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FOR INFORMATION

THIRD ITEM ON THE AGENDA

Policy coherence: Growth, investment and employment

Report on the Fourth Informal Meeting of the Policy Coherence Initiative on Growth, Investment and Employment and the Tripartite Seminar on Growth Investment and Employment in Southern Africa

Introduction

1. During the November 2005 session of the Working Party, several delegations requested information about: (a) the Fourth Informal Meeting of the Policy Coherence Initiative (PCI) on Growth, Investment and Employment; and (b) the Tripartite Seminar on Growth Investment and Employment in Southern Africa. [1] This paper responds to this request and reports on the organization and substantive findings of both meetings.

Fourth Informal Meeting of the Policy Coherence Initiative on Growth, Investment and Employment

2. The Fourth Informal Meeting of the Policy Coherence Initiative on Growth, Investment and Employment brought together participants from the multilateral system on 8 December 2005 at the ILO in Geneva. They came from the International Fund for Agricultural Development (IFAD), the International Monetary Fund (IMF), the United Nations Conference on Trade and Development (UNCTAD), the United Nations Industrial Development Organization (UNIDO), the United Nations Department of Economic and Social Affairs (DESA), the World Bank and the World Trade Organization (WTO). In addition to senior ILO staff from across the Office, one participant from the International Confederation of Free Trade Unions (ICFTU) and one from the South Africa Chamber of Mines (attending on behalf of the Employers' group) joined the discussions.

[1] GB.294/14.

3. As on earlier occasions, the Office emphasized the informal and technical nature of the meetings. Their purpose was to determine where the views of the participating international organizations coincided, to share methodologies, and to reach a common understanding of policy coherence. While the previous meeting, held on 8 June 2005 in Geneva, had addressed labour market institutions and policies, the Fourth Meeting focused on the interaction between macroeconomic policies and labour markets. Discussions were based on technical papers presented by the ILO, the World Bank and UNCTAD.

4. As the first contribution, the ILO presented a technical paper on financial openness and employment [2] that was written along the lines of the Governing Body paper discussed during the last session of this Working Party. [3] In doing so, the Office followed the proposal made by this Working Party in November 2005 to engage with the World Bank and the IMF on the theme, and to place the dialogue on the employment impact of financial openness within the PCI. [4] The presentation argued that there was no strong correlation between financial openness and growth, but that financial liberalization had left many countries vulnerable to volatility and financial crises. These have adverse long-term effects for enterprises and workers alike, and it is from this perspective that the ILO is concerned about the consequences of financial openness. Countries should therefore take into account the risks before embarking on financial liberalization, and do so only after considering their particular circumstances. At times, flexible capital controls and management of the real exchange rate could be appropriate policy instruments to achieve better employment outcomes.

5. The ILO contribution on the topic was welcomed during the discussion. Many of the concerns expressed by the paper were shared, such as the often disproportionately large impacts of financial crises on labour and the lag in the recovery of employment indicators. However, the participant from the IMF warned against drawing the simplistic conclusion that financial liberalization is necessarily bad for employment, and acknowledged that the paper had avoided doing so. He argued that domestic factors – internal institutional weaknesses and governance issues – played an important role in sparking financial crises. This point was also underlined by the participant from the World Bank. This provoked the criticism that the international financial institutions (IFIs) had in the past not paid enough attention to these weaknesses when advocating financial liberalization. However, the IFIs have encouraged countries to strengthen the soundness of their banking system as a key prerequisite for financial liberalization. It was argued that when liberalization is performed in a gradually sequenced and carefully planned way, it can bring about significant benefits. Others stressed that premature liberalization can have undesirable outcomes, such as deindustrialization. In sum, there was a general agreement that financial liberalization has both costs and benefits, but participants disagreed on their relative importance. There was also a general understanding that country-specific factors needed to be considered carefully prior to embarking on financial liberalization.

6. The presentation by the World Bank addressed the distributional impact of reforming labour market regulations. [5] The interest in the theme was driven by the assessment that labour is often the only asset the poor have, and that employment is therefore central to

[2] Rolph van der Hoeven and Malte Lübker. 2005. *Financial openness and employment: The need for coherent international and national policies.* Geneva: ILO, mimeo.

[3] GB.294/WP/SDG/2(&Corr.).

[4] GB.294/14, paras. 7 and 12.

[5] Coudouel, Aline. 2005. *Analyzing the distributional impact of reforms*. Washington, DC: World Bank.

poverty reduction. However, it was argued that labour market regulation can increase access barriers for those that are outside the labour market, while protecting the interests of relatively privileged insiders. For example, while minimum wage legislation might be aimed at compressing the wage distribution, the primary effect can be to increase the wages of those above the minimum wage level while reducing the demand for labour, thus hurting the poor. The same would also hold for other areas of employment protection legislation. Hence, reforming labour market regulation can improve employment prospects for the poor. It therefore becomes critical to determine the optimal design and degree of labour market interventions, and to find ways to implement appropriate reforms.

7. The discussion acknowledged that labour market regulation can have costs if inappropriately designed or applied excessively. However, several participants said that the presentation was one-sided in focusing on the negative sides of labour market regulation, and had not adequately discussed its benefits. It was argued that without regulation, labour markets do not function well. Also, in focusing on the formal rules, the paper had not captured the fact that these rules are not effectively enforced in some countries. In other countries, labour regulations provide a framework but much of the content of work rules is set by collective bargaining. The study did not capture the interaction between labour law systems and social dialogue. Given these difficulties, the large body of aggregate data analysis had thus far not been successful in resolving the debate. This indicates the need to study the effects of labour market regulation more thoroughly through more detailed micro-level studies. The presenters acknowledged that determining the appropriate level of labour market regulation was a difficult task, and that the paper did not imply that labour market regulation should be abolished. There was agreement that the balance between flexibility and security needs careful consideration, and further research on this is a priority (see also paragraph 18 below).

8. The research presented by UNCTAD focused on foreign direct investment (FDI) in Africa. [6] While the continent had remained on the fringes of the FDI boom, inflows had increased considerably since 1989. A detailed look at these inflows shows that a large portion went into export-oriented zones in the primary sectors, with little linkage to the rest of the economy. FDI is therefore not tantamount to development, and not a surrogate for a dynamic investment process. The policy lessons are that: (i) opening economies and downsizing the state cannot be the solution; (ii) public and private domestic investment are crucial complementary elements to establish a dynamic investment process; and (iii) the surge in FDI to extractive sectors warrants caution since it can establish dependency on commodities and have distortional impacts on other parts of the economy. What is needed is a more balanced approach with greater emphasis on industrial policies, more coherent fiscal policies, and international action to create the policy space that improves the bargaining position of developing countries towards foreign investors.

9. The view that FDI is not panacea for development in Africa was generally shared during the subsequent debate. At the same time, the participant from the World Bank pointed out that FDI can make a positive contribution to development, and that mining can play a positive role. The participant from UNIDO drew attention to research undertaken by her organization on how to optimize local linkages and capture spill-over benefits from FDI. Domestic factors, such as lack of secure property rights and low productivity, were also debated. The presenter acknowledged the important role of mining in Africa, but went on to say that mining could not serve as the main engine for employment growth. The question was whether Africa could use its resources to develop a non-mining focused development path.

[6] UNCTAD. 2005. *Economic development in Africa: Rethinking the role of foreign direct investment.* New York and Geneva: United Nations.

Tripartite Seminar on Growth, Investment and Jobs in Southern Africa

10. During its March 2005 deliberations, the Working Party developed the idea to draw on the knowledge and experience of the ILO's constituents to advance and influence the Office's work in the area of growth, investment and employment. [7] In response to this initiative, the Subregional Office for Southern Africa (ILO/SRO-Harare) and the Policy Integration Department (INTEGRATION) proceeded to organize a first tripartite workshop that would tap constituents' expertise on the theme. This step was widely welcomed during the November 2005 session of the Working Party and several delegations called on the Office to organize similar workshops in their respective subregions. [8]

11. The seminar took place on 5-6 December 2005 in Johannesburg, South Africa. In its invitation letter to constituents in the nine countries of the subregion, the Office had emphasized that the intent of the seminar was to bring together constituent experts for a technical discussion and encourage them to nominate participants with expertise in the field of labour economics. This was well received by constituents, as evidenced by the high calibre of participants and the high participation rate (only three apologies were received). [9] The substantive discussions of the seminar were based on two background papers, one dealing with the nexus of growth, investment and jobs in general and the other with financial openness and employment (along the lines of parallel papers for the November 2005 Working Party and the Policy Coherence Initiative; see above). Participants were divided into three working groups on two occasions in order to allow room for an intense exchange of ideas and national experiences; the findings were then presented to the plenary for debate.

12. Throughout the seminar the message emerged that the disconnect between growth and employment creation is a common experience in the southern Africa subregion. Even countries that managed to achieve relatively high rates of growth in recent years had made only minor progress towards creating employment. There was a general consensus that this problem could not be solved through labour market instruments alone, but that policies from other domains had an important impact on employment outcomes. Participants supported the idea that macroeconomic policies should not only aim at achieving growth, but also make employment creation an explicit objective.

13. Some participants reported encouraging developments in this direction. For example, in South Africa, there is now a general recognition that the past policy focus on growth has not solved the country's employment problem. Hence, a heated debate has evolved on how trade, monetary and fiscal policies contribute to employment creation and, as an end result, to poverty alleviation. Through the National Economic Development and Labour Council (NEDLAC), the social partners took an active part in this and achieved some coherence between different policy domains. A further example is Botswana where, despite good growth performance, unemployment remains a major challenge. There are now efforts on the part of the Ministry of Finance and Development Planning to draft a comprehensive employment strategy. ILO support for this has been secured and the Ministry representative assured social partners that they will be involved at an early stage.

[7] GB.292/15(Rev.).

[8] GB.294/14.

[9] Unfortunately, the gender composition of the workshop was highly unbalanced, with 21 male and only three female participants (all of whom were nominated by governments).

14. The role of investment as a major driving force behind growth and job creation was discussed prominently during the entire seminar. Participants acknowledged that FDI can make an important contribution and generally agreed that political stability and the rule of law are prerequisites for attracting FDI. However, participants also voiced their frustrations with the emphasis given to foreign investment in the prevailing policy approach. Firstly, even if "good governance" and the other "enabling conditions" are in place, there is no guarantee that foreign investment will flow into a country. Secondly, competition for foreign investment should not lead to a lowering of labour standards. Therefore, greater regional coordination is needed to prevent the risk of a "race to the bottom". It was argued that much of the Decent Work Agenda is an integral part of countries' constitutions and should be non-negotiable. Thirdly, the special terms given to foreign investors should not lead to discrimination against national investors.

15. There was a general agreement that more emphasis should be put on increasing investment from national sources and on putting in place the right conditions for domestic investors. Stopping capital flight would be a major step in making available the necessary resources. Low or moderate levels of inflation, a stable macroeconomic environment, low real interest rates and an adequate real exchange rate were cited as important elements. Participants highlighted the potential that lies in small and medium-sized enterprises from the formal sector as well as in micro-enterprises from the informal economy. Increasing investment here could have a major impact since national investment often entails higher employment creation than foreign investment, and jobs tend to be more sustainable. Public investment, particularly into infrastructure, was seen as an important complementary element. It not only generates employment and growth on its own terms, but can – if adequately designed – attract further private investment, leading to further job creation.

16. In discussing these interactions, the tripartite experts laid out some building blocks for a coherent macro strategy that aims at accelerating growth and creating employment simultaneously. While the nature of the seminar did not foresee formal recommendations, participants generally appreciated the exchange of ideas and national experiences as a mutual learning experience that will be beneficial for advancing policy coherence at the national level. For the Office, the seminar was an important opportunity to receive feedback on its work, to study the subregion's multi-faceted experience and to learn about constituents' priorities. The exchange with constituents also gave the Office the reaffirmation that it should push ahead with its work on growth, investment and employment as a matter of urgency.

Outlook for future activities on the theme of growth, investment and employment

17. While it is not yet possible to give a final assessment of the Office's experience on policy coherence, there are some encouraging signs. It is clear that the call for greater policy coherence made in the report of the World Commission on the Social Dimension of Globalization has found resonance with other agencies, both on their boards and among staff. As reported above, the various agencies recognize the need for more coherent policies, especially on questions of growth, investment and employment, and are willing to discuss related issues in an open and frank manner. The meetings have also strengthened informal contacts and the Office is increasingly consulted on emerging issues. For example, various research activities are being jointly developed with the World Bank. On the national level, there is a greater acknowledgment of the need for more coherence and the support of constituents to actively work on this.

18. The Office will therefore continue its activities on the theme of growth, investment and employment. The World Bank offered to host the next informal meeting of the Policy

Coherence Initiative in Washington, DC in late April 2006, following the spring meetings of the IFIs. Participants agreed to narrow the focus to a single, specific topic – the balance between flexibility and security in developing countries (see paragraph 8 above).

19. In the light of the positive experience with the first tripartite seminar with constituents in southern Africa, the Office will follow up the requests made during the November 2005 session of this Working Party and will progressively organize similar seminars in other subregions.

Geneva, 20 February 2006.

Submitted for information.