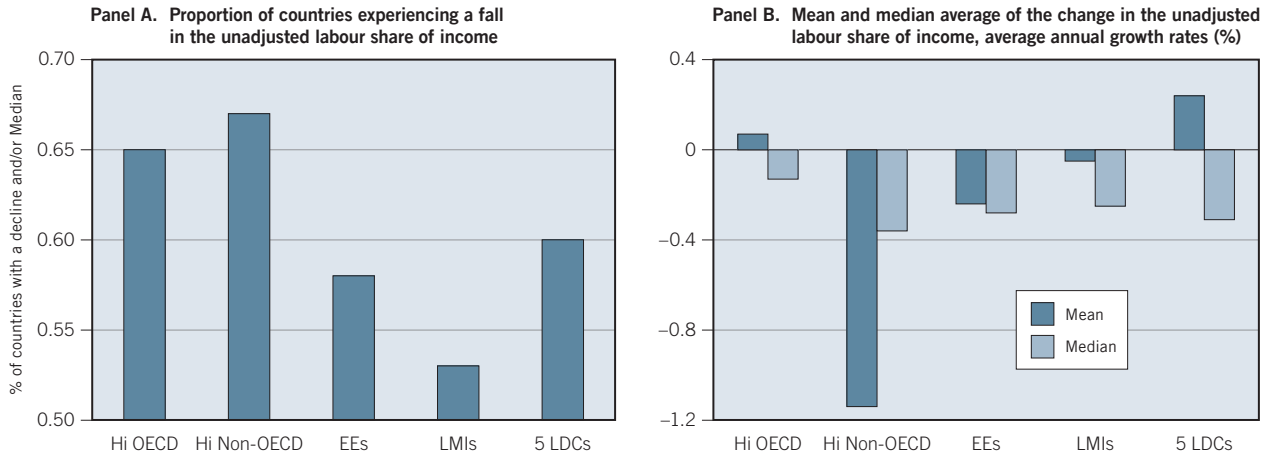
6. Value added by sector as a percentage of GDP (nominal values at constant 2005 US$). Source: World Bank.

7. Interestingly, many of those countries with a positive correlation between the labour share of income and GDP per capita are found in the former Eastern European economies.

Figure 8.3 Changes in the unadjusted labour share of income by income group, 2000–08



Note: For definition of the labour share of income, see Figure 8.2. HI = high-income countries.

Country groups: EEs: Azerbaijan, Belarus, Brazil, Bulgaria, Chile, China, Colombia, Costa Rica, Cuba, Jamaica, Jordan, Kazakhstan, Latvia, Lithuania, Mauritius, Mexico, Namibia, Panama, Peru, Romania, Russian Federation, Serbia, South Africa, Thailand, Tunisia and Bolivarian Republic of Venezuela; LMIs: Armenia, Plurinational State of Bolivia, Cameroon, Egypt, Honduras, India, Kenya, Kyrgyzstan, Mongolia, Morocco, Paraguay, Philippines, Republic of Moldova, Sri Lanka and Ukraine; LDCs: Lesotho, Mozambique, Niger, Senegal, Tanzania – Mainland; HI OECD: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Republic of Korea, Luxembourg, Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, United Kingdom and United States; HI non-OECD: Bahrain, Croatia, Czech Republic*, Estonia*, Hong Kong (China), Hungary*, Israel, Kuwait, Liechtenstein, Malta, Oman, Poland*, Portugal*, Qatar, Singapore, Slovakia*, Slovenia* and Trinidad and Tobago. *OECD countries included in non-OECD category because they present a shorter time series than most OECD countries.

Source: Authors' own calculation based on data from the United Nations Statistics Division; China: National Bureau of Statistics; *Penn World Tables*, OECD.

The proportion of countries experiencing a fall in the unadjusted labour share of income over the period 2000–2008 is 58 per cent in EEs, 53 per cent in LMIs, and 60 per cent in LDCs (Figure 8.3, panel A). Over the same period, the unadjusted labour share of income fell in over two-thirds of high-income countries.

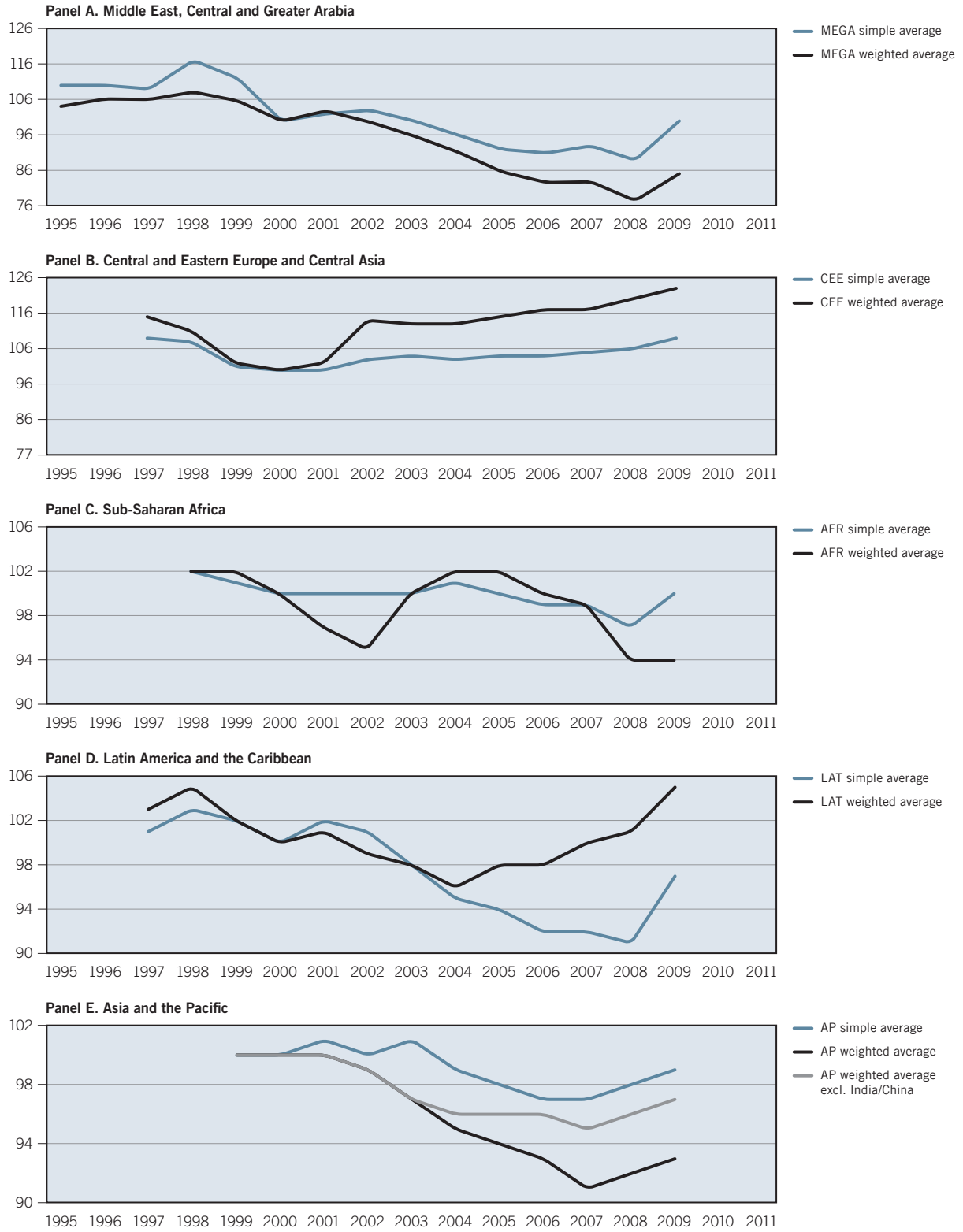
The size of the decline in the unadjusted labour share of income is also significant, especially in high-income countries (Figure 8.3, panel B). The only exception is LDCs, where the mean unadjusted labour share of income increased by 0.24 per cent. The positive outcome in the case of LDCs is related to a highly skewed distribution of changes within the group. Indeed, when the median is considered, the change in the unadjusted labour share of income becomes negative (see Appendix B for further details).

In all but one region, the unadjusted labour share of income has declined

Trends at the regional level show a similar picture. The unadjusted labour share of income has declined in all regions, with the exception of the Central and Eastern Europe and Central Asia region. Among the countries with available information, during the period 2000–08, the unadjusted labour share of income declined in 100 per cent of Middle East countries, in 75 per cent of African countries (including three North African countries, namely Egypt, Morocco and Tunisia), in 77 per cent of the Asian and Pacific countries and in 75 per cent of Latin American countries.

The regional dynamics of the unadjusted labour share of income are presented in figure 8.4. As noted, the Central and Eastern Europe and Central Asia region is the only region with an unambiguous increase in the unadjusted labour share of income. Following a decline in the late 1990s, the unadjusted labour share

Figure 8.4 The unadjusted labour share of income, by region (weighted average; share in 2000 equals 100)



Note: Compensation of employees is defined as in figure 8.2, using 2000 as the base year. The country groups are defined as follows: **Sub-Saharan Africa:** 1997–2010: Cameroon, Kenya, Lesotho, Mauritius, Mozambique, Niger, Senegal and South Africa; **Asia and the Pacific:** 1998–2009: Australia, China, Hong Kong (China), India, Japan, Republic of Korea, New Zealand Singapore, Sri Lanka and Thailand; **Central and Eastern Europe and Central Asia:** 1997–2009: Armenia, Azerbaijan, Belarus, Czech Republic, Estonia, Kazakhstan, Kyrgyzstan, Lithuania, Republic of Moldova, Poland, Russian Federation, Serbia, Slovakia, Slovenia and Ukraine; **Latin America and the Caribbean:** 1997–2009: Bolivia, Brazil, Chile, Colombia, Costa Rica, Cuba, Mexico, Panama, Paraguay, Peru, Trinidad and Tobago and Venezuela; **Middle East and Greater Arabia:** 1995–2009: Bahrain, Israel, Jordan, Kuwait, Oman and Qatar; Northern Africa: 1998–2009: Egypt and Morocco.

Source: Authors' own calculation based on data from the United Nations Statistics Division; China: National Bureau of Statistics.

Box 8.1 Labour share of income in Europe and North America

The unadjusted labour share of income in Europe and North America has followed a long-term downwards trend, though with a short-lived "bouncing back" period during the Great Recession (see figures A.4 and A.5 in Appendix A). In Europe, the unadjusted labour share of income reached its historically highest point around 1980 and declined thereafter. Since 1995, it has remained below its 1970 level. In North America, the unadjusted labour share of income has seen a steady decline with some cyclical variations. Overall, it fell from 64 per cent in 1970 to 59 per cent in 2008.

The causes of this declining trend have been extensively discussed (e.g., EC, 2007; IMF, 2007; ILO, 2008), 2010; OECD, 2012). Many studies point to the role of technological change, but most recent studies highlight the importance of institutional and policy factors (ILO, 2013; Stockhammer, 2013; Charpe, 2011). Such studies include both labour and social protection institutions and policy factors which promote financialization and globalization, all of which contribute to changes in bargaining power over the distribution of market incomes.

increased by 9 percentage point from the lowest level of 2000.[8] By contrast, the Middle East region exhibits the largest decline. While the unadjusted labour share was already falling in the late 1990s, it declined by a further 11 percentage points between 2000 and 2008. The weighted average depicts a more pronounced decline as the labour share of income drops by 22 percentage point over the same period of time. This rather extraordinary development deserves more careful analysis, although the result may be related to wage compression among migrant workers, who account for a large share of the labour force in these countries.

In Latin America, the trends in the unadjusted labour share of income are sensitive to the choice between simple versus weighted averages. The simple average shows a decline from 101 in 1997 to 91 in 2008, while the weighted average shows a growth from 96 in 2004 to 105 in 2009. This trend is mainly explained by the trajectory of Brazil, where the unadjusted labour share increased continuously from 46 to 51 per cent between 2003 and 2009.

The simple average of the unadjusted labour share of income in Asia and the Pacific declined by a few percentage points up to the Great Recession but recovered back to 100 its level in 2000. Yet the picture changes completely when the weighted average is considered. An increasing proportion of the regional GDP is taken by China and India, which witnessed a significant decline in the unadjusted labour income between 2000 and 2008, of almost 4 percentage points in China and roughly 7 percentage points in India. At the same time, their contributions to the regional GDP grew from 15 to 36 per cent in China and from 6 to 9 per cent in India. When China and India are excluded, the regional average of changes in the unadjusted labour share of income becomes smaller, dropping by 3 percentage points.

Both the employment structure and wage developments are associated with the declining trends in the unadjusted labour share of income

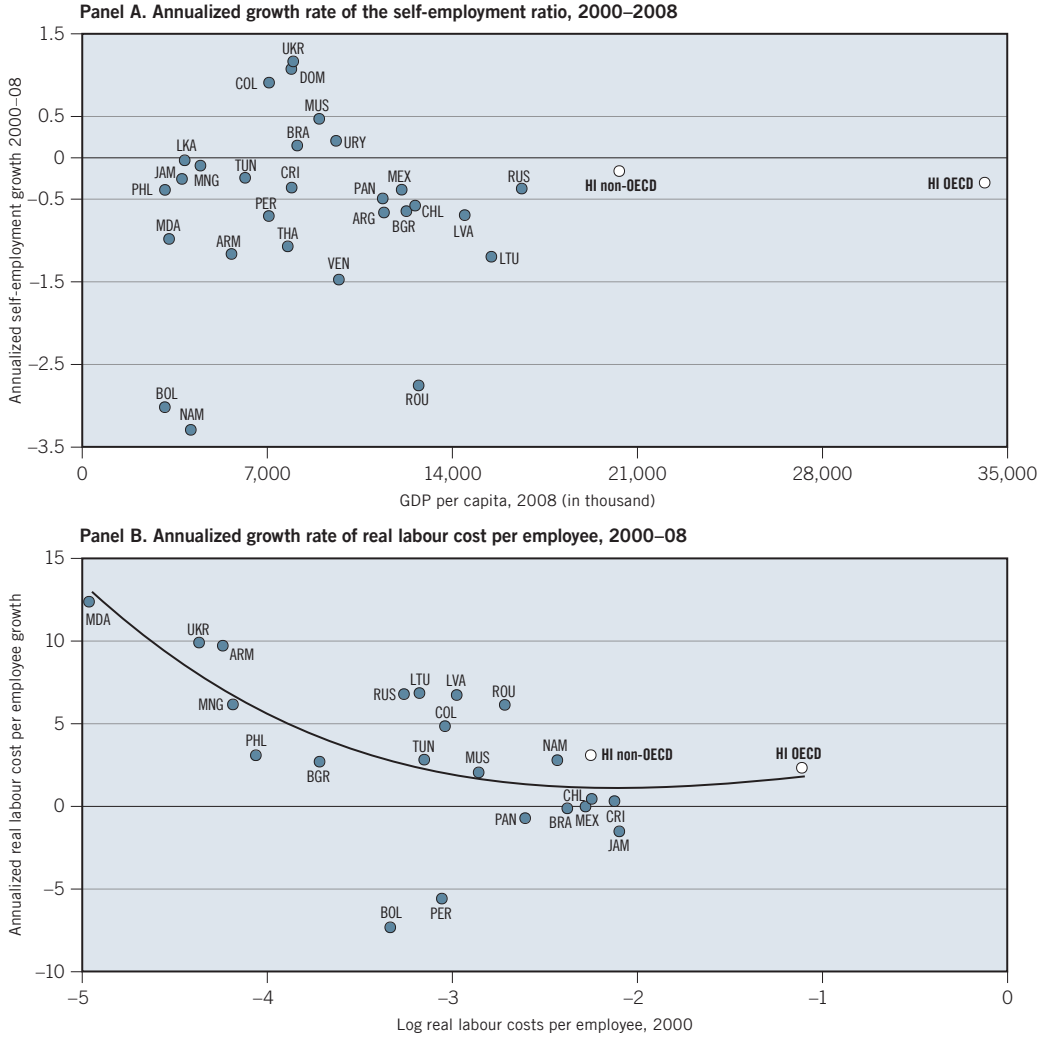
The observed decline in the unadjusted labour share of income across countries is related to two important developments in the labour market (see Figure 8.5). First, the expected transition from self-employment to dependent employment has been

8. The weighted average displays an even more impressive increase. The difference between simple and weighted averages can be explained by the Russian Federation where the labour share increased from 55 per cent in 2002 to 63 per cent in 2009.

relatively slow. As shown in Chapter 3, while the incidence of self-employment declined in a majority of countries for which data exist, this decline is moderate for most of these countries – indeed, judged on historical trends, a faster decline in the incidence of self-employment could have been predicted, given the fast growth that characterized the 2000s in most developing countries.

Second, wages have grown less strongly than could have been predicted on the basis of growth and productivity developments. Figure 8.5 analyses the extent to which countries with relatively low wages in 2000 experienced faster growth of real wages in the following decade. With some exceptions among Latin American countries, where real wages fell (e.g., Bolivia and Peru), the majority of countries have experienced real wage growth. Yet, again, the growth rate is modest overall, typically lower than 5 per cent. The wage growth was mainly driven by East European countries, where the process of recovering wages continued after the sharp and immediate wage cut in the early years of economic transition (ILO, 2013).[9]

Figure 8.5 Growth in self-employment and real wages: 2000–08



Note: HI = high-income. The figure displays wage levels in 2000 (proxied by the log of real labour costs per employee in that year), x axis; and average annual growth rates of real labour costs per employee during the period 2000–08, y axis.
Source: Authors' own calculation based on data from the United Nations Statistics Division.

9. Figure 8.5 indicates that the increases in the labour share were mainly accomplished through real wages adjustment rather than changes in employment structure. This result contrasts with the dual labour model (e.g., the Lewis model), which assumes that the adjustment takes place through employment first and that wage adjustments follow (e.g., from rural to urban sectors).

C. Adjusting the labour share for self-employment income

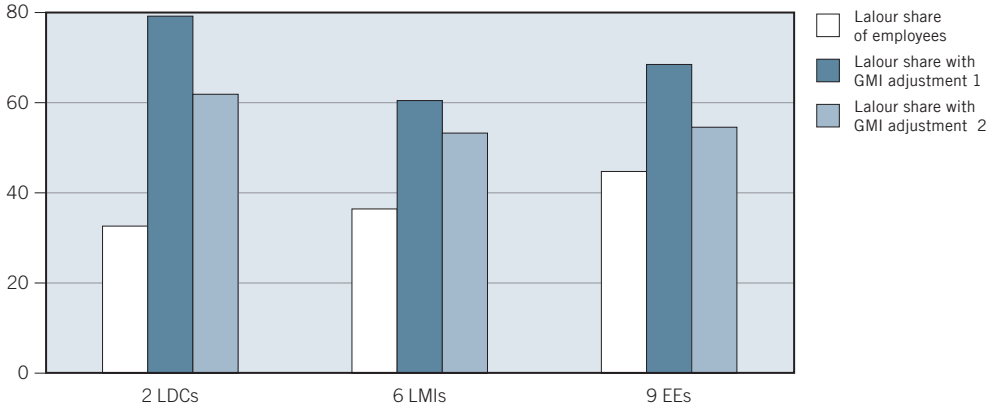
The adjustment for self-employment income shifts the labour share upwards

For a more meaningful comparative analysis, it is important to adjust the labour share of income to reflect the incomes of the self-employed. Such adjustments can be done using the gross mixed income (GMI) available from national accounts (Appendix B).

Figure 8.6 shows three different estimates of the labour share of income, depending on how adjustments are made: no adjustment and two discrete methods of adjustments. For the countries for which data exist, the unadjusted labour share of income averaged around 32 per cent in LDCs, 36 per cent in LMIs, 45 per cent in EEs and about 60 per cent in high-income countries.[10] However, adjustments for self-employment reduce these gaps considerably.

When the first method is adopted (i.e., gross mixed income is added to total compensation of employees), the labour share shifts up to 79 per cent in LDCs, 60per cent in LMIs and 68 per cent in EEs. As expected, the magnitude of such changes depends to a large extent on the share of self-employed in a given economy. This method of adjustment tends to overstate the labour share of income, as it assumes that all incomes of self-employed are "labour income" (see Appendix B). Due to the potential upward bias of this method, an alternative method has often been used, which assumes that the operating surplus from unincorporated enterprises owned by members of households is split between labour and capital

Figure 8.6 Adjusting the labour share of income: Different methods and results (%)



Note: This figure shows simple averages of the labour share of income between 1997 and 2010 according to different adjustments.

"Labour share of employees" =
(Compensation of employees) ÷ (GDP – taxes less subsidies for production and imports)

"Labour share with GMI adjustment 1" =
(Compensation of employees + GMI) ÷ (GDP – taxes less subsidies for production and imports)

"Labour share with GMI adjustment 2" =
(Compensation of employees) ÷ (GDP – taxes less subsidies for production and imports – GMI).

The sample of countries is restricted to those with available information for GMI over an extended period of time. The resulting smaller sample includes two LDCs, six LMIs and nine EEs. **EEs:** Belarus, Brazil, Colombia, Kazakhstan, Latvia, Lithuania, Panama, Serbia and Venezuela; **LMIs:** Egypt, Honduras, India, Kyrgyzstan, Republic of Moldova and Mongolia; **LDCs:** Lesotho and Niger.

Source: Authors' own calculation based on data from the United Nations Statistics Division.

10. The difference with the number given in Figure 8.2 part B is explained by different country coverage.

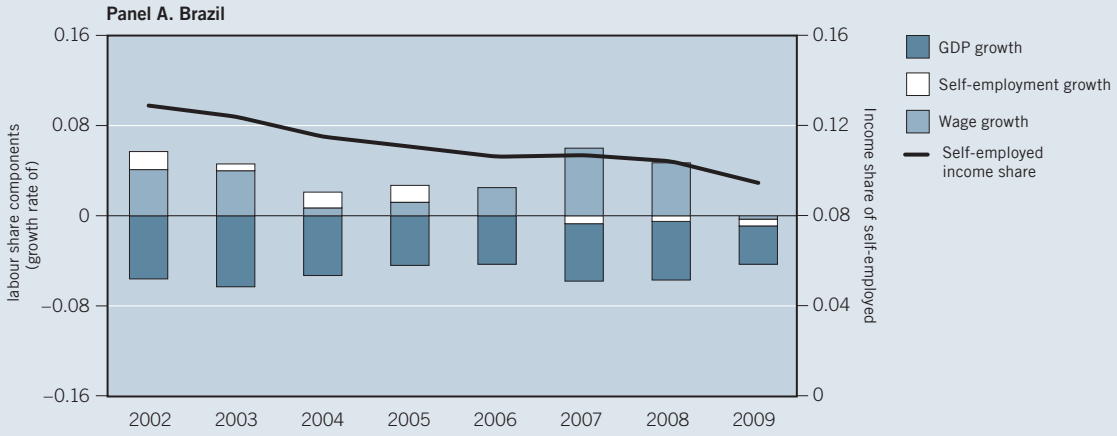
Box 8.2 Underlying these trends is the decline in the income share of the self-employed

How, then, can we make sense of the impacts of these adjustments on the labour share of income? The developments in the income of the self-employed are critical in this respect. There are three possible explanations. First, self-employment and its income do grow, on average, but not fast enough to keep up with economic growth. Second, as discussed earlier, transition from self-employment to employee status has been slow. Third, the earnings gap between the two groups of workers may have increased so that the labour share of income is sensitive to composition effects.

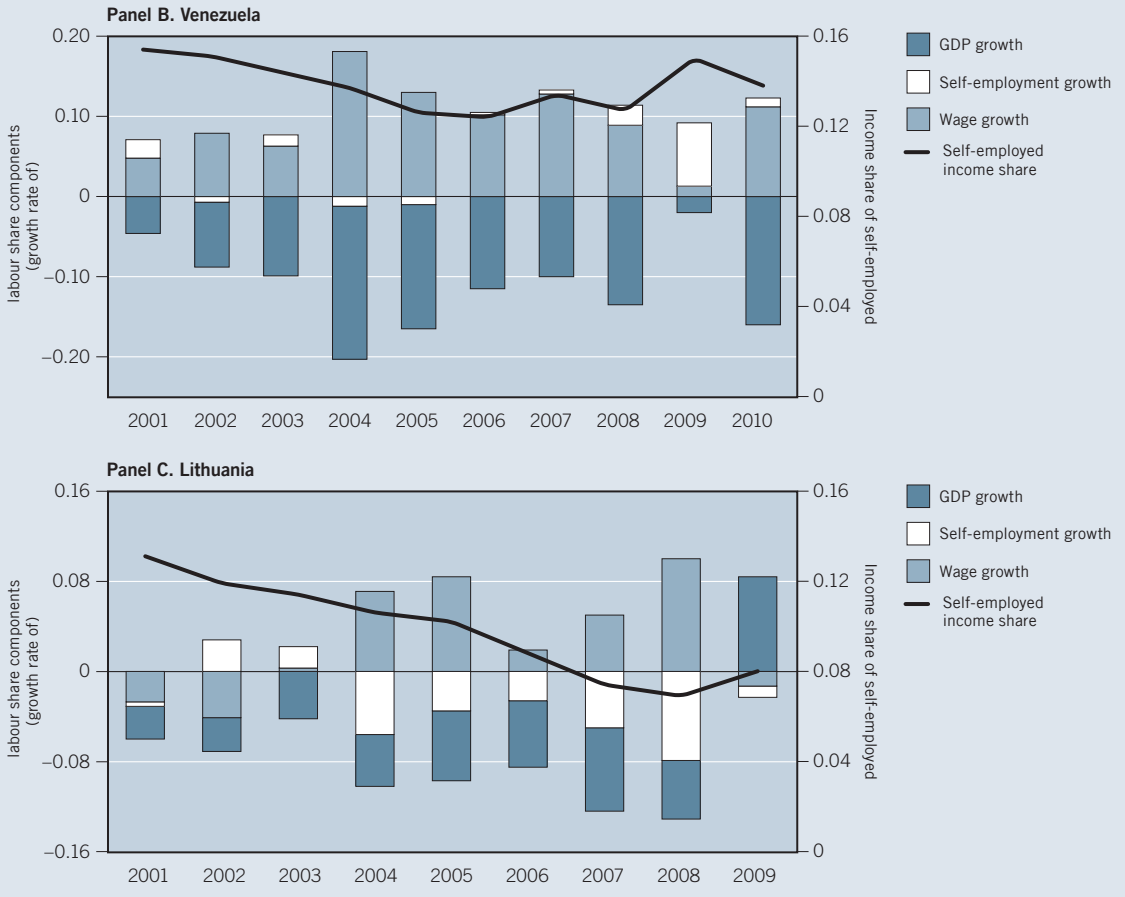
In order to see how these three factors can play out, Figure 8.7 shows the income share of the self-employed for three countries: Brazil, Venezuela and Lithuania. The income share of the self-employed is defined as GMI divided by gross value added at factor costs. In all three countries, the income share of the self-employed declined: by 3.4 percentage points in Brazil, by 1.3 percentage points in Venezuela and by 5.2 percentage points in Lithuania.

Figure 8.7 also decomposes the gross rate of the income share of the self-employed into three components: the growth rate in self-employment, nominal income per self-employed and gross value added at factor costs. The income share of the self-employed increases if the growth rate of nominal income per self-employed plus the growth rate of self-employment exceed the growth rate of gross value added at factor costs. Interestingly, the results show that, in all three countries, the decline in the income share of the self-employed is associated with a decline in the number of self-employed rather than a decline in the average income per self-employed. The average income of the self-employed fluctuates over time but remains positive most of the time. In contrast, the growth in self-employment, which is positive in Brazil and Lithuania in the early 2000s, turns negative in the late 2000s.

Figure 8.7 Changes in the income share of the self-employed and its components (2000's)



income in the same proportion as the overall national ratio (e.g., if the unadjusted labour share is 60 per cent, then the labour income portion of the mixed income is assumed to be 60 per cent). According to the second method, the labour share averages 62 per cent in LDCs, 53 per cent in LMIs and 54 per cent in EEs. Overall, this method scales the labour share upwards, but to a lesser extent. The labour share of income in the second method tends to be closer to the 60 per cent observed in high-income countries.



"Income share of the self-employed" = GMI ÷ (GDP – taxes less subsidies for production and imports).
The growth rate of the income share of the self-employed can be decomposed into three elements: the growth rate of nominal income per self-employed, the growth rate of self-employment and the growth rate of gross value added at factor costs. More formally,

$$\log(ws\ se_t) - \log(ws\ se_{t-1}) = \log(w_t \div w_{t-1}) + \log(se_t \div se_{t-1}) - \log(gvafc_t \div gvafc_{t-1})$$

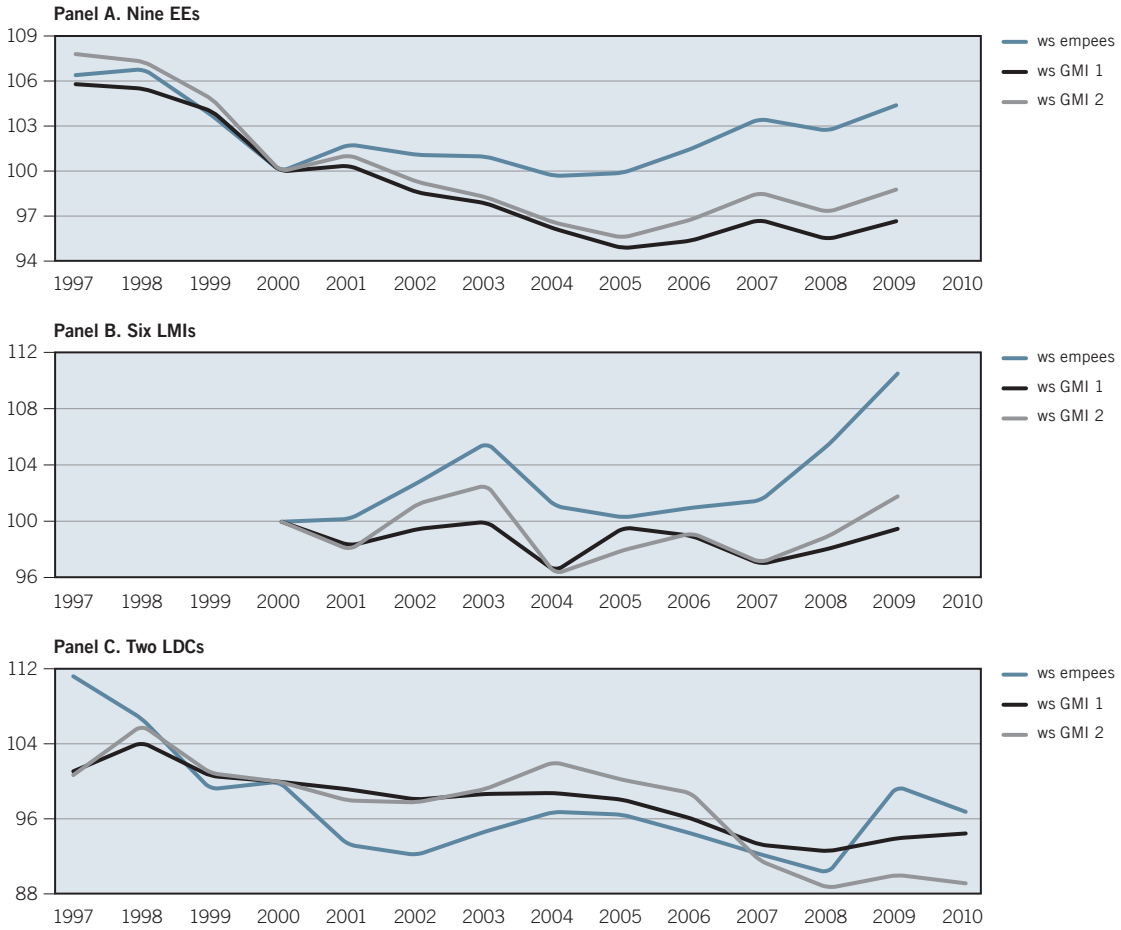
where
- Wage share of the self-employed: $ws\ se_t$
- income per self-employed: w = (GMI ÷ se)
- self-employment: se = total employment – employees
- gross value added at factor costs: gvafc = compensation of employees + operating surplus + gross mixed income.

Source: Authors' own calculation based on data from the United Nations Statistics Division.

The adjusted labour share of income indicates a larger scale of decline in labour income

While adjusting the labour share of income for self-employment increases the labour share in addition to providing a more realistic picture of labour income, it also provides new insights into trends in labour income, especially in terms of both direction and magnitude of changes. Figure 8.8 illustrates how the two GMI adjustments impact the trends in functional income distribution. For the nine EEs for which data exist, the (unadjusted) labour income shows a decline in the late 1990s, followed by relative stability in the early 2000s and then an increase in the late 2000s. However, two types of adjusted labour share of income show a contrasting and downward trend. Under the first method of adjustment, the adjusted labour share reached a low point of 94.9 in 2005 and then stabilized at

Figure 8.8 Trends in the adjusted labour share of income (1997–2009, base year = 2000)



Note: The figure shows the labour share of income measured as follows:

– "wage share of employees" =
(Compensation of employees) ÷ (GDP – taxes less subsidies for production and imports)

– "wage share of employees GMI 1" =
(Compensation of employees + GMI) ÷ (GDP – taxes less subsidies for production and imports)

– "wage share of employees GMI 2" =
(Compensation of employees) ÷ (GDP – taxes less subsidies for production and imports – GMI).

Aggregates are obtained using the simple average method.
The country groups are as follows: **EEs:** Belarus, Brazil, Colombia, Kazakhstan, Latvia, Lithuania, Panama, Serbia and Venezuela; **LMIs:** Egypt, Honduras, India, Kyrgyzstan, Republic of Moldova and Mongolia; **LDCs:** Lesotho and Niger
Source: Authors' own calculation based on data from the United Nations Statistics Division.

96.7 in 2009. The second adjustment (GMI 2) confirms the declining trend but with smaller magnitudes.

Similar effects hold for LMIs and LDCs. Regarding the six LMIs for which data exist, the unadjusted labour share of income shows an increase of 10 percentages points between 2000 and 2009. This large surge in labour income disappears in the adjusted labour share of income, which fluctuated around the level of the base year, 2000. In the two LDCs for which data exist, the trends are negative, irrespective of adjustments, but the scale of decline increases with adjustment. The unadjusted labour share declined by 3.2 percentage points between 2000 and 2009, but adjustment by each of the two methods widens the extent of the decline to 5.5 and 10.8 percentage points, respectively.

D. Economic impacts of changes in the labour share of income

The above analysis shows that the labour share of income has tended to decline, though with significant cross-country differences in the direction and size of these trends. The question arises regarding what specific impact such trends have had on growth and development. This section examines this issue, based on different methodologies which make it possible to identify specific impacts of changes in labour share of incomes on consumption, investment and competitiveness channels (box 8.3).

A rebalancing of functional income distribution may boost growth and jobs

The labour share of income multiplier measures the percentage increase in output following a 1 per cent increase in the labour share of income. Figure 8.10, panel A shows the implicit labour share of income multiplier for three income groups – EEs, LMIs and LDCs (see Appendix C for technical details). Estimations show that the multiplier is above 1 in EEs and significantly smaller than 1 in LMIs and LDCs. The lower multipliers in LMIs and LDCs may be explained by the degree of duality in the economy that makes wage policies less effective in poorer countries. The effect is strong and sustained over time as the multiplier is still positive after five years. This is explained by the nature of the experiment illustrated in this section: a permanent increase in the labour share of income.

These multipliers are derived from the Global Policy Model (see Cripps 2013), which encompasses 15 individual developing countries and 12 country groups. The value added of such a model is that it integrates countries within a unified framework and tracks international spillovers between countries.[11]

The estimation is based on a panel of annual data, starting in 1980, and differentiates between the consumption effect, the investment effect and the net export effect associated with an increase in the labour share of income.[12] Figure 8.10, panel B presents the reaction of consumption, investment and net export to a change in the labour share. The direction of the three effects follows the theoretical literature, as consumption increases, as labour income sustains consumer spending decisions, while both investment and net exports are crowded out by lower profit share. By contrast, firms base new investment decisions on their profitability, which is adversely affected by lower mark-up. The deterioration in the trade balance may be associated with the high consumption of households in a globalized world. The loss of competitiveness depends on the transmission between lower mark-up and price inflation. Overall, the positive consumption effect outweighs the negative investment and net export effects and leads to an increase in growth in the three regions.

11. Figure 8.9 displays an implicit labour income multiplier as the experiment undertaken in this simulation is a reduction in the mark-up of firms. Directly increasing nominal labour income might be misleading, as this translates into higher inflation.
12. The policy experiment is a reduction in the mark-up of firms, which is equivalent to an increase in the labour share of income.

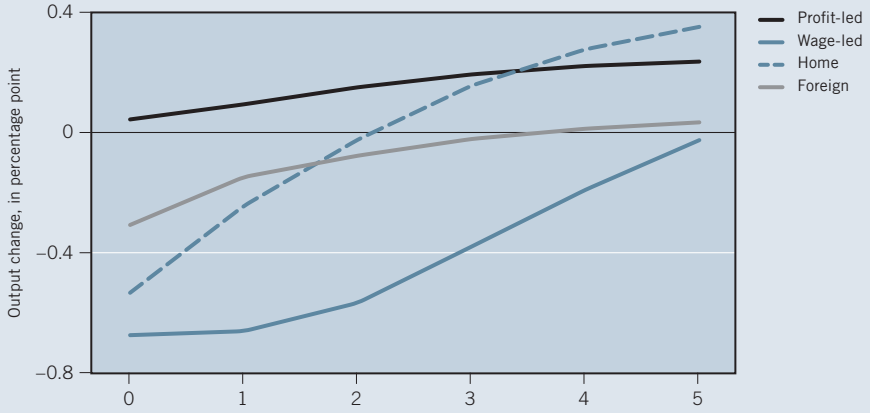
Box 8.3 Aggregate demand and output effects of changes in the functional distribution of income in high-income countries

In high-income countries, analysis of the relationship between income distribution and aggregate demand highlights three effects: consumption, investment and trade (or competitiveness) effects. For instance, in the case of a fall in the labour share of income, consumption may be negatively affected. By contrast, falling labour incomes mean higher profits, which, other things being equal, may stimulate investment. The relative strength of these two effects determines the type of demand regimes in a closed economy framework. When the propensity to consume out of labour income is higher than the propensity to invest out of profits, the demand regime is termed "labour income-led". This means that the net effect of a fall in the labour share is a reduction in aggregate demand. The labour income-led regime is illustrated by the solid red line in Figure 8.9. In the opposite case, the demand regime is "profit-led": a fall in the labour share boosts aggregate demand (solid blue line in Figure 8.9).

In an open economy, a competitiveness effect should also be taken into account. This arises because a lower labour share of income is associated with a reduction in unit labour costs, resulting in improved cost competitiveness and possibly higher net exports. The demand regime is said to be "export-led" when the competitiveness dominates the consumption effect. In Figure 8.9, the dash-dotted purple line shows that, on impact, economic activities decline due to the consumption effect. However, output becomes positive after two quarters following the increase in net exports.

Following a decline in labour costs in the home country, the question arises of whether the competitiveness effect has a detrimental impact on trading partners. In such a case, lower labour cost in the home country has a beggar-thy-neighbour effect on trading partners. The output reaction in the foreign economy following a decline in the labour share in the home country is illustrated by the light blue dotted line. Figure 8.9 shows that the foreign economy is negatively impacted by the loss of competitiveness relative to the home country.

Figure 8.9 Impacts of a declining labour share of income on output

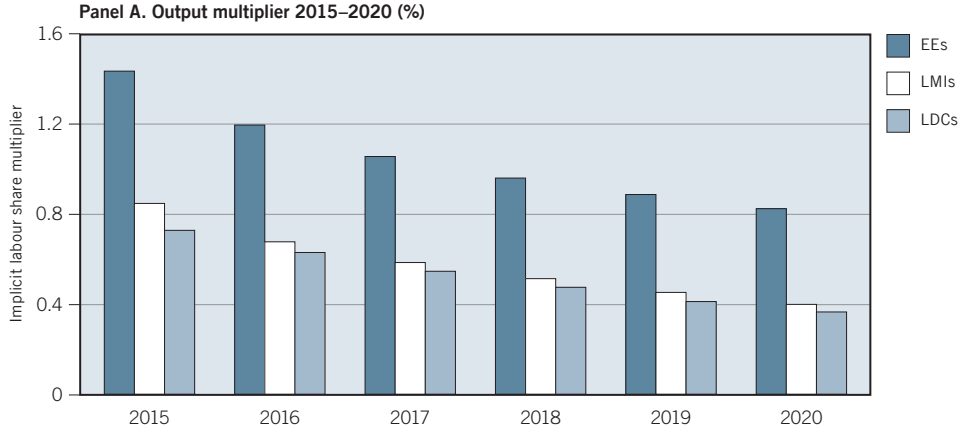


Note: This figure displays the deviation of output (in percentage point deviation) from steady state following a decline in the labour share of income by 0.5 percentage points. Numerical simulations are performed based on a two country DSGE model.

Source: Charpe and Kühn (2012, 2013).

Figure 8.10 Simulated impact of higher labour share of incomes in 2015

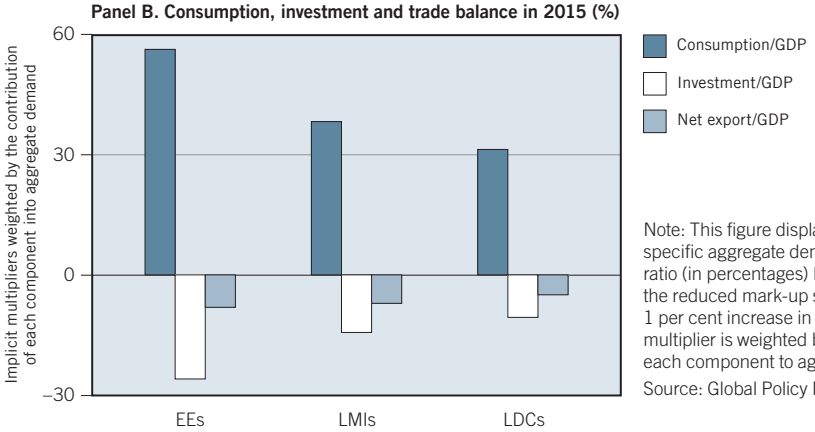
Panel A. Output multiplier 2015–2020 (%)



Note: this figure display the increase in GDP (in percentages) associated with a 1 per cent increase in the labour share of income.

Source: Global Policy Model, Cripps (2013).

Panel B. Consumption, investment and trade balance in 2015 (%)



Note: This figure displays the increase in the specific aggregate demand component to GDP ratio (in percentages) between the baseline and the reduced mark-up scenario associated with a 1 per cent increase in the labour share. Each multiplier is weighted by the contribution of each component to aggregate demand.

Source: Global Policy Model, Cripps (2013).

Single country estimation shows that demand regime is mainly labour income-led for five Latin American countries with sufficient time series available

Table 8.1 shows the outcome of estimation of demand regime for five Latin American countries: Columbia, Honduras, Mexico, Panama and Venezuela. These five countries were selected, as the Economic Commission for Latin America (CEPAL) produces long time series of the labour share of income that allow for single countries estimations. One shortcoming of the panel data estimation presented above is that demand regimes are estimated for each pool of countries, which conceals individual country effects. Data availability starts in 1970 in Columbia, Mexico and Venezuela, in 1960 in Panama and in 1950 in Honduras. The labour share is defined using the compensation of employees and therefore ignores self-employment incomes.

The estimation strategy is to rely on a reduced form equation for the level of economic activity. One strand of the literature relies on the estimation of different elements of aggregate demand – a consumption function, an investment function and a net export function – to identify the demand regime. Despite the advantages of this approach, it does have certain shortcomings, one of which is the difficulty of comparing parameters across equations. A second shortcoming is that each component of aggregate demand is estimated in isolation.

Table 8.1 Demand regime estimation: Single country estimation

	Dependent variable: d log(yt)				
	Colombia	**Honduras**	**Mexico**	**Panama**	**Venezuela**
d log(y_{t-1})	0.96***	0.37**	0.45***	0.58***	0.58***
d log(ws_{t-1})	0.29***	0.09	–0.30***	0.05***	–0.11***
d log(rer_{t-1})	0.20***	0.02	–0.07***	–0.59***	0.06***
Nber Obs	39	49	40	49	39
Demand regime	Labour income-led	Undetermined	Profit-led	Labour income-led	Profit-led

Note: This table displays the result of the GDP per capita reduced form equation: y = the GDP per capita, ws = the labour share of income, rer = the real exchange rate and Nber Obs = the number of observation. Variables are expressed in difference of the log (d log) to deal with unit root. Tests for autocorrelation and heteroscedasticity in the error term have been performed on the OLS estimator. As a result of these tests, we use weighted least square. The asterisks indicate significance at *** 10 per cent, ** 5 per cent and * 1 per cent.

Using our specification, the dependent variable and the explanatory variables are tested for unit root using the Augmented Dickey Fuller test. As the test shows non-stationarity, the estimations are performed using first difference (see Appendix D for a description of the methodology).

The dependent variable is the difference in the log of GDP per capita. There are three explanatory variables, all expressed in the difference of the log. The lagged GDP per capita captures the auto-correlation in the data for GDP per capita. The lagged labour share captures the demand regime in each country. The advantage of the reduced form approach is that the sign of the coefficient for the labour share indicates directly the type of demand regime. When the parameter is positive, the demand regime is labour income-led. The opposite sign indicates a profit-led demand regime. Finally, the real exchange rate captures the openness of the different economies considered. Additional explanatory variables could not be incorporated due to missing information. One key missing variable is the real interest rate, as this captures the impact of financial conditions in the rate of capital accumulation. Another key variable is the regional GDP per capita, as it would capture the dynamic of trading partners.

Table 8.1 presents the results of the GDP per capita equation for each of the five countries. The sign in front of the labour share of income variable is significant and positive in two out of four countries. The demand regime in Honduras cannot be interpreted from this exercise as the sign is not significantly different from zero. This indicates that the demand regime is labour income-led in Colombia and Panama. Additionally, the estimation displays important autocorrelation in the GDP per capita, which is to be expected. Finally, the sign for the real exchange rate is positive. A depreciation of the real exchange rate improves the competitiveness of the country and has a positive impact on economic activities. The estimator used is a weighted least square. The choice of the estimator is motivated as the error term is heteroskedastic in the case of the OLS estimator. The advantage of the weighted least square is to improve the t-stat, that are not robust in the case of an OLS estimator.

E. Summary and policy implications

Considering the growing evidence associating inequality with slower growth and development, this chapter has examined the key trends in the labour share of income in developing countries and their economic impacts. While further elaboration is needed, two major findings stand out.

First, the labour share of income has seen a declining trend, including in developing economies, although with significant variations across countries. In the case of unadjusted labour share of income (where, the income of self-employed is not included), while it tends to increase with overall income growth, recent years have witnessed the weakening of this linkage. In other words, the labour share of income increased more slowly than the growth of GDP per capita in some cases, and even decreased in other cases. Such trends remain unchanged overall, even when the labour share of income is adjusted to reflect the income of the self-employed.

Second, such declining trends in the labour share of income are not neutral in terms of economic development. Rather, there is evidence that, with some notable exceptions, they may have negative impacts on economic growth and such impacts are larger in emerging economies than in other income groups. This is primarily due to the fact that the consumption effects of the labour share of income exceed the combined effects of lower labour shares on investment and export.

These results confirm the growing consensus that income distribution is an essential element of sustainable growth and that the developing world is no exception to this. In particular, our analysis of functional income distribution suggests that "distributional failure" within the labour market can be sizable and policy actions to address this issue would improve the efficiency of the labour market and the economy as a whole.

What, then, can be done? The answer certainly depends to a large extent on correctly identifying the factors that have caused the labour share of income to fall. Although this chapter has not examined this question directly, a recent comprehensive study on developing G20 countries identified three major factors: labour and social protection institutions, globalization and financialization, which all contributed to a shift of bargaining power in favour of non-labour income (ILO, 2013). Therefore, policy efforts are needed to influence these contributory factors.

Considering the scope of this report, we focus on labour and social protection institutions. The key principle is to strengthen these institutions to ensure that wages grow in line with labour productivity (hence, at least stabilizing the labour share of income). Institutions that deal with wage determination, such as minimum wages, trade unions and collective bargaining, are an essential element of policies to rebalance bargaining power. However, recent structural changes in the labour market, compounded by rapid technological changes, have made it more difficult to organize workers and ensure workers' rights. Even when unions exist, they are often confined to a relatively small group of formal workers, while leaving out a large segment of low-paid informal workers. Therefore, more supportive and enabling environments must be created to encourage wage bargaining and extend its coverage, especially for low-paid workers. One important condition for effective wage bargaining is the existence of minimum wages (either statutory or through collective bargaining) which provide a decent wage floor. For instance, employment guarantee schemes that pay minimum wages offer employment opportunities for vulnerable groups of workers but also have the effect of creating a de facto wage floor and thus creating incentives for private firms to comply with

the minimum wage. We have already seen in Chapter 6 that minimum wages, if properly designed and implemented, do not produce significant negative impacts on employment. In the case of the developing world, greater emphasis should be placed on reaching out to the majority of workers who fall outside the formal labour market, including the self-employed. Social protection institutions (see Chapter 7) are important policy tools that can provide income security and thus also improve the bargaining position of workers (through increasing what economists call "reservation wages").

Rebalancing the labour share of income echoes the overarching theme of the report: the necessity of having a well-articulated policy package of labour and social protection institutions in achieving equitable and sustainable development. This is not an easy task, but is achievable, as demonstrated by countries which have managed this challenge rather successfully. Brazil is a case in point (see Appendix A). After a decade of declining labour share of income up to the mid-2000s, Brazil put together both strong wage (e.g., minimum wages) and social protection policies (e.g., "formalization" through social security registration and Bolsa Família). Thanks to these combined policy efforts, the labour share of income hit an inflection point and began to increase, with simultaneous improvements in personal income distribution (Berg, forthcoming; Lee and Gerecke, 2013).

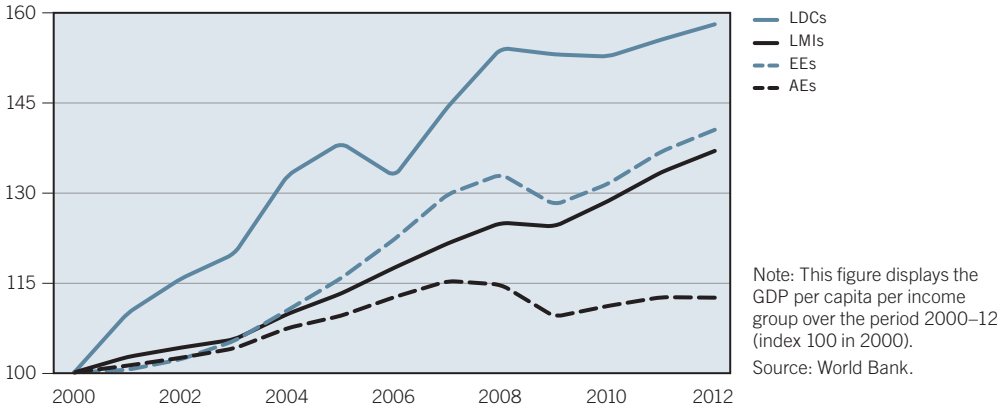
Appendix A

Trends in the labour share of income (additional analysis)

Figure 8.A1 displays GDP per capita per income group (as an index with base year 2000 = 100). This figure illustrates that developing countries experienced higher growth rates than high-income countries over the period 2000–2012. The figure highlights that a relative catch-up has been taking place between developed and developing countries, although aggregation conceals the variations in trajectories at the individual country level.

Figure 8.A2 displays the annualized growth rate of GDP per capita and the annualized growth rate of the labour share over the period 2000–2008. This figure identifies those developing countries that are performing well with respect to the economic development indicator as well as in terms of income distribution.

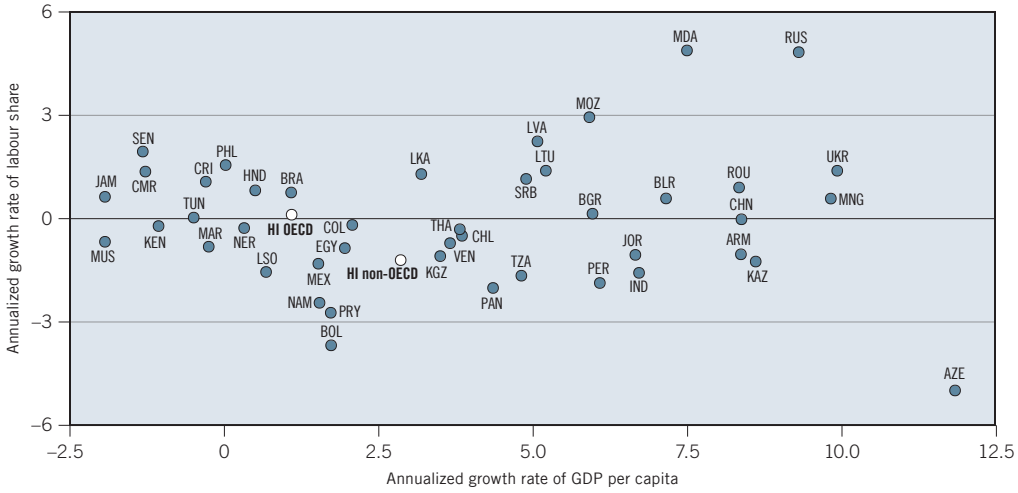
Figure 8.A1 GDP per capita per income group (at constant US$, 2000 = 100)



Note: This figure displays the GDP per capita per income group over the period 2000–12 (index 100 in 2000).

Source: World Bank.

Figure 8.A2 Annualized growth rate of the labour share of income and of GDP per capita (2000–2008: annualized growth rates)



Note: This figure displays the annualized growth rate of the labour share of income measured as (Compensation of employees) ÷ (GDP – taxes less subsidies for production and imports) with respect to the annualized growth rate of the GDP per capita over the period 2000–08.

Source: United Nations Statistics Division; OECD; National Statistics Offices; *Penn World Tables*.

An alternative way to describe the evolution of the labour share is to look at the simple and weighted average labour share per income group (see Figure 8.A3). The number of countries was restricted to those with continuous data over the period considered: 1997–2009 for EEs, 1998–2009 for LMIs and 1998–2010 for LDCs. The size of the groups may therefore differ from those considered in Figure 8.A2.[13]

In EEs, the labour share is constant at 38.8 per cent in 2000 and 38.3 per cent in 2008 when looking at simple averages. The relative decline took place in the late 1990s, with the labour share falling by 4.5 percentage points since 1998.

The weighted average labour share increases by 7 percentage points between 2000 and 2008 when China is included. Excluding China, the weighted labour share shows a marked increase of 12 percentage points.

The difference between the two weighted measures is explained by the increasing size of China's GDP in the EEs' total GDP. China accounts for 40 per cent of the EEs' aggregate GDP in 2007. In China, the labour share dropped from 52.7 in 2000 to 48 in 2008.

In the absence of China, the increase may be due to another large economy that driving the aggregate labour share of income. Excluding China, Brazil accounts for 25 per cent of the EEs' aggregate GDP in 2007, ahead of Russia at 24 per cent and Mexico at 19 per cent.

In Brazil, while the labour share followed a continuous decline between 1995 and 2003 it has followed a continuous upward trend from 46.2 per cent in 2003 to 51.2 per cent in 2009. In Russia, the labour share displays large fluctuations in the late 1990s and early 2000s, the labour share being equal to 50 per cent in 1997 and 40 per cent in 2000. The labour share of income has then increased continuously from 55 per cent in 2002 to 62 per cent in 2012. In contrast, the labour share declined by 3 percentage points in Mexico.

The evidence presented above tend to suggest that high growth rates in EEs and LMIs have not been matched by an increase in the labour share of employees. This could be explained by either a slow increase in labour incomes of employees or a slow shift from self-employment to salaried work in the majority of countries. It is most notable in Russia and Brazil that the labour share of income has followed an upward trend.

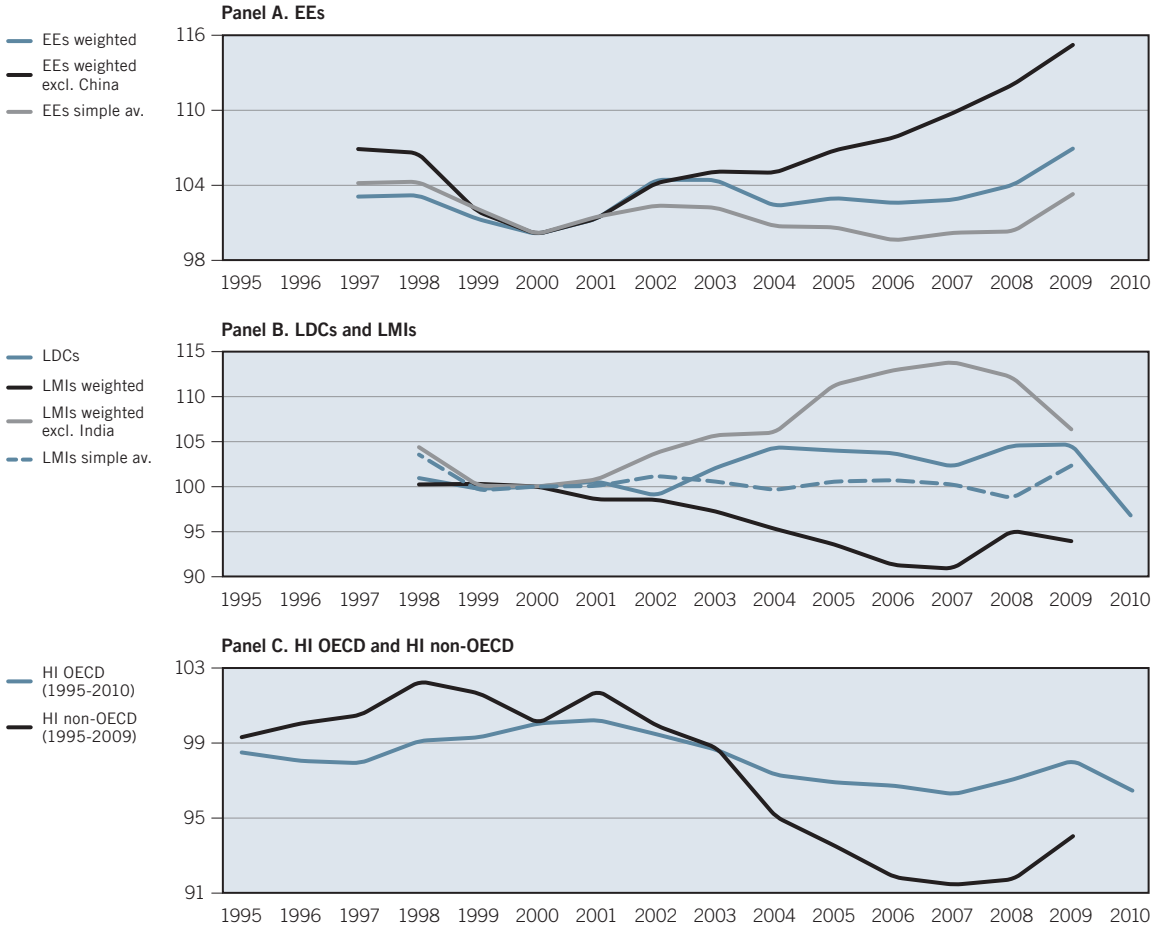
In LMIs, the decline over the period 1998–2008 is largely explained by circumstances in the late 1990s. The weighted average is driven by the different trends in the two largest economies in the groups. In India, the labour share of income declined by 7 percentage points, while it increased by 8 percentage points in Ukraine.

In LMIs, the labour share of income decline is by 4.3 percentage points between 1998 and 2008. However, this decline takes place at the beginning and at the end of the time period, while the labour share is constant in the 2000s.

The weighted average shows a large drop of 9 percentage points between 1998 and 2007. This drop is due to a composition effect related to India. The labour share of income is relatively low in India, around 35 per cent, while India accounts for a large share of LMIs' GDP. Additionally, the labour share declined from 38 per cent in 1998 to 31.7 per cent in 2007.

13. In Figure 8.A3, panel A, the total number of EEs considered is 26 countries, as opposed to 21 in Figure 8.A1. The five countries dropped are Bulgaria, Jamaica, Namibia, Romania and Tunisia. The total number of LMIs considered is 15 countries, as opposed to 12 in Figure 8.A1. The three countries dropped are Honduras, Mongolia and Philippines.

Figure 8.A3 The labour share of income across income categories (index 2000 = 100)



Note: This figure displays the labour share of income measured as (Compensation of employees) ÷ (GDP – taxes less subsidies for production and imports). The country groups are defined as follow: **EEs:** Azerbaijan, Belarus, Brazil, Chile, China, Colombia, Costa Rica, Cuba, Jordan, Kazakhstan, Latvia, Lithuania, Mauritius, Mexico, Panama, Peru, Russian Federation, Serbia, South Africa, Thailand and Venezuela; **LMIs:** Armenia, Bolivia, Cameroon, Egypt, India, Kenya, Kyrgyzstan, Morocco, Republic of Moldova, Paraguay, Sri Lanka and Ukraine; **LDCs:** Lesotho, Mozambique, Niger, Senegal, Tanzania – Mainland; **HI non-OECD:** Bahrain, Estonia*, Hong Kong (China), Hungary*, Kuwait, Oman, Poland*, Portugal*, Qatar, Singapore, Slovakia*, Slovenia* and Trinidad and Tobago; **HI OECD:** Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Republic of Korea, Luxembourg, Netherlands, Norway, Spain, Sweden, United Kingdom and United States.
HI = high-income.
* OECD countries included in non-OECD category because they present a shorter time series than most OECD countries.
Source: United Nations Statistics Division; China: National Bureau of Statistics; OECD statistics.

The weighted average shows opposite trends when India is excluded, increasing by 14 percentage points by 2007. In the absence of China, Egypt and Ukraine are the two largest economies in the LMI group, accounting for 28 per cent and 30 per cent of the LMIs total GDP respectively in 2008. Although the labour share of income is fairly constant in Egypt, at around 27 per cent, the labour share has risen in Ukraine from 48.8 per cent in 2000 to 56.8 per cent in 2010.

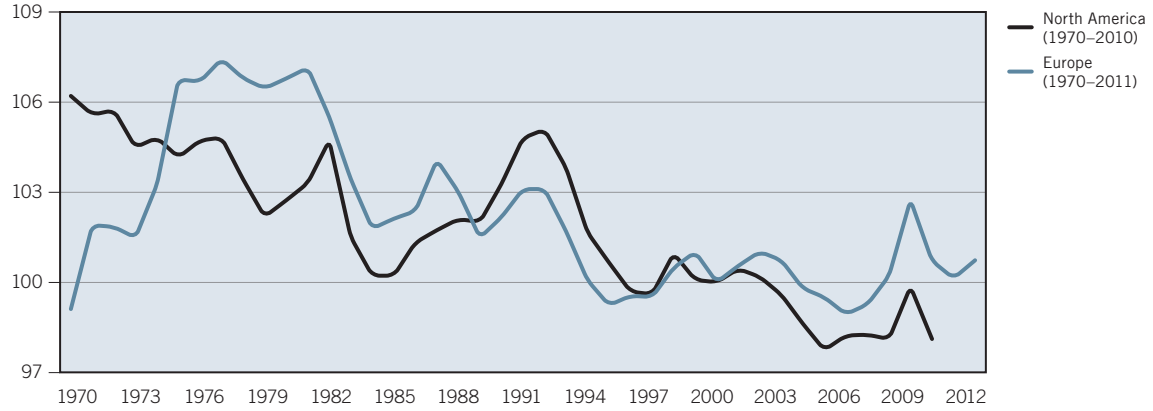
Figure 8.A3, panel C presents the labour share trends (simple average) in high-income OECD countries and high-income non-OECD countries. In high-income OECD countries, the labour share shows a 4 percentage point decline between 2000 and 2007.

The largest decline took place in Germany, with an average annual fall of –1 per cent, followed by Austria and Australia with –0.73 per cent. Large countries, such as Japan and the United States, have also followed a pattern of decline, by –0.36 per cent and –0.33 per cent respectively. The greatest increases in annual growth rates took place in Ireland (1.8 per cent), New Zealand (1.5 per cent), Republic of Korea (0.9 per cent) and Denmark (0.8 per cent).

Within Europe, some of the countries which were hardest hit during the Great Recession show an increase in the labour share between 2000 and 2008. The average annual growth rate of the labour share is 0.46 per cent in Greece, 0.33 per cent in Portugal, 0.68 per cent in Italy and 1.8 per cent in Ireland. In contrast, Spain experienced a decline in the labour share by an average of –0.24 per cent per year.

High-income non-OECD countries display the largest decline, from 106 in 1995 to 94 in 2008. It is only since the crisis that the labour share has recovered to its starting point. This group of countries is composed primarily of Middle Eastern countries, which have experienced a large fall in the labour share of income. For instance, the labour share dropped by 4 percentage points in Bahrain, 6 percentage points in Oman and 7 percentage points in Qatar over the period 2000–2008.

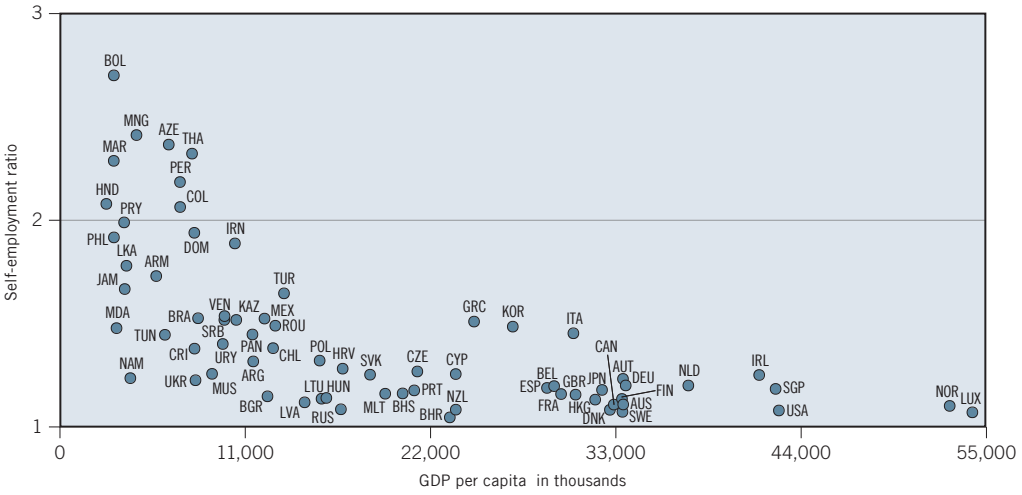
Figure 8.A4 The labour share of income in North America and Europe, 1970–2000 (simple average, index 2000 = 100)



Note: This figure displays the labour share of income measured as (Compensation of employees) ÷ (GDP – taxes less subsidies for production and imports). The country groups are defined as follows: **Europe:** Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden and United Kingdom; **North America:** Canada and United States.

Source: OECD.

Figure 8.A5 Self-employment ratio by income level (2008)



Note: This figure shows the self-employment ratio with respect to GDP per capita in 2008. The self-employment ratio is defined as "total employment over total employees".

Source: ILO-KILM; *Penn World Tables*.

Appendix B

Methodologies to adjust the labour share of income for self-employment income

There are three main methodologies to estimate the labour income of the self-employed.

The first option is to scale up compensation of employees using a self-employment ratio. The self-employment ratio is defined as "total employment over total employees". This adjustment assumes that the self-employed earn, on average, an income similar to that of employees. This adjustment has been extensively used in high-income countries, often using hours worked rather than employment.

$$\text{Labour share} = (\text{compensation of employees} \times \text{SER}) \div (\text{GDP} - \text{taxes less subsidies for production and imports})$$

where SER = (total employment ÷ total employees).

The main shortcoming of this methodology is that the wage gap between employees and self-employed is much larger in low- and middle-income countries. The large number of self-employed, the prevalence of informal jobs and the importance of agricultural employment all generate a large income differential across the different segments of the labour market. This adjustment overstates the labour share, which casts doubt on its accuracy. Some authors have made the assumption that the self-employed average wage is only a fraction (usually two-thirds) of the average wage of employees (see Bentolila and Saint-Paul, 2003). This assumption is, however, ad hoc as it is not based on microeconomic evidence.

A second adjustment is to measure the income of the self-employed from the national account. In the national account, the operating surplus of unincorporated enterprises owned by members of households captures the income of the self-employed. A first version of the adjustment is to add gross mixed income to the compensation of employees. The labour share then reads:

$$\text{LS} = (\text{compensation of employees} + \text{gross mixed income}) \div (\text{GDP} - \text{taxes less subsidies for production and imports})$$

This assumes that all the income of the self-employed is labour income. Although it seems reasonable to believe that a majority of the self-employed works in the agricultural sector in low- and middle-income countries and that this sector is labour intensive, this assumption, in fact, leads to an overvaluation of the labour share of income.

An alternative is to subtract gross mixed income (GMI) from the denominator. The labour share then reads:

$$\text{LS} = \text{compensation of employees} \div (\text{GDP} - \text{taxes less subsidies for production and imports} - \text{GMI})$$

The implicit assumption here is that the operating surplus of unincorporated enterprises owned by members of households is shared between labour and capital in proportions that are similar to the rest of the economy.

A third measure is an extension of the self-employment ratio adjustment where the income of the self-employed is imputed using micro data. Using Labour Force Surveys or Households Surveys, the imputation rule is that the self-employed earn, on average, the same labour income as employees of similar age, with similar education and from the same sector of activities (see Young, 1995; Freeman, 2011).

Appendix C

The Global Policy Model

Main features of the Global Policy Model (GPM)

The GPM model is a multi-country/global model, comprising 123 countries, including G20 countries. The GPM model is an empirical/estimated model: annual data over 1970–2011 with the following main characteristics (Cripps, 2013):

- national accounts;
- fiscal policy and public debt;
- trade and capital flows;
- labour market module.

GPM country blocks definition:

- high-income: United States, Asia-Pacific HI, Europe HI, West Asia HI;
- emerging economies: other Africa EE, other America EE, Argentina, Brazil, Russian Federation, China, Europe EE, Mexico, Malaysia, Thailand, Turkey, other West Asia EE, South Africa:
  - other Africa EE: Algeria, Gabon, Libya, Tunisia;
  - other America EE: Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, Grenada, Jamaica, Panama, Peru, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Uruguay, Venezuela;
  - Europe EE: Bosnia and Herzegovina, Bulgaria, Macedonia FYR, Montenegro, Romania, Serbia;
  - other West Asia EE: Iran, Jordan, Lebanon;
- low- and middle-income: other Africa LMI, America LMI, Asia Pacific LMI, Egypt, Indonesia, India, Pakistan, other South-West Asia LMI, Vietnam:
  - other Africa LMI: Cameroon, Cape Verde, Rep. Congo, Côte d'Ivoire, Ghana, Kenya, Morocco, Nicaragua, Nigeria, Zimbabwe;
  - America LMI: Belize, Bolivia, El Salvador, Guatemala, Guyana, Honduras, Paraguay;
  - Asia Pacific LMI: Fiji, Republic of Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Papua New Guinea, Philippines, Tonga;
  - other South-West Asia LMI: Occupied Palestinian Territory, Iraq, Sri Lanka, Syrian Arab Republic;
- least developed: other Africa LDC, Bangladesh, Asia Pacific LDC, Ethiopia, other South-West Asia LDC;
  - other Africa LDC: Angola, Benin, Burkina Faso, Burundi, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, the Gambia, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Somalia, South Sudan, Sudan, Tanzania, Togo, Uganda, Zambia;
  - Asia Pacific LDC: Bhutan, Cambodia, Kiribati, Lao PDR, Myanmar, Samoa, Solomon Islands, Timor-Leste, Tuvalu, Vanuatu;
  - other South-West Asia LDC: Afghanistan, Nepal, Yemen.

Baseline scenario

- Estimations based on the period 1980–2011, alignment up to 2014:
  - IMF: GDP at constant price, GDP and current account in current dollars and nominal exchange rate.
  - ILO: labour force and unemployment.
  - UNCTAD: world oil price.
- For the period 2014–2030, the simulations are given by the projections of the historically estimated equations of the model.

Increases in the labour share of income in low- and middle-income countries

- Labour share policies: the objective is to increase the labour share of income, corrected for gross mixed income, to close to 60 per cent of GDP. This is achieved by a reduction in the profit mark-up, starting in 2014.

Appendix D

Economic impact analysis for five Latin American countries

Data definition

The raw data for Colombia, Honduras, Mexico, Panama and Venezuela and their sources are reported in Table 8D.1.

It is worth making a few preliminary remarks on these Latin American raw data. First, compensation of employees measures the share of the total income of an economy that goes to the employees (salaried workers). In turn, operating surplus measures the share of the total income of an economy that goes to the enterprises. Note that we do not have details about incomes received by the unincorporated enterprises owned by households (that is, the income of the self-employed). We do know that they are included in the operating surplus in Venezuela from 1997. Second, except in the case of Colombia, all data on operating surplus are expressed in net terms. More precisely, we would need to add the consumption of fixed capital (CFC) to these data in order to gain a gross measure of the operating surplus. Note also that we have different time series for some of the macroeconomic variables, namely compensation of employees, operating surplus, consumption of fixed capital, gross domestic product (GDP) and consumption price index (CPI). For instance, in the case of Colombia, there are three different time series for the compensation of employees. Each of them covers a different sample. Although the three time series overlap, we cannot simply join them onto each other to get a

Table 8D.1 Data source

	Variable	Compensation of employees	Operating surplus	CFC	GDP at market price	Population	Exchange rate	CPI
Colombia	Sample	1970–2010	1970–2010		1970–2010	1970–2010	1970–2010	1970–2010
	Unit	LCU	LCU	LCU	LCU	Inhabitants	LCU per US$	Index
	Source	CEPAL	CEPAL	CEPAL	CEPAL	World Bank	World Bank	CEPAL
Honduras	Sample	1950–2011	1950–2011	1950–2011	1950–2011	1961–2011	1961–2011	1961–2011
	Unit	LCU	LCU	LCU	LCU	Inhabitants	LCU per US$	Index
	Source	CEPAL	CEPAL	CEPAL	CEPAL	World Bank	World Bank	World Bank
Mexico	Sample	1970–2011	1970–2011	1970–2011	1970–2011	1970–2011	1970–2011	1970–2011
	Unit	LCU	LCU	LCU	LCU	Inhabitants	LCU per US$	Index
	Source	CEPAL	CEPAL	CEPAL	CEPAL	World Bank	World Bank	World Bank
Panama	Sample	1960–2011	1960–2011	1960–2011	1960–2011	1961–2011	1961–2011	1961–2011
	Unit	LCU	LCU	LCU	LCU	Inhabitants	LCU per US$	Index
	Source	CEPAL	CEPAL	CEPAL	CEPAL	World Bank	World Bank	World Bank
Venezuela	Sample	1970–2010	1970–2010	1970–2010	1970–2010	1970–2010	1970–2011	1970–2010
	Unit	LCU	LCU	LCU	LCU	Inhabitants	LCU per US$	Index
	Source	CEPAL	CEPAL	CEPAL	CEPAL	World Bank	World Bank	CEPAL

longer time series for compensation of employees because each of them is defined using a different base. Instead, we have to splice them together in order to achieve a longer time series. Finally, the nominal exchange rate defines how much money one can get with 1 US dollar (US$) in the local currency unit (LCU).

Variables of interest

For the purpose of our analysis we need to construct the following macroeconomic variables for each Latin American country considered here: GDP, labour share and real exchange rate.

The labour share in country $iw_{i,t}$ is calculated as follows:

$$w_{i,t} = \frac{ce_{i,t}}{ce_{i,t} + gos_{i,t}}$$

where $ce_{i,t}$ denotes the compensation of employees in country i and $gos_{i,t}$ denotes the gross operating surplus in country i. The latter is defined as follows

$$gos_{i,t} = os_{i,t} + cfc_{i,t}$$

where $os_{i,t}$ is the net operating surplus in country i and $cfc_{i,t}$ is the consumption of fixed capital in country i.

The real exchange rate (rer) of country i with respect to the United States is calculated as follows:

$$rer_{i,t} = e_{i,t} \frac{p^*_{i,t}}{p_{i,t}}$$

where $e_{i,t}$ denotes the nominal exchange rate of country i, $p^*_{i,t}$ is the foreign consumption price index (in our case the consumption price index of the United States),[14] , and $p_{i,t}$ is the consumption price index of country i. Note that we take the same base year for both consumption price indexes (i.e., 2005).

14. The raw data on the United States CPI is obtained from the US Bureau of Labor Statistics.

Unit root test

Methodology

To detect the presence of a unit root in the data we choose to implement the Augmented Dickey Fuller (ADF) test. Before implementing the ADF test, one has to choose the lag length of the regression. To do so, we follow Ng and Perron's (1995) selection procedure. To determine whether the value of lag is satisfactory, we test the significance of the last lagged difference. The ADF regression can take three different forms, depending on whether a deterministic trend and/or an intercept is included. Therefore, one difficulty when implementing the ADF test is to choose the right specification. Indeed, omitting a deterministic trend when the data actually has one, biases the ADF test towards detecting a unit root. However, including a deterministic trend when the data actually do not contain one, decreases the power of the ADF test. Here, we follow a strategy developed by Elder and Kennedy (2001).

Table 8D.2 ADF tests for unit roots (variables are in level)

	Variable	Model	Lags	t–stat	Critical value at 5%	Stationarity
Colombia	Real per capita GDP	Trend and intercept	2	0.19	–3.53	Unit root
	Labour share	Trend and intercept	5	–5.56	–3.54	Trend stationary
	Real exchange rate	Intercept	4	–1.88	–2.94	Unit root
Honduras	Real per capita GDP	Trend and intercept	7	–2.09	–3.50	Unit root
	Labour share	Intercept	0	–1.43	–2.91	Unit root
	Real exchange rate	Intercept	3	–2.01	–2.92	Unit root
Mexico	Real per capita GDP	Trend and intercept	3	–1.42	–3.53	Unit root
	Labour share	Intercept	1	–1.27	–2.93	Unit root
	Real exchange rate	Intercept	1	–3.28	–2.93	No unit root
Panama	Real per capita GDP	Trend and intercept	1	–1.98	–3.50	Unit root
	Labour share	Intercept	8	0.07	–2.93	Unit root
	Real exchange rate	Trend and intercept	10	–2.05	–3.52	Unit root
Venezuela	Real per capita GDP	Trend and intercept	1	–1.78	–3.52	Unit root
	Labour share	Trend and intercept	0	–4.33	–3.52	Trend stationary
	Real exchange rate	Intercept	3	–2.13	–2.94	Unit root

Regression methods

Since, the ADF test points to the existence of unit root, we take the log of the first difference in the regression undertaken in this chapter. The methodology is to estimate an equation for GDP growth similar to an output gap equation and to add a variable measuring income distribution. The equation estimated is of the following form:

$$y_t = \beta_y y_{t-1} + \beta_x rer_{t-1} + \beta_{ws} ws_{t-1} + \varepsilon_t$$

where y = the GDP, rer = the real exchange rate, ws = the wage share and ε = the error term. A first set of estimator is a simple OLS in a first step. OLS diagnostic tests are performed including auto-correlation tests and heteroscedasticity test. Diagnostic shows that the error terms are heteroskedastic. It follows that we use a weighted least square estimator.

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International migration and development*

9

Introduction

A key message from this report is that decent work can drive economic development through several channels, chief among which are the enhancement of individual and collective capabilities (Chapters 2 and 5), broadening the production and demand base by enlarging the middle class (Chapters 3 and 4), alleviating inequalities and enhancing social sustainability of pro-growth policies (Chapters 6, 7 and 8). But no discussion of job quality and its impact on development is complete without a thorough discussion of international migration, which in large part is a reflection of the lack of decent jobs in many developing and emerging economies. Indeed, one of the main drivers of international migration is the search for better economic opportunities abroad (Pritchett, 2006; UNDP, 2009; Goldin et al., 2011). This chapter seeks to contribute to a better understanding of the incentives behind migration and its effects on economic growth and development for both sending and receiving countries in line with the recommendations set forth by the United Nations in the High Level Dialogue on Migration and Development.[1] Furthermore, this chapter underscores the need to include international migration in the post-2015 development strategy, which will replace the Millennium Development Goals (MDGs).[2]

Section A of the chapter details the current state of migration across the globe, including stocks and flows of migrants and their basic characteristics. It also highlights some relevant changes in trends that influence migration's impact. Section B looks at the impact of migration on receiving countries. The relationship between remittances and macroeconomic indicators in sending countries is

* Excellent research assistance was provided by Michelle Fu and Yi Qu.

1. This was held in October 2013 as part of the UN's 68th General Assembly in New York.

2. In 2000, the MDGs did not include migration as a tool to reduce poverty, but given the ongoing debate at the UN Open Working Group on Sustainable Development Goals (which is coordinating the deliberations on the post-2015 strategy), it seems likely that migration will be part of the new development agenda.

also examined. The objective is to identify relevant mechanisms behind human mobility across countries and the channels through which migration influences the labour market as well as economic and social outcomes. Section C ends with policy considerations with a view to better leveraging migration and remittances for economic growth, development and poverty reduction.

A. Trends in international migration

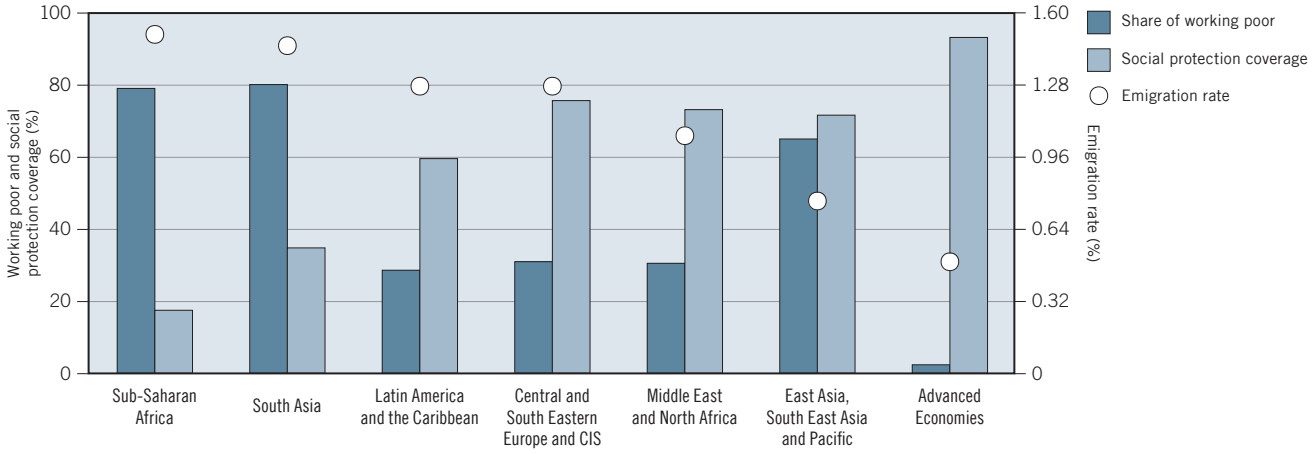
People's desire to migrate is related to the labour market situation at home

Survey data collected by Gallup across 150 countries and territories suggests that young people's (15–24-year-olds) willingness to locate to another country permanently is above 25 per cent for most regions of the world. For example, in the two regions where the world's poorest populations are located – South Asia and Sub-Saharan Africa – around 30 per cent of the young people would like to move abroad permanently. Furthermore, for countries in these regions (unlike, say, Latin America), the willingness to migrate does not decline significantly with age.

Economic literature on the determinants of emigration is vast and points clearly in the direction of income differential between the source and destination country (Harris and Todaro, 1970; Borjas, 1999; Massey, 1993; Massey et al., 2002).[3] Hicks (1932), first among such studies, showed that wage differential between the source and destination country is a primary determinant of emigration. In general, the gap in wages between receiving and sending countries tends to be as high as 10 to 1 (Pritchett, 2006). Indeed, emigration rates tend to be higher in the regions where the share of working poor is higher and social protection coverage is lower (figure 9.1).

There are other factors which play an important role, such as families and networks, demography, political conditions, government policies, etc. (Goldin et al.,

Figure 9.1 A snapshot of global emigration rates, 2005–10



Note: Emigration rate (2005–10) is based on the data by Abel and Sander (2014). Working poor and social protection coverage are the ILO's estimates.

Source: ILO Research Department.

3. For further information, please consult the literature on the determinants of emigration. For example, Goldin et al. (2011) and Pritchett (2006) provide an excellent review of the economic literature on the topic.

2011). Indeed, the desire to migrate because of wage and income differentials is not a sufficient condition to turn a potential migrant into an actual migrant. "Migration assumes different levels of cost and risk for each individual, depending on their level of education, financial resources, social capital, access to information, social networks and other endowments" (Goldin et al., 2011, p. 120). While purely income-based analysis of emigration is more common, there are several studies in the literature that highlight the role played by these factors in driving emigration.

Most migrants in the world continue to live in the developed economies and the European Union[4]

In 2013, 231.5 million people were living in a country other than the one in which they were born. The total number of migrants has risen by 57 million since 2000 and 19 per cent of this increase occurred within the past three years. Developed economies and the European Union (EU) continued to be the main destinations for migrants around the world with 51 per cent of all migrants living in this region. However, while the share of migrants living in developed economies and the EU continued to rise, its growth rate slowed down relative to previous decades (and was constant relative to 2010), probably as a consequence of the recent economic crisis. Meanwhile, the share of migration towards the Middle East increased by 3 percentage points between 2000 and 2010, partly due to the enhanced demand for migrant labour in this region, and remained constant in 2013 relative to 2010.

While both the developed economies and the EU and the Middle East regions increased their share as destination countries for migrants, the trends underlying each of these increases differ. In the case of developed economies and the EU, the growth rate in annual inflows remained stable in the period 2000–2010 relative to 1990–2000 and actually slowed down after 2010. By contrast, the average annual growth rate of inflows towards the Middle East increased from 0.8 per cent between 1990 and 2000 to 6.9 per cent from 2000 to 2010.

Moreover, the rise in migration towards developed economies and the EU observed in 2010 and 2013 is concentrated in countries that already had a significant share of the migrant population. By contrast, in the case of the Middle East, while in 2000 only Saudi Arabia ranked among the top ten destination countries for migrants (in eighth position), by 2013 Saudi Arabia and the United Arab Emirates had 9.1 million and 7.8 million migrants living within their borders, making them the fourth and fifth countries in the world with the largest migrant population respectively.

Male migrants were the main contributor, but there has been a change in migration patterns by gender across destinations with different levels of development[5] …

Out of the 57 million new migrants across the globe in 2013 (compared to 2000), 56 per cent were between 25 and 50 years old. Within this age group, a larger share of the inflows corresponds to male migrants while the gender distribution is fairly similar for other age groups. Furthermore, in contrast to the inflows between

4. This is based on the regional classification used by the ILO's *Global Employment Trends* (GET).
5. Development levels are determined based on the United Nation's definition of economic development.

1990 and 2000, when 51 per cent of migration flows corresponded to females, from 2000 to 2013 women's share in migration flows decreased to 44 per cent. This reduction in the share of female inflows in turn led to a 1 percentage point decrease in the share of women in the total migration stock. Indeed, in 2013, the share of female migrants across the globe decreased to 48 per cent from 49 per cent in 1990 and 2000. This happened despite the fact that women migrants represented a higher share of total migration towards more developed regions in 2013 relative to 2000; this increase was outweighed by a decrease in the share of female migrants living in less developed regions.

Meanwhile, it is important to highlight that the decrease in women's share of migration to less developed regions is not due to a decrease in the rate of growth of female migration towards these region. In fact, worldwide, female migration average annual growth rate increased by 0.9 percentage points to 2.3 per cent between 2000 and 2013. Indeed, the decrease in the ratio of female to male migration in less developed regions is instead due to a higher flow of male migrants towards these countries, which outweighed the increase in female flows. While in the decade between 1990 and 2000 migration flows by gender were fairly similar across regions of high and low development, male migration flow towards less developed regions was twice as high as that of female migration between 2000 and 2013, creating the increase in the gender gap.

… and the age distribution also shows that younger migrants tend to move towards less developed regions, while older ones relocate to more developed ones

Between 1990 and 2013, the age distribution of migrants worldwide has changed: the percentage of migrants under 30 years old decreased from 39 per cent to 32 per cent while the share of migrants between the ages of 30 and 59 increased from 44 per cent to 52 per cent. While part of this trend can be explained by the ageing of the existing migrant population through time, an analysis of data on flows shows that a change in the pattern of inflows also contributed to the variation in migrants' age distribution. For example, between 1990 and 2000, most incoming migrants were between 35 and 54 years old (61 per cent of all inflows in the period). In the 2000–2013 time frame, inflows for all age groups increased significantly; however, unlike the preceding decade, the dominant incoming age group was younger and concentrated in migrants between 25 and 44 years old (accounting for 46 per cent of all inflows in the period).

These differences in migration patterns across age groups can be traced back to variations in migrant inflows towards regions of high and low levels of economic development. While younger individuals' higher propensity to migrate to less developed regions was already apparent in the 1990–2000 period, this trend was reinforced between 2000 and 2013 (figure 9.2). While, between 1990 and 2000, most migration inflows were concentrated among 35–55-year-olds heading towards more developed countries, between 2000 and 2013 there was an important change in inflow patterns by age group and destination region. Inflows by younger migrants towards regions with low levels of economic development increased from half a million to over 12.8 million. Although this age group's migration inflows towards more developed regions also increased, their growth paled in comparison to that exhibited by this group's mobility towards low development countries. Meanwhile, the increase in inflows to more developed regions can be attributed to an older group of migrants.

Box 9.1 Defining "North" and "South"

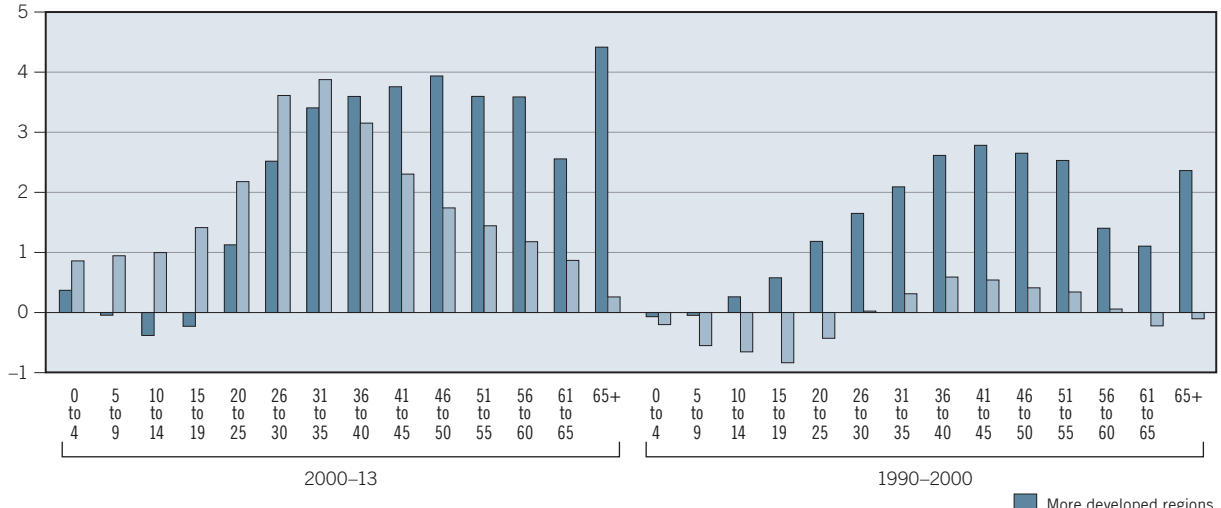
Distinguishing between "North–South" and "South–South" migration is of great relevance to understanding current developments in migration. However, placing countries within North and South categories is not a straightforward task. The use of different definitions can lead to varying estimates of each of these types of migration and, to date, even within international organizations focused on migration and economic development issues, such as the United Nations and the World Bank, there is no agreement on how best to categorize countries into South and North.

Despite this prevalent lack of consensus, three definitions developed by the UN Department of Economic and Social Affairs (UN DESA), the World Bank (WB), and the United Nations Development Programme (UNDP) have become widespread in the literature (Bakewell, 2009). The UN DESA's definition of "North" excludes some OECD countries, such as Chile, Israel, Mexico, the Republic of Korea, and Turkey, as well as some high-income non-OECD countries, such as Bahrain, Hong Kong (China) and the United Arab Emirates. Moreover, several countries in Eastern Europe (such as Belarus, the Republic of Moldova, the Russian Federation and Ukraine) are considered to be part of the North. This definition seeks to go beyond income in distinguishing South and North countries. The World Bank (WB) classifies countries every year according to their gross national income (GNI) per capita. Eastern Europe is generally considered to be South, while high-income countries are classified as North.

The World Bank's method benefits from having a unique and straightforward standard for categorizing all countries. However, such a unilateral classification leaves countries such as those in the Gulf and special administrative regions of China (e.g., Macao and Hong Kong) in the North category. Taking this categorization as the basis for defining South–South changes, the picture significantly, as millions of migrants are living in the high-income Gulf countries. Hence, the WB's method would inappropriately classify the recent rise in migration towards the Gulf documented in section A as a continuation of South–North migration rather than as a change in trend brought about by higher demand for low-skilled labour.

Addressing this issue, UNDP instead groups countries using their human development index (HDI). Until 2008, UNDP divided countries into three groups – low HDI (<0.5), medium HDI (≥0.5 and <0.8) and high HDI (≥0.8) – and defined North countries as those with a high HDI and all others as South. In its 2009 *Human Development Report*, UNDP redefined these categories adding a new "very high development" (HDI ≥0.9) and determined that North countries were only those falling within this new category since the previous methodology placed countries such as Argentina, Brazil, Chile and Mexico in the North. However, the UNDP's new cut-off point of 0.9 HDI classifies countries such as Austria, Belgium and Finland, among others, as South. The analysis herein takes a similar approach to the UNDP but instead employs the inequality-adjusted HDI and uses the 0.8 cut-off to distinguish between North and South countries. This approach maintains countries such as Austria, Belgium, Finland and Luxembourg in the North category.

Figure 9.2 Age distribution of migrant inflows by development at destination (1990–2000 and 2000–13) (million)



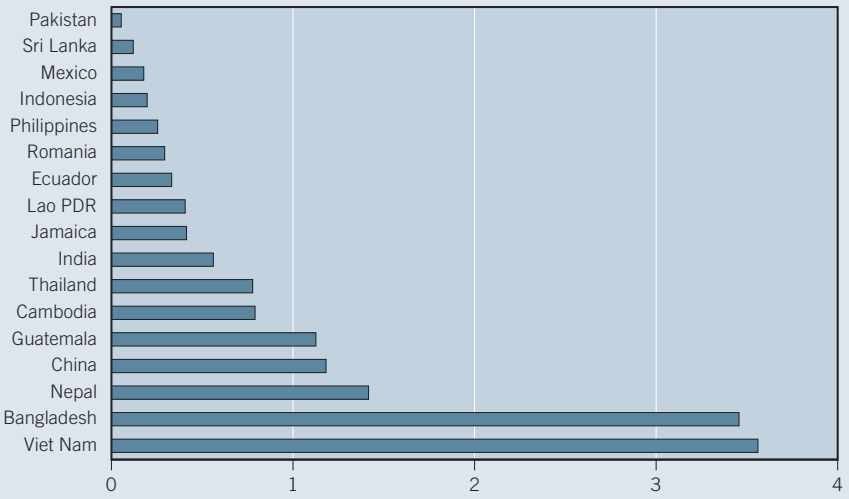
Source: ILO Research Department based on the United Nations, Department of Economic and Social Affairs (2013), Trends in international migrant stock: The 2013 revision (United Nations database, POP/DB/MIG/Stock/Rev.2013).

Box 9.2 Abuse of migrant workers at home and abroad

Abuse at the hands of recruiters at home

Recruitment agencies have been playing a key role in the Asia–Middle East migration corridor. According to an ILO estimate, 80 per cent of labour migrants in this corridor come through private employment agencies (PEAs).[1] PEAs are supposed to provide a valuable service – information about migrants' rights and working conditions – in addition to helping them find jobs in the Gulf countries. However, studies have shown that migrants face abuse in their home countries, particularly by overpaying for recruitment and logistical help. For example, recruitment fees in Bangladesh and Viet Nam are around 3.5 times the per capita income (figure 9.3). Several countries have laws governing recruitment fees but they are widely ignored as enforcement is generally very weak. That said, some countries have done better at enforcement than others – for example, Nepal does a better job at regulating recruiters than does Bangladesh, as workers from Nepal do not need to pay any placement fee, while Bangladesh has a relatively high fixed maximum fee that a PEA can charge. High recruitment fees place a significant debt burden on migrants and some estimates suggest than more than 10 per cent of their income goes to servicing debts at home.

Figure 9.3 Cost of migration in selected sending countries, 2013 (as a share of GDP per capita)



Source: ILO Research Department estimates based on International Organization for Migration, Migration Policy Institute, American University Washington College of Law, Centro de los Derechos del Migrante, Inc., Amnesty International, National Guestworker Alliance, Chulalongkom University, Human Rights Watch, International Federation of Building and Wood Workers, Institute of Southeast Asian Studies, Migrant Forum in Asia, Southern Poverty Law Center, World Bank and Verité.

Under- and delayed payment

Not only are would-be migrants overpaying for recruitment, they are not given accurate information regarding the nature of the work, wages or working and living conditions. According to a recent study,[2] 15 per cent of low-income migrants that arrived in Qatar found themselves put to work in a different position than the one for which they had signed up before they left home, while 20 per cent arrived in Qatar to find themselves on a different salary scale than the one promised by the recruitment agents. Indeed, the practice of re-signing contracts on arrival day is a frequent occurrence in the Gulf countries. Delayed payment has been identified as another widespread practice among several employers of foreign workers. According to a study conducted by Amnesty International, one-fifth of low-income workers in Qatar never received their salaries on time and the practice was most prevalent in the construction sector. Meanwhile, domestic workers are usually those that are most vulnerable to delayed and

underpayment. Largely excluded from local judicial coverage, they do not benefit from the minimum wage laws. A Human Rights Watch report (2007)[3] showed that, in Saudi Arabia, Sri Lankan domestic workers earned only one-fifth of the prevailing minimum wage; in Lebanon, they typically received wages that were half the minimum wage for local private-sectors employers.

Forced labour and trafficking

In the Middle East, the ILO has estimated that there are approximately 600,000 forced labour victims and that 3.4 in every 1,000 of the region's inhabitants are compelled to work against their will. They are prevented from leaving their place of work by various kinds of penalties and threats, including passport confiscation, withholding of wages and the use of psychological, physical and sexual violence. Other research shows that, in Qatar, 90 per cent of the respondents to the survey reported having their passports confiscated by employers. The report from Amnesty International in 2013[4] also suggested that dozens of construction workers were prevented from leaving the country and were trapped in Qatar. In addition to threats from employer, the sponsorship system called *kafala*[5] fuels exploitation and forced labour. The *kafala* system is used in all of the six Gulf Cooperation Council (GCC) states and keeps the worker's visa and legal status tied to the employer, which severely constrains workers' mobility.

Health and safety issues

There have been several incidents of workplace accidents in the Middle East that have brought healthy and safety issues (long hours, inadequate supply of water, limited access to health facilities, etc.) to the fore. For example, in 2012, 276 Nepali workers died in Qatar, 20 per cent of whom died at their workplace. According to the research done by Amnesty International, workers in the construction sector are the most vulnerable to workplace accidents, due in no small part to demanding hours in hot weather. Furthermore, the study showed that some employers penalized their workers (through pay cuts) for taking medical leave. In addition to the risky working conditions, migrant workers are also facing significant challenges in trying to access the local health services.[6] One study showed that 56 per cent of the workers in Qatar lacked a government-mandated "health card" for accessing health care in the state's public health system.

Degrading living conditions

Migrant workers in the Middle East are often housed by their sponsors in dormitory-style blocks called "labour camps". Evidence from various field studies has shown that most of them live in unacceptable and degrading conditions: with overflowing sewage, septic tanks left uncovered, lack of power and clean water, missing or malfunctioning air conditioning, etc.[7] The working and living conditions for migrant workers in Qatar have even been described as "modern-day slavery".[8] In Doha, it is routine for between ten and 15 workers to sleep in one small room. Similarly, in Dubai, a township of more than 150,000 migrant workers lies between a waste dump and a cemetery. The accommodation unit looks like prison block with six or more men living in each of the 3×3 metre rooms, where they sleep on the floor. It should be noted that, given the harsh criticisms in the global media, some countries such as Qatar and the United Arab Emirates have started to take action to improve the working conditions of migrant workers.[9]

[1] Harroff-Tavel and Nasri (2013). [2] A survey of 1,189 low-income migrant workers in Qatar carried out by a study funded by the Qatar National Research Fund, published in the *Journal of Arabian Studies*, June 2013, pp. 1–17. [3] Human Rights Watch conducted research in 2006, based on in-depth interviews with 100 women migrant domestic workers from Sri Lanka and published their findings in the report: Exported and exposed. [4] Amnesty International carried out research in Qatar, from October 2012 to March 2013, interviewing 210 male construction workers, 47 women domestic workers and 32 workers from other sectors. [5] ITUC (International Trade Union Confederation), 2011. [6] International Organization for Migration-Migration Policy Institute Issue in Brief No. 2 – *Asian Labour Migrants and Health: Exploring Policy Routes*, 2012. [7] Amnesty International research in Qatar. [8] In a statement issued by ITUC's General Secretary during the International Labour Conference in Geneva, 2012. [9] ITUC, 2011.

Meanwhile, most of the increase in total migration between 2000 and 2013 was due to higher levels of South–South migration …

In order to better understand the recent global trends in migration, this chapter takes a novel approach and distinguishes countries in "North" and "South" by using the inequality-adjusted human development index (HDI) of the UNDP (see box 9.1 for more detail). This allows for a better understanding of migration flows and highlights some of the recent increases in migration flows to the Gulf countries, as most of these countries are included in the South category. Indeed, in 2013, over 116 million migrants were individuals born in the South and residing within this region, but in a country different from that of their birth. This increasing trend in migration within countries in the South is a phenomenon that only began to be apparent after 2000. While, during the 1990–2000 decade, South–North migration was the main driver of the increase in total worldwide migration, during the 2000–2013 period, migration flows across countries within the South region represented 57 per cent of all flows during the period.

Between 2000 and 2013, South Asia was the largest contributor to the South–South migration, with 30 million new migrants relocating outside their country of birth. Moreover, South Asia's migration flow towards other South regions represented 26 per cent of total South–South flows between 2000 and 2013. In 2013, 52 per cent of all migrants in the Middle East were originally from India, Bangladesh, Pakistan and Afghanistan; migration towards the Middle East from India, Bangladesh and Pakistan increased at an average annual rate of 9 per cent, 13.3 per cent and 8.5 per cent respectively within the period.

… which has raised issues concerning working conditions of migrants in some countries

The increase in South–South migration has coincided with the increased incidence of abuse and exploitation of low-skilled workers, particularly in the Gulf countries. While statistics on the incidence of abuse and exploitation remain patchy at best, recent media reports have shown that Asian migrant workers in the Gulf are vulnerable to exploitation and face significant abuse of workers' rights, including forced overtime, delayed wages, poor working and living conditions, limited access to health care, etc. Moreover, the abuse starts in their home countries at the hands of recruiting agencies that are known to charge exorbitant fees, irrespective of the regulations put in place by the Government to curb those practices. When the migrants arrive in their countries of destination, there have been cases of underpayment, with delayed payment being all too common. Also, there have been several studies that have brought to light the issue of trafficking and forced labour (see box 9.2 for more detail).

B. Economic consequences of international migration

As Section A showed, while migration to the developed economies and the EU still accounts for a large share of global migrants, the demand for low-skilled labour from the Middle East has significantly increased its share of migrant population in recent years. Most importantly, 57 per cent of the increase in total migration between 2000 and 2013 was due to higher levels of South–South migration. At the individual level, the benefits of migration include: better employment opportunities, higher wages and, generally, a better standard of living (see table 9.1 for a brief summary of benefits/costs of migration).[6] At the macro level, the receiving countries also benefit from immigration as it tends to offset the effects of ageing and population decline and contribute to economic growth. Meanwhile, for sending countries, particularly the least developed countries (LDCs), the inflow of remittances alleviate one of the constraints to growth, namely access to international capital markets. This is particularly relevant given the prevalence of South–South migration – in particular, Asian migrants working in the Gulf countries tend to send most of their incomes home and also tend to return in the medium to long term. This section examines a couple of issues that are salient for development: first, the impact of immigration on economic growth in receiving countries and, second, the impact of remittances on sending countries.

Table 9.1 Benefits and costs of international migration

Individual		Sending countries		Receiving countries	
Positive	**Negative**	**Positive**	**Negative**	**Positive**	**Negative**
Employment; wage improvements	Underemployment in receiving country	Remittances: spillover effects on education, poverty, local development	Brain drain, constraining growth	Economic growth and development	Competition for low-skilled jobs
Welfare enhancement (education, health); poverty reduction	Subject to abuse	Reduced labour supply	Labour shortage (high-skilled workers)	Address ageing/ working-age population decline	Downward pressure on wages
Better returns on skills and education	Costly/regulation regarding migration	Brain circulation (diaspora network)		Fulfilling skill needs/shortages	

Source: Based on Goldin et al, 2011 and Pritchett, 2006.

Empirical analysis shows that migration has a small positive impact on economic growth in receiving countries …

In the advanced economies, one-fifth of the population is already aged 60 or older, with the expectation that this share will rise to more than 30 per cent by 2050. On the contrary, in many developing countries, less than 10 per cent of the population is aged 60 or older. Migration can offer a path to leverage this difference in population structures, potentially benefiting both developed and developing economies. Using data covering 68 countries between 1986 and 2007, the results show that migration has a small positive impact on growth.[7] The impact is particularly relevant in receiving countries that currently experience low population growth.

6. Refer to the literature on the benefits/costs of international migration for a comprehensive review; Golding et al. (2010) and Pritchett (2006) provide a solid review of the literature.
7. See Appendix A – Decomposing per capita GDP growth in a model with migration and human capital for the theoretical and empirical model used in the analysis.

Moreover, the results highlight the importance of considering the human capital contribution to migration, and not just its overall effect on population growth.[8] On average, a 1 percentage point increase in migrant human capital weighted inflows increases GDP per capita growth by one-fifth (0.20) of a percentage point. This effect is composed, on the one hand, of a 0.32 per cent of a percentage point decrease caused by the capital dilution and increase in the number of individuals sharing in the total gross domestic product and, on the other hand, a 0.53 per cent of a percentage point increase caused by the change in the human capital weighted labour input and its effect over total production. Countries with decreasing and ageing populations have more to gain from migration than countries with positive population growth. Moreover, receiving countries have incentives to foster human capital investment within their migrant population. In this sense, receiving countries may be better off fostering appropriate labour market opportunities for migrants so that they can make use of their relative human capital and, furthermore, have incentives to invest in increasing it.

… while evidence points to higher unemployment among migrants and job market mismatch

Data from the OECD show that migrants face a more restrictive labour market. Unemployment rates among migrant populations are higher than those of their native-born counterparts, even after controlling for differences in education and schooling. On average, the unemployment rate for migrants living in the OECD is 4.4 percentage points higher (12.3 per cent as opposed to 7.9 per cent for native-born workers in 2010). Moreover, those migrants who are employed seem to face different labour market challenges. In terms of job stability, data for the OECD indicate that, while 15 per cent of employed immigrants have a temporary job, less than 10 per cent of native-born workers have such a contract; for example Spain (39 per cent as opposed to 20 per cent), Portugal (32 per cent as opposed to 21 per cent) and Greece (21 per cent as opposed to 10 per cent).

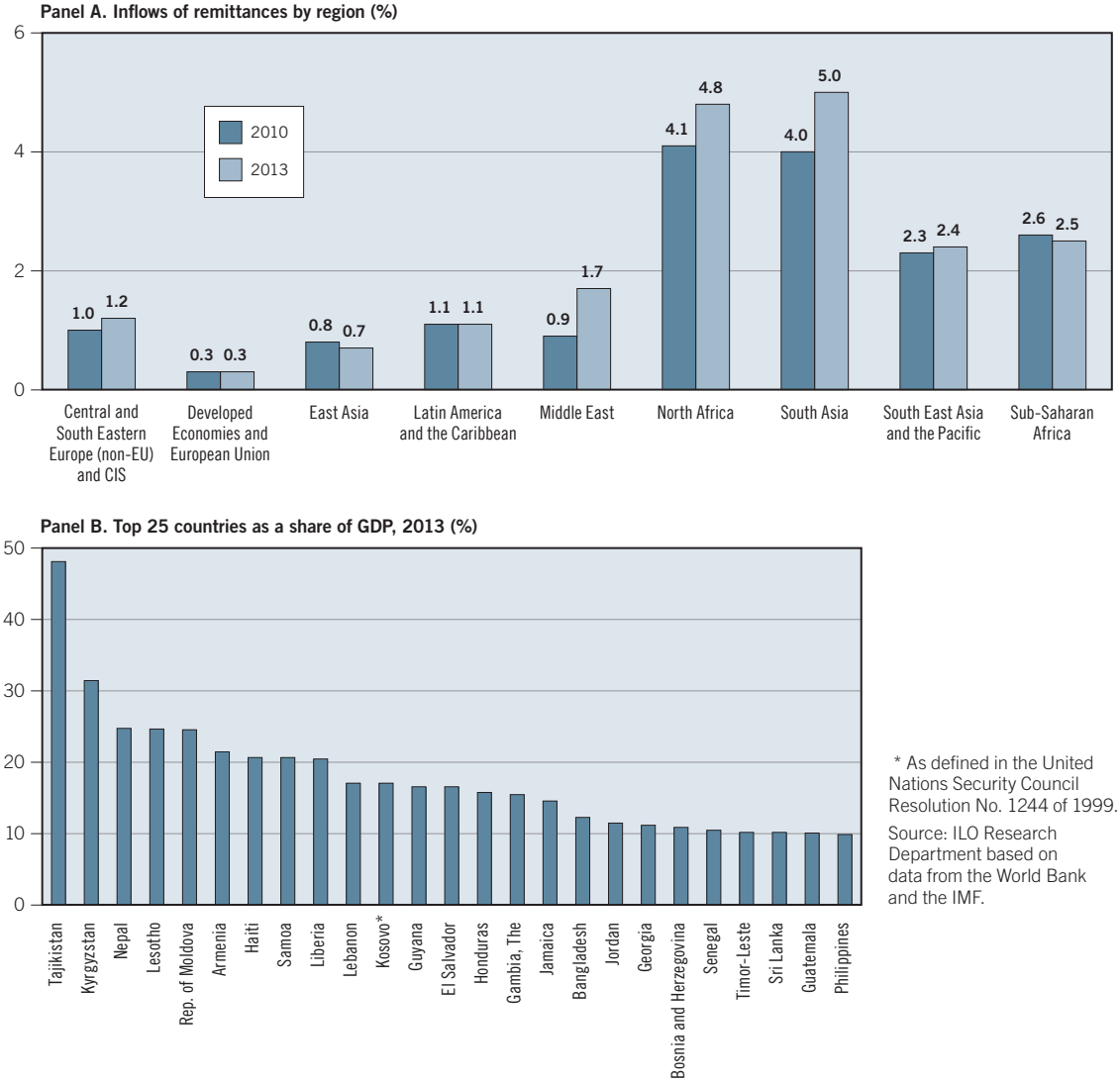
Migrants make up a larger share of the workers in low-skilled jobs in all the OECD countries; conditional on having a job, the probability of it being a low-skilled job is three times higher for a migrant than for a native-born worker. The fact that migrants are over-represented in the low-skilled labour market is not, on its own, an indication of mismatch or poor job quality. However, when this information is combined with the average education of migrants, evidence of over-qualification for employed migrants can be found across the OECD countries. On average, in 2010, 34.5 per cent of educated migrants who were employed had jobs whose characteristics required lower qualifications than those implied by their education. In contrast, only 17.9 per cent of educated native-born workers are formally overqualified for the positions they hold.

Inflows of remittances are an important share of national income for many developing countries …

One of the most visible impacts of modern-day migration is the steady flow of money back to the labour-sending countries. South Asia and North Africa have the largest remittance inflow as a share of GDP (figure 9.4, panel A). In the case of South Asia, it increased by 1 percentage point during the period between 2010

8. See Appendix A for detailed results.

Figure 9.4 Global overview of remittances



* As defined in the United Nations Security Council Resolution No. 1244 of 1999.

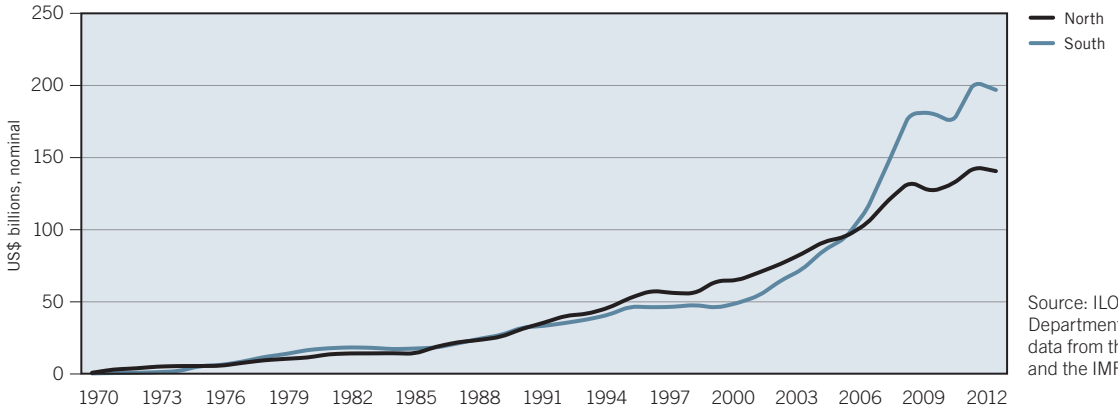
Source: ILO Research Department based on data from the World Bank and the IMF.

and 2013 alone. Other regions of the world that are more reliant on remittances are South-East Asia and the Pacific and Sub-Saharan Africa (with 2.4 and 2.5 per cent of GDP respectively). Among the labour-sending countries, in 25 countries (all developing or emerging economies) remittances as a share of GDP amount to over 10 per cent per year (figure 9.4, panel B). In some countries, remittances as a share of GDP are higher than 20 per cent: Armenia (21.4 per cent), Haiti (20.3 per cent), Krygyzstan (31.4 per cent), Lesotho (24.6 per cent), Liberia (20.4), Republic of Moldova (24.5 per cent), Nepal (24.7 per cent), Samoa (20.6 per cent) and Tajkistan (48.1 per cent). Many of these developing economies do not have access to international capital markets and they have rudimentary financial systems. Finally, in absolute terms, the countries which are among the largest recipients of remittances in 2013 include: India (US$71 billion), China (US$60 billion), Philippines (US$26.1 billion), Mexico (US$22 billion), Nigeria (US$21 billion), Egypt (US$20 billion) and Bangladesh (US$15 billion).

… while remittances flowing from the South have increased in recent years

Furthermore, recent trends in remittance flows reflect the increase in South–South migration detailed above. Indeed, 2005 was the first year in which more remittances were sent from South countries than from countries in the North. This trend has only strengthened with time, to such an extent that the share of remittances that are generated in South countries increased from 42 per cent in 1999 to 58 per cent in 2012 (figure 9.5). Moreover, these outflows have been destined primarily for developing economies. Before the onset of the financial crisis, Sub-Saharan Africa, South Asia and East Asia and the Pacific experienced exorbitant, constant annual growth rates in received remittances of 71 per cent, 40 per cent and 35 per cent, respectively. In particular, between 2000 and 2013, Myanmar, Liberia, Lao PDR, Belarus and Armenia were the five countries with the highest constant annual growth rates in remittance inflows.

Figure 9.5 Remittance outflows by region (2013)



Source: ILO Research Department based on data from the World Bank and the IMF.

Empirical analysis shows that remittances are a strong determinant of savings and investment

Studies have shown that remittances could help in economic and social development through various channels: poverty reduction, health and education improvements, local development and collective transfers (see box 9.3 for more detail). Inflow of remittances has alleviated the foreign exchange constraints facing developing and emerging economies and also generally improved the balance of payments by augmenting national savings. For developing countries, such as Bangladesh and Nepal, remittances have enabled the countries to overcome credit constraints stemming from the lack of a developed financial system and limited access to external financing (Giuliano and Ruiz-Arranz, 2009). Remittances that translate into savings can be a valuable source of finance for increasing production and investment in developing countries, especially given the limited availability of development assistance. An econometric exercise based on a database of 165 countries between 1994 and 2010 reveals that remittances have a positive and significant impact on both savings and investments. In particular, a 10 per cent increase in remittance leads to an increase in national deposits by 2.1 per cent and in investment by 1.9 per cent (figure 9.6). Moreover, among the different sources of capital inflow, such as foreign direct investment (FDI) and Official Development Assistance (ODA), remittances are the most important driver of investment and the second most important driver of savings.

Box 9.3 Link between remittances and development: A review of empirical evidence

Poverty reduction

A study of 71 developing countries shows that "international migration and remittances significantly reduce the level, depth and severity of poverty in the developing world" (Adams and Page, 2005). Furthermore, a 10 per cent increase in per capita remittances can lead to a 3.5 per cent decline in the proportion of people living on under US$1 per day in the source country (Ratha, 2007). In addition, remittance-receiving households are less likely to fall below the poverty line compared with households that do not receive remittances (ibid.). However, it should be noted that the extremely poor do not have access to migration; hence, they are excluded from the benefits of migration.

Health and education improvements

Country studies have shown that remittances improve the health and education of children and have a positive influence on infant health and in reducing child mortality (Goldin et al., 2011). For example, school drop-out rates are lower among households receiving remittances in El Salvador and Sri Lanka (Ratha, 2007). Also, in Sri Lanka, children in remittance-receiving households have higher birth weights, which indicate better access to health care and nutrition. Meanwhile, a study commissioned by the United Nations shows that children from Mexican families in which one or more members had migrated completed 0.7 to 1.6 more years of schooling than children who did not have family members abroad (Taylor, 2006). Similarly, studies conducted in Jordan, Philippines and Thailand, show that remittances have raised the levels of children's education (Goldin et al., 2011).

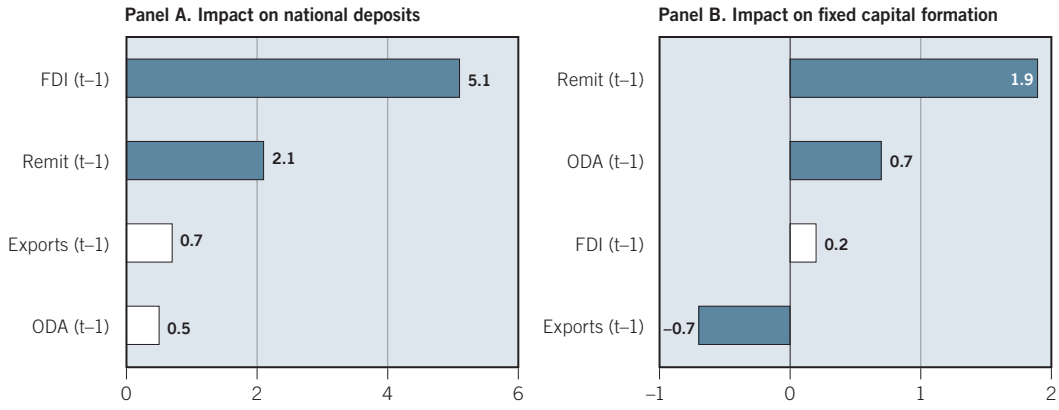
Local development

Remittances have also been shown to stimulate local development (Goldin et al., 2011). For example, in Pakistan and Thailand, families receiving remittances are reported to use them to hire farm labour and purchase agricultural equipment, which tend to enhance agricultural productivity and growth in the long run, while ushering in farm modernization. Furthermore, studies conducted in China and South Africa show that remittance-receiving households increased crop production over time by investing the extra capital available from remittances (Ghosh, 2006). Meanwhile, remittances have been shown to promote self-employment by providing much needed financing for small businesses (Rapoport and Docquier, 2005). For example, in the case of Mexico, one-fifth of the capital invested in small enterprises comes from remittances (Taylor, 2006). By some estimates, in Mexico, a remittance receipt of US$2 billion is shown to have created additional economic growth of US$5.8 billion (Durand et al., 1996).

Collective transfers

There have been several country-level efforts at collective transfers that have proved instrumental in the economic development of low- and middle-income countries (Goldin et al., 2011). For example, Mexicans living abroad made collective contributions equal to US$20 million through Home Town Associations (HTAs) – committees established to support development efforts at home (Castles and Miller, 2009). Moreover, HTAs have become an important part of Mexico's development efforts – for example, the Government matches each dollar sent through collective remittances and the funds go to philanthropic causes and infrastructure development (Portes, 2008). HTAs are especially effective when based on local development needs, ranging from funding clinics and building roads and bridges to supporting schools and universities (Goldin et al., 2011).

Figure 9.6 Impact of remittances on savings and investment: A global overview



Note: Blue bars represent statistical significance, while the white bars represent a lack of statistical significance.
Source: ILO Research Department; see Appendix B for details.

C. Policy considerations: Leveraging labour migration for growth and international development

As this chapter has shown, migration can be an important poverty reduction and development tool, which highlights the need for its inclusion in the post-2015 development strategy of the United Nations (the set of guidelines that will replace the MDGs). But in order to maximize the development impact of migration, there is a need to adopt a comprehensive approach to migration (UNDP, 2009). In particular, as the populations of developed economies and the EU get older, more immigrants will be needed to maintain a stable workforce. This will necessitate policies to attract immigrants and make use of their full potential. In the case of sending countries, there is a clear need to adopt a comprehensive migration policy that ensures that abuse of potential migrants does not take place, workers have the rights they deserve when they are abroad and benefits of remittances are better harnessed at home. Most importantly, the overall development strategy of sending countries should view migration more as a complementary measure rather than as a substitute to development. Keeping in line with the proposals of the UN Open Working Group on Sustainable Development Goals, body responsible for the post-2015 development agenda, some of the policy measures include the following:

Demand for migrants in the advanced economies: Population decline and ageing

As this chapter has documented, there has been an unprecedented increase in international migration in the twenty-first century and, given the persistent inter-country inequality and wage disparities and the growing working age population in developing countries (combined with rising educational standards), this trend is only likely to continue in the future. Due to persistently low fertility rates in the advanced economies, shortages of labour are likely to intensify, which will bring pressure to allow the inflow of migrants in order to sustain current levels of economic growth.

- *Promoting economic integration of migrants*: As this chapter has shown, unemployment rates among migrants are higher than among native-born populations and migrants tend to be highly qualified for the jobs they hold. In order to harness the benefits of migration, there is a need to address these distortions in the labour market. Moreover, for a sustainable and lasting economic and labour market recovery, it is imperative to utilize the full productivity of migrants.

- *Allowing for increased legal migration*: Since the reality facing many advanced economies is a shrinking workforce, allowing for legal migration to meet the labour market needs is of paramount importance. Many advanced economies need both skilled and less skilled migrants, but the legal institutions currently prevalent make migration of less skilled workers difficult, hence illegal migration among these workers is widespread.

- *Putting in place initiatives to combat xenophobia, discrimination and abuse*: As this chapter highlighted, South–South migration has become an important aspect of labour migration. And, as countries in the southern hemisphere

continue to develop, this will increasingly be the case. This means that the advanced economies in the north will face competition for workers, particularly the less skilled workers that are much needed in the service sectors. In order to attract and retain foreign-born workers, countries in the north need to put in place policy interventions against xenophobia, discrimination and abuse.

Comprehensive approach to migration: Policies for pre-departure, while abroad and eventual reintegration

- *Introduce measures to improve pre-departure information*: First, it is important to engage would-be migrants before they leave the country. Those wishing to leave should be informed of any job opportunities domestically but should also be provided with pre-departure counselling regarding working conditions abroad, goals and objectives of migrating, potential remittance transfer and savings options and other financial/investment services. This could be achieved through the provision of orientation courses and migrant resource centres. For example, an orientation programme in the Philippines offers: (i) a pre-employment orientation seminar aimed at those who have not yet decided whether to migrate, and (ii) a pre-departure orientation seminar for those who are about to leave. The latter is compulsory and provides information on each migrant's contract, as well as their rights while travelling abroad. Depending on the migrant's destination country, there may be requirements regarding language courses or other certifications.

- *Continue to provide assistance to migrants while abroad*: When migrants are in their country of destination, their Government, through its embassies and consulates, can provide basic services, such as how to adjust to the new environment, language support and legal support. Before foreign ministry staff leave on their diplomatic missions, it is important to provide adequate training on issues related to migrants – for example concerning the labour laws in the host country and regulations relating to safety in the workplace. It is also important that countries should put in place bilateral agreements to ensure that all workers can work in a safe environment. In that respect, countries must first ratify the ILO Convention on Decent Work for Domestic Work.

- *Reintegration upon return*: There remain significant challenges in reintegrating low-skilled migrants who have returned home after working abroad. This is particularly the case with low-skilled migrants who return from the Gulf countries. A first step would be to keep a database of the skill profiles of returnees, which is surprisingly lacking in many countries. Also, providing business and entrepreneurship training to the returnees is an important factor in facilitating the best use of the financial resources of migrants.

Better leverage of remittances for investment and development

- *Matching funds*: One of the ways to encourage remittance use for development is through the provision of matching funds, where the Government matches every dollar that overseas migrant groups or HTAs remit. For example, Mexicans living abroad use HTAs to support development efforts at home and now the programme has become an important part of Mexico's development and poverty reduction efforts. The matched funds are used to finance infrastructure

projects based on local needs, and range from building bridges and roads to schools and health centres.

- *Incentive schemes for investment*: Similarly, countries could provide investment schemes in the form of preferential treatment for migrants that buy land, build businesses, invest in machinery and equipment, etc. Moreover, depending on the country's specific needs, governments can be creative in designing financial and investment products. Through a programme called LINKAPIL (Link for Philippine Development) the Government of Philippines encourages and facilitates the flow of assistance and donations from Filipinos abroad to specific projects back at home. For example, in the field of education, Filipinos living and working abroad can support children from poor communities in pursuing their education; other efforts include providing financial help for micro-enterprises, small-scale infrastructure projects, and health and welfare programmes.

Appendix A

Decomposing per capita GDP growth in a model with migration and human capital

The theoretical model used for estimating migration's impact on GDP growth closely follows the Solow-Swan neoclassical growth model (Mankiw et. al., 1992). Output (Y) is produced using physical capital (K), human capital (H) and labour (L). All countries are assumed to have access to a Cobb-Douglas production function with constant returns to scale and labour augmenting technological progress (A). The functions parameters are allowed to vary both through time and across countries.

$$Y = K^{\alpha} H^{\beta} \left(AL\right)^{1-\alpha-\beta} \text{ where } \alpha+\beta<1$$

Following the standard neoclassical growth model, the analysis presented in this chapter assumes that technological progress evolves at a constant rate g_A.

Migration affects growth directly, by changing the size of the labour force, and indirectly, by modifying the level of both physical and human capital per capita. Focusing first on the effect on labour force size, this input's growth rate is given by:

$$\dot{L} = nL + M + E$$

where n is the natural population growth rate, M is the total immigration flows and E is total emigration flows.

As mentioned above, migration also indirectly affects production by changing the availability of other inputs per unit of labour. Whether this effect reinforces or contradicts the positive impact of a larger endowment of labour on per capita output depends on the skills of migrants relative to the local population. Following the standard Solow-Swan augmented growth model, GDP per capita growth is, on the one hand, negatively related to the net migration rate because of the capital dilution effect. This effect is, however, counterbalanced by a positive impact of human capital accumulation. The overall effect of migration on economic growth depends on the relative human capital contributions of foreign-born migrants relative to the local population as well as to the parameters of the production function,

which determine the return on human capital. An increase in the inflow of foreign workers will have a positive impact on productivity growth only if new migrants are, on average, more qualified than the resident population. This difference in relative productivity or skill must, moreover, be large enough to overcome the capital dilution effect caused by the decrease in physical capital per capita.

Given the growth equations derived from the theoretical model, per capita GDP growth can be decomposed into the contributions from labour-augmenting technical growth, investments in human and physical capital and the effects of population growth.[9] This last effect can be further divided into the effect on the size of the labour force and the indirect effect caused on both human and physical capital per capita. Based on the implications from the theoretical model, the empirical model estimated to determine the effect of migration on development is:

$$ln(y_{i,t}) = \beta_1 + \beta_2 ln(y(0)_{i,t}) + \beta_3 ln(s_{Ki,t}) + \beta_4 ln(s_{Hi,t}) + \beta_5 ln(\delta + g_A + n_{i,t}) + \beta_6 \frac{\frac{h_{i,t}^{I}}{\hat{h}_{i,t}} m_{i,t}}{(\delta + g_A + n_{i,t})} + \beta_7 \frac{\frac{h_{i,t}^{E}}{\hat{h}_{i,t}} e_{i,t}}{(\delta + g_A + n_{i,t})} + u_{i,t} + \gamma_i + v_t \qquad (1)$$

where y_i and v_t are, respectively, country and time fixed effects.

An attempt to estimate the effects of migration on growth runs into several methodological and practical issues: first, while data availability on migration has improved significantly in recent years, data on migration inflows and outflows is still restricted to a limited time frame and contains several missing values across time for various countries; this poses a problem since migration flows can be expected to be serially correlated across time and, without access to a long time series of data flows, controlling for such correlations becomes harder. Second, the direction and magnitude of migration over development depends on the skill of migrants relative to the local population. However, data on human capital (proxied by educational levels) only became available recently and exclusively for OECD countries, so even for these countries long time series do not exist. In order to overcome this issue, an assumption regarding migrants' human capital relative to that of the average population in their country of origin is made. For estimation purposes, it is assumed that migrants have a fraction of the average human capital in their native countries. This is a conservative assumption since it is reasonable to expect migrants, within each occupational category, to migrate expecting better returns on their skills, net of migration costs, in their destination country. Moreover, both theoretical and empirical literature supports the assumption that migrants, within occupational categories, are on average better qualified than their local counterparts.

The final challenge involved in estimating the determinants of growth relates to the process underlying economic development. Several characteristics of the theoretical model underlying growth can lead to estimation bias if the econometric method employed does not account for them. In the case of economic growth and migration the following estimation concerns arise:

- Arbitrarily distributed fixed country effects make a panel database necessary. Cross-time variation for each country is needed in order to isolate fixed country effects. Hence, cross-section regressions must be avoided and time series for all countries in the sample are needed.

9. For the full theoretical model, please contact khatiwada@ilo.org.

Table 9A.1 Data used to estimate the impact of international migration on growth

Parameter	Definition	Data source
S_K	Investment in physical capital as a share of GDP	Penn World Table – Domestic investment as a share of GDP
S_H	Investment in human capital as a share of GDP	World Bank – Public spending on education as a share of GDP
n	Population growth rate	World Bank – Growth rate of the working-age population
δ	Capital depreciation rate	Penn World Table
α, β	Technology function parameters	Feenstra, Inklaar and Timmer (2013)
$\hat{h}$	Migrants' average human capital	World Bank – Share of population (in origin country) with tertiary education time. (later tested for robustness)
$e_{i,t}, m_{i,t}$	Migrants inflows and outflows	World Bank – Migration inflows and outflows for each country

Table 9A.2 Results: Impact of migration on growth

ln(GDP per capita growth)	Coef.	Robust std. Err.	z	P>z	[95% conf.	interval]
ln(GDP per capita growth t–1)	–0.25*	0.11	–2.26	0.024	–0.46	–0.03
ln(investment in capital)	5.77*	2.95	1.96	0.05	–0.01	11.55
ln(investment in human capital)	3.39	2.27	1.49	0.14	–1.07	7.85
ln(population growth)	–0.23*	0.10	–2.24	0.03	–0.42	–0.03
convergence (initial GDP per capita)	–0.95*	0.37	–2.59	0.01	–0.17	–0.02
human capital weighted inflows	0.52*	0.24	2.19	0.03	0.55	0.98
inflows	–0.32*	0.77	–4.2	0	–0.48	–0.17
outflows	0	0	–1.47	0.14	0	0

* indicates statistical signficance.

- Economic growth is inherently a dynamic process and, hence, current realizations of per capita GDP, the dependent variable in this model, are influenced by past ones. Including lagged values for the dependent variable as regressors will not necessarily solve the problem and may exacerbate it if other regressors are also not strictly exogenous, as is the case for migration.
- Migration inflows and outflows are not exogenous. Relative GDP per capita across countries is one of the main incentives underlying migration decisions.
- The number of time periods of available data is small, making it harder to use lagged values and difference estimators to solve for the problems described above.

These elements of the interaction between development and migration, coupled with the characteristics of available data, motivate the use of a system general method of moments (system GMM) to estimate the effects of migration on growth. Data sources and definitions used to estimate each of the parameters in equation 1 are detailed in table 9A.1. The results are presented in table 9A.2.

Appendix B

Macroeconomic impact of remittances

Based on previous research on the link between financial development and remittances, the analysis conducted for this chapter aims to investigate the impact of remittances on both national savings and investment.[10] To this end, a panel database with information on remittance flows to 165 countries between 1994 and 2010 is employed. In particular, this analysis looks at the link between remittances and savings, which is measured as deposits at banks and financial institutions. Second, a similar analysis is conducted to investigate the link between remittances and investment, proxied by countries' fixed capital formation. Table 9B.1 lists the sources of the variables used in the analysis.

As shown in the equation below, national deposits are explained by remittances (*Remit*) while controlling for variables also known to affect saving and investment decisions in an economy. In particular, all equation regressions control for countries' GDP per capita (*GDP_cap*), the log of GDP (*GDP*), inflation (π), as well as for different capital and income inflows, such as exports, foreign direct investment (*FDI*), and development assistance (*ODA*). Subsequently, the same set of variables is used to explain countries' fixed capital formation. It must be noted that, except for GDP, GDP per capita and inflation, all variables are expressed as a percentage of GDP. In addition, to avoid endogeneity concerns related to reverse causality, all explanatory variables have been introduced in lags.

$$Deposits_t = \beta_0 + \beta_1 Remit_{t-1} + \beta_2 GDP\_cap_{t-1} + \beta_3 GDP_{t-1} + \beta_4 \pi_{t-1} + \beta_5 Exports_{t-1} + \beta_6 FDI_{t-1} + \beta_7 ODA_{t-1} + \mu_t$$

Except for inflation, all variables should have a positive impact on savings and investment. In particular, higher GDP per capita is indicative of a larger number of wealthy individuals who are able to save and invest a relatively larger share of their income. Second, country size, proxied by each country's GDP, might indicate

Table 9B.1 Data source: Impact of remittances on savings and investment

Deposits to GDP (*Deposits*)	Financial system deposits to GDP (%)	Global Financial Development, the World Bank
Fixed capital formation to GDP	Gross fixed capital formation (% of GDP)	World Development Indicators (WDI)
Remittances to GDP (*Remit*)	Workers' remittances and compensation of employees, received (% of GDP)	WDI
GDP per capita (*GDP_cap*)	GDP per capita (constant 2000 US$)	WDI
GDP	Log of GDP (constant 2000 US$)	WDI
Inflation (π)	Inflation, GDP deflator (annual %)	WDI
Exports to GDP (*Exports*)	Exports of goods and services (% of GDP)	WDI
FDI to GDP (*FDI*)	Foreign direct investment, net inflows (% of GDP)	WDI
ODA to GDP	Net official development assistance received (% GDP)	WDI

10. See Aggarwal et al. (2011), Chowdhury (2011) and Ratha and Shaw (2006).

Table 9B.2 Impact of remittances on savings and investment

	Deposits				Fixed capital formation			
	1	2	3	4	5	6	7	8
Remit (t–1)	0.671***	0.664***	0.221**	0.205**	0.273***	0.272***	0.193***	0.192***
	[0.122]	[0.121]	[0.102]	[0.103]	[0.0465]	[0.0465]	[0.0516]	[0.0519]
GDP cap. (t–1)	0.00243***	0.00244***	0.00301***	0.00304***	–0.0000306	–0.00003	0.000054	0.000055
	[0.000147]	[0.000147]	[0.00103]	[0.00103]	[1.92e–05]	[1.93e–05]	[0.000141]	[0.000142]
Ln (GDP) (t–1)	0.864*	0.811*	–2.228	–2.591	0.0241	0.0219	8.823***	8.809***
	[0.450]	[0.451]	[5.931]	[5.929]	[0.114]	[0.115]	[2.983]	[2.992]
Inflation (t–1)	–0.0102***	–0.0101***	–0.003	–0.003	–0.000461	–0.00046	0.000527	0.000524
	[0.00317]	[0.00313]	[0.00193]	[0.00193]	[0.000728]	[0.000727]	[0.00134]	[0.00134]
Exports (t–1)	0.471***	0.476***	0.068	0.067	0.0454***	0.0456***	–0.0700*	–0.0701*
	[0.0491]	[0.0491]	[0.0783]	[0.0782]	[0.00735]	[0.00738]	[0.0407]	[0.0407]
FDI (t–1)	0.980***	0.977***	0.509***	0.509***	0.0116	0.0115	0.0209	0.0209
	[0.0729]	[0.0728]	[0.0433]	[0.0431]	[0.0101]	[0.0101]	[0.0178]	[0.0178]
ODA (t–1)	–0.127	–0.121	0.052	0.050	–0.04	–0.0398	0.0719**	0.0719**
	[0.0782]	[0.0786]	[0.0571]	[0.0566]	[0.0247]	[0.0247]	[0.0360]	[0.0360]
Constant	–14.680	–13.860	85.960	94.290	19.99***	20.03***	–186.5***	–186.2**
	[11.74]	[11.74]	[142.9]	[142.8]	[2.970]	[2.976]	[71.25]	[71.46]
Observations	2'101	2'101	2'101	2'101	2'167	2'167	2'167	2'167
R-squared	0.73	0.73	0.55	0.55	0.11	0.11	0.11	0.11
First year	1994	1994	1994	1994	1994	1994	1994	1994
Last year	2009	2009	2009	2009	2009	2009	2009	2009
Country FE	NO	NO	YES	YES	NO	NO	YES	YES
Time FE	YES	YES	YES	YES	YES	YES	YES	YES
Number of countries			165	165			165	165

Robust standard errors in brackets. In equation models # 3, #4, #7 and #8, standard errors have been adjusted for 165 clusters in country.
*** p<0.01, ** p<0.05, * p<0.1

the presence of a critical mass, allowing the financial system to cover the fixed cost of operating in the market and to increase efficiency in the allocation of financial resources. Third, exports, FDI and ODA inflows, are money injections into the economy that may afterwards be channelled into national savings and investment.

Results are presented in table B.2; all regression equations include time-fixed effects to control for shocks and time trends shared across countries. It is interesting to note that, among all factors included in the analysis, only remittances appear to have a positive and significant impact on both savings and investment across specifications. In particular, a ten-point increase in the remittances to GDP ratio raises the deposits to GDP ratio by 2.05 points and the fixed capital formation to GDP ratio by 1.92.

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