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Growth with employment for inclusive and sustainable development

Chapter 5

Policies for Employment-Intensive Growth in the LDCs

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A. Introduction

The State has a dual role: enacting policies to promote output expansion and employment creation in the private sector, and directly generating jobs.

Chapter 4 of this Report argued that in the medium to long term, the only sustainable way of ensuring that the LDC economies generate jobs in sufficient quantity and quality is through the development of productive capacities. However, while in theory the private sector should generate most jobs, it is still weakly developed in these countries. This requires a dual role for the State: enacting policies to promote output expansion and employment creation in the private sector, and directly generating jobs through the expansion of public employment in socially essential or desirable activities. Achieving these objectives will require implementing a broad range of mutually supportive policies aimed at building productive capacity and fostering structural transformation. Policy interventions should cover three broad areas: macroeconomic policies, enterprise development, and public sector investment and actions for job creation. This chapter presents the broad policy direction that LDC Governments need to follow in order to attain employment-rich growth and to establish the strong investment-growth-employment nexus described in chapter 4.

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For LDCs, there must clearly be two complementary objectives concerning employment: to expand the number of jobs, so as productively to absorb the growing labour force; and to raise the labour earnings generated by these jobs through productivity gains, which in turn implies diversifying the economy towards higher value added activities. These objectives require a range of mutually supportive policies — not just short-term macroeconomic or labour market policies, but strategies aimed at structural change. This includes longer-term policies that "should strive for an expansion of productive capacity and an increase in the employment content of growth, to the extent that increasing the employment content of growth does not jeopardize growth itself" (van der Hoeven, 2013: 22). Furthermore, given the high degree of synergy and complementarity between appropriate development policies (Rodrik and Rosenzweig, 2010), different policies (macroeconomic, sectoral, micro, social, trade and industrial policies) must be coherent and mutually supportive.

National policies are strongly conditioned by the external environment and must also be able to respond to that environment flexibly.

There are obvious constraints on policy formulation and implementation in LDCs. One important set of constraints arises from the nature of their integration with the global economy. Since LDCs tend to be open economies that rely heavily on primary commodity and low value added manufactures exports, and that are dependent on various forms of capital inflows to support the balance of payments, they are often disproportionately affected by changes in global trade and capital flows, as well as by flows in cross-border migration. National policies are thus strongly conditioned by the external environment and must also be able to respond to that environment flexibly, which often makes it more difficult to pursue them in a systematic and planned manner.

Another frequently mentioned constraint is the supposedly limited capacity of LDCs to design and implement policies, which is usually attributed to their dearth of technical, human, political, financial and institutional resources and/or to the prevailing type of governance. This has been used as a strong argument against their industrial policies, on the grounds that government failures are worse than market failures, especially when States do not have the capacity to design and implement industrial policy and are not competent at "picking winners". It is also argued that industrial policy is liable to corruption and rent-seeking; is associated with resource misallocation and waste; and allows the persistence of inefficient firms. However, as has been noted in previous editions of *The Least Developed Countries Report* series, several of these perceived

shortcomings in LDCs are themselves due to fiscal retrenchment dating back to the structural adjustment era, weak country ownership of many policies, and lack of interest of the international community in devoting resources to capacity-building in most policymaking areas. Despite this, many LDCs do have islands of excellence in public administration or executive agencies and can build on them strategically, which would allow them incrementally to expand bureaucratic competence and gradually build developmental States using industrial policy (UNCTAD, 2009: 15–56). It should be recognized that industrial policy is a learning process (Rodrik, 2004, 2008) and that policymaking capability evolves along with productive capacities (Nelson, 1994; Freeman, 2008; Moreau, 2004; Shimada, 2013). Indeed, this has been the experience of successful latecomer industrializing countries (Chang, 2011). But donors can also play a useful role in strengthening LDC policy capacity, including industrial policy (O'Connor, 2007; UNCTAD, 2009: 46–49).

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Yet another important background consideration involves technology choice, as discussed in chapter 4. LDC policymakers are faced with potentially contradictory priorities. On the one hand, they need to give high priority to policies that generate more jobs. On the other hand, they need to diversify their economies to increase labour productivity and labour earnings so as to alleviate the pervasive problems of poverty and underemployment. Productivity improvements are usually associated with more modern technologies which are invariably more capital-intensive and labour-saving, and which can run counter to the first objective of increasing employment. In other words, policymakers often face a trade-off between efficiency and equity. However, this need not always be the case. Ensuring adequate decent work for the labour force is possible if reasonably rapid growth of average productivity is combined with the rejuvenation of some traditionally important, employment-intensive activities (such as some forms of agriculture), expansion of service activities that meet social needs, and growth in the volume of economic activity. This has of course been the case with countries undergoing a rapid industrialization process in which manufacturing activities – which typically exhibit increasing returns to scale – render rapid growth of average productivity possible.

Ensuring adequate decent work for the labour force is possible if reasonably rapid growth of average productivity is combined with the rejuvenation of some traditionally important, employment-intensive activities.

Thus, the adoption of labour-saving technologies need not be a problem if the volume of production expands sufficiently to generate higher absolute levels of employment. Modern technologies that reduce the drudgery and arduousness of work are to be desired in their own right. It is, of course, preferable if they are associated with increases in labour productivity in society as a whole. Accordingly, the focus must not be on preventing labour-saving technological progress. It should rather be on ensuring that the surpluses from the activities carried out through labour-saving technologies are mobilized (directly through taxation or indirectly through the provision of incentives) and transferred to create demand for more labour-intensive products. These surpluses can also be used in a wide range of service activities, ranging from the provision of such essential services as health, sanitation and education to entertainment and cultural activities – anything that improves the quality of life. In this way policymakers can reach both goals: employment expansion and improving per capita incomes. Specific sectoral policies that can be deployed to ensure more employment are discussed below.

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With these points in mind, the rest of this chapter builds on the analytical framework developed in chapter 4. It identifies some broad policy areas that may be relevant for LDCs to consider in the light of the current global environment and their own conditions, as discussed in chapters 1, 2 and 3.

B. Macroeconomic strategies

This Report has argued that macroeconomic policies in LDCs need to be reoriented away from a single-minded focus on price stability and budget balance towards a strategy that is more focused on growth with sustainable employment creation. This is important because macroeconomic policy frequently involves trade-offs between different goals. For example, a quest for macroeconomic stability focusing on inflation control may imply sacrificing employment, certainly in the short run, and may also weaken workers' bargaining position, depress wages and therefore indirectly increase poverty. These short-run goals in turn have a bearing on development policies. The quest for macroeconomic stability may lead to less emphasis on strategies for sustainable and more inclusive development, or for improving human development and meeting broader social objectives. It is also often the case that price stability and correcting external imbalances become the dominant pursuits, such that pervasive unemployment or underemployment is allowed to persist, even though a shift in focus to make productive employment generation the most critical goal need not generate imbalances or instability.

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Given the potential conflicts between goals and across instruments, the choice of policy mix is not a purely technocratic exercise, but reflects political choices and has social implications. There are strong distributional implications, especially with respect to asset and income distribution and the differential provision of public goods and services across groups in the population. These implications relate not only to differences across economic classes and social groups, but also to gender differences. Such effects may vary depending on the characteristics of the country, such as the degree of indexation of wage incomes; how investors, especially foreign ones, respond to changes in local conditions; the particular activities in which employment is generated or lost; and so on.

Over the past decade, most LDCs have followed "prudent" and fiscally restrained macroeconomic policies.

Short-run macroeconomic policies and longer-term growth strategies are inextricably linked, not separate and independent. Over the past decade, most LDCs have followed "prudent" and fiscally restrained macroeconomic policies. While some have attributed the higher rates of income growth in this period to such a strategy, it is more likely that rising commodity exports and a favourable external environment were responsible. What is clear is that if the LDCs' development strategy is to shift towards a greater emphasis on productive employment generation and sustainable economic diversification, it will require supportive macroeconomic policies. In addition, a major concern of macroeconomic policy must be the reduction of economic volatility, which is undesirable for many reasons.

Public spending and taxation are key instruments for shaping the distribution of income in the economy, strengthening the process of capital accumulation and placing the economy on a job-rich growth path.

In this context, fiscal policies become quite prominent. Public spending and taxation are key instruments for shaping the distribution of income in the economy, strengthening the process of capital accumulation and placing the economy on a job-rich growth path. They are also the main instruments for establishing linkages between enterprises in modern sectors and the rest of the economy, thus making the process of structural change more dynamic and headed in the right direction. They can help accelerate diversification of economic activities and develop sectors that are of strategic importance for national development.

Fiscal policy can favour employment-intensive economic growth particularly through investment by the State. Public investment in physical and social infrastructure is absolutely critical for LDCs, as it improves both aggregate supply and aggregate demand conditions. Public investment in roads, railroads,

irrigation systems or public goods in urban areas creates physical capital, thereby expanding the country's productive capacities. Not all such investments need be executed by the public sector; they can be implemented by private involvement driven by public expenditure. This in turn provides more opportunities for private investment in activities that have become profitable because of the new infrastructure. Both of these effects expand the aggregate supply. At the same time, the employment created by public investment means additional incomes for workers, with positive multiplier effects, which boosts aggregate demand.

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In many LDCs the public sector is a major purchaser of goods and services and the largest formal sector employer in the economy. So public spending in general (both investment and consumption) already has a crucial influence on many markets for goods and services, as well as on the labour market. This means that government procurement policy (relying more on locally produced inputs and output, for example) can be used to induce employment creation in the economy and create possibilities for expansion of SMEs, once again with positive multiplier effects.

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Maximizing the benefits accruing from public investment and other public spending obviously requires fiscal space — the ability to mobilize resources from internal and external sources so as to meet the requirements of public expenditure. Broadening the available fiscal space in turn requires diversifying the sources of financing of the public sector and especially strengthening domestic resource mobilization (UNCTAD, 2009: 57–90). Possible actions in this regard include broadening the tax base, improving the collection system and making the tax system more progressive. Tax administration and enforcement can be improved by making more public resources available for such activities. Reforming the tax administration by improving information management and cross-checking statements and declarations leads to greater efficiency in tax collection.[1] Setting up a special unit for high-income taxpayers has also been found to be helpful. Reducing or eliminating exemptions and loopholes, as well as enticing more businesses to join the formal sector, can go a long way towards broadening the tax base. It may be useful to combine the carrots of some incentives for tax payment with sticks of better enforcement. In all cases, however, revenues will rise only if the Government has the political will, makes its intentions clear and is consistent and determined about tax administration.

Broadening the available fiscal space requires diversifying the sources of financing of the public sector and especially strengthening domestic resource mobilization.

It is important to diversify the sources of tax revenue rather than relying on a single indirect tax, such as value added tax (VAT). The principle should generally be to rely as far as possible on rules-based and non-discretionary tax instruments that are corruption-resistant and have lower transaction costs. Some specific tax measures that have proven effective include:

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- Increasing personal income tax collection from the rich, and raising taxes on luxury consumption;
- Taxing capital more effectively without affecting investment, often simply by tightening administration and through greater use of information technology;
- Reducing VAT exemptions on non-essential goods and raising the VAT rate on luxury consumption;
- Raising excise taxes on alcohol, tobacco and vehicles;
- Reducing tax holiday and exemptions for corporations and high-income expatriates;
- Increasing taxation on urban property (where the wealthiest live);
- Revising and implementing the taxation of the financial sector (where it is reasonably developed), possibly through measures like transaction taxes on financial transactions; and

- Refraining from further trade tariff cuts until alternative sources of revenue are put in place.

Resource-rich LDCs can increase fiscal revenue by reversing the current practice of offering extremely favourable terms to foreign investors in agriculture and mining.

For LDCs rich in energy and mineral resources, domestic resource mobilization may be achieved particularly through improvements in the capture and redistribution of resource rents (UNCTAD, 2010a: 199–203; UNCTAD, 2010b: 155–158). It is now more widely accepted that "In cases where the allocation of exploitation rights was flawed, governments should renegotiate the concession to restore a proper balance between private return and public revenue" (Commission on Growth and Development, 2008: 80). Resource-rich LDCs can increase fiscal revenue by reversing the current practice of offering extremely favourable terms to foreign investors in agriculture and mining. In the case of agriculture, this can involve imposing a tax on land leased for large-scale investment projects or raising the existing lease on land, as well as revising the taxation on the activity undertaken by such projects. Where mining is concerned, Governments can raise their revenues by adopting higher levies, royalties, income taxes or, in specific cases, export taxes. These can be usefully directed towards strengthening human capital formation and expanding infrastructure, which provide the long-term basis for economic diversification. This is especially critical because the resources generating these rents are exhaustible.

LDC Governments can strive to strengthen the mobilization of external resources from both traditional and non-traditional sources.

At the same time, LDC Governments can strive to strengthen the mobilization of external resources from both traditional and non-traditional sources. This includes negotiating for a non-reduction in ODA from traditional donors in the present context and, at a later stage, for an increase. A matching funds approach may also be considered, which provides an incentive for domestic revenue rising in order to obtain additional ODA. As proposed by the United Nations Department of Economic and Social Affairs, it is also worth working towards international consensus on non-traditional forms of development finance, such as a currency transaction tax; regular allocations of IMF special drawing rights (SDRs); and the use of "idle" SDRs (UN/DESA, 2012). Another non-traditional source of development finance is the channelling of a fraction of the resources of Sovereign Wealth Funds to LDCs, either directly or through regional development banks, as proposed by UNCTAD. A simple calculation estimated that through the latter alternative, if 1 per cent of the assets from those funds were directed to the capital base of regional development banks, this could mobilize an additional $84 billion in their annual lending capacity (UNCTAD, 2011: 109–123).

Regional funding of infrastructure can boost labour-intensive public works projects, e.g. in the context of regional integration schemes or of internationally funded border-crossing infrastructure projects.

Diversification of donors is a real possibility, given recent changes in the international economy, so LDCs can look beyond traditional donors to raise more financial assistance from partner Governments in the South.[2] Multilateral financial institutions can also provide additional resources for public investment. Regional funding of infrastructure can boost labour-intensive public works projects, e.g. in the context of regional integration schemes or of internationally funded border-crossing infrastructure projects, as was the case in the Greater Mekong Subregion of South-East Asia (UNCTAD, 2011: 102–104).

Since many LDCs continue to rely on ODA for a substantial part of their public spending, it is important to use such aid effectively. Until quite recently, aid inflows to many of these countries were not put to good use because of a fear of the adverse effects of currency appreciation and the perceived need to keep higher levels of foreign exchange reserves in order to guard against potential financial crises. While the recent decline in global economic activity has reduced this tendency to some extent, it is still essential to ensure that ODA translates into higher public investment, preferably in areas where there are shortages or which form bottlenecks for production, or in areas where existing levels of provision are socially suboptimal.

While fiscal sustainability is a crucial medium-term issue, there should be some flexibility with respect to fiscal targets, especially when deficits are the result of productive public expenditure, and during economic downswings. Rigid rules on fiscal deficits in the short run reduce the possibility of effective countercyclical policies, which are likely to become important once again in the uncertain global environment. The general rule for developing countries to maintain fiscal sustainability should be for the public sector deficit not to exceed the long-term trend growth rate of the economy, while allowing for short-term cyclical variations (UNCTAD, 2013a).

While fiscal sustainability is a crucial medium-term issue, there should be some flexibility with respect to fiscal targets.

The extent to which the LDCs can use the fiscal stance to address short-run situations of excess capacity or cyclical downswing is typically more limited than in developed countries. However, even this reduced policy space can and should be used as effectively as possible. For example, many LDCs adopted countercyclical measures, mostly of a fiscal nature, during the strong downturn in 2008–2009 (Brixiová et al., 2011; IMF, 2010). A case could also be made for a fiscal deficit composed entirely of public capital investment, *as long as the social rate of return from such investment exceeds the rate of interest*, which can effectively be financed through borrowing in exactly the same way as private investors do. This is particularly important, as noted above, in physical and social infrastructure, where public investment is essential since the presence of externalities means that the private sector is not likely to invest at socially optimal levels. A simple rule would be to limit debt financing in the medium term to the level of expenditure for public investment (UNCTAD, 2013a).

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Monetary policy is not only about price stabilization and inflation control, but should be an integral part of macroeconomic and overall development strategies. Particularly in LDCs, it should aim at expanding credit for investments that are considered necessary or strategic, improving livelihood conditions in sectors that employ a large proportion of the labour force, such as agriculture, and generating more productive employment by providing institutional credit to small-scale producers in all sectors. The primary function of financial markets in providing financial intermediation for development should never be forgotten.

Monetary policy should aim at expanding credit for investments and generating more productive employment.

That is why basing monetary policy solely on inflation targeting is problematic. It is true that macroeconomic instability expressed in high inflation can kill growth. However, macroeconomic stability (when broadly defined so as not to be focused on a narrow target, such as inflation) is only a necessary condition for growth, not a sufficient one. Periods of accelerated growth can be associated with moderate or even intense inflation when supply constraints are encountered. Indeed, there is no conclusive evidence that moderate inflation has adverse effects on growth (Stiglitz et al., 2006), but the distributive implications can certainly be adverse, especially in LDCs where most incomes are not indexed to inflation. In such cases, the focus of policymakers must be on preventing inflation from becoming excessive. This can be addressed by the following:

Macroeconomic stability is only a necessary condition for growth, not a sufficient one.

- Eliminating current and potential supply bottlenecks;
- Correcting sectoral imbalances that may add to inflationary pressure, for example in agricultural production;
- Ensuring that the growth process is not adversely affected by policies to control inflation;
- Countering possible regressive effects of inflation through specific measures directed at the poor, such as public provision of certain basic needs; and
- Ensuring that inflationary expectations and speculative tendencies do not build up in the system, thereby causing higher rates of inflation over time.

One alternative to a monetary policy fixated on attaining an inflation rate in the low single digits is a macroeconomic strategy that targets those real variables that are important for a particular country. These can include aggregate growth, productive investment, employment generation and poverty reduction. Monetary policy must be part of the overall macroeconomic policy directed towards these targets, rather than operating on a separate track of addressing monetary variables only. It should be coordinated and aligned with fiscal and exchange rate policies. Since the chosen target must be met within other constraints, interest rate management will not suffice; other instruments will have to be used by the central bank, including directed credit. Policymakers should avoid being fixated on one particular target and should be prepared to adjust targets and instruments depending on the requirements of changing situations.

The volume of credit is often a more critical variable than monetary supply.

The volume of credit is often a more critical variable than monetary supply, especially in LDCs where money markets and capital markets are less developed and relatively few households and enterprises have access to borrowing from formal institutions for consumption and investment. This is especially critical for MSEs and farms that cannot provide collateral for credit and are thus deemed not creditworthy by the banking sector. Microfinance institutions are valuable channels in this respect for small enterprises to access formal credit lines. Indeed, in many LDCs, and Bangladesh in particular, such institutions have served as effective instruments for including a large group of poor people in formal financial channels. Despite their benefits, however, these channels cannot be relied on as sources of credit mobilization for productive asset creation and the development of a dynamic enterprise sector. High interest rates, short gestation periods and the small size of loans tend to militate against their usefulness in poverty reduction and asset creation. Proper financial inclusion is likely to require larger financial institutions, some form of subsidy, as well as creative and flexible approaches by central banks and regulatory regimes to ensure that different banks (e.g. commercial, cooperative, development) reach excluded groups like women, as well as micro, small and medium-sized enterprises (MSMEs), self-employed workers, peasants and those without land titles or other collateral.

Microfinance cannot be relied on as sources of credit mobilization for productive asset creation and the development of a dynamic enterprise sector.

Productive diversification involves ensuring that MSMEs receive bank loans on similar terms as large capital. To this end, policymakers need to adopt a more ambitious and creative approach to the expansion of financial service provision, which is designed to facilitate access to credit for sectors and activities that are relatively deprived but that are of great importance for the economy. Relevant policy instruments in this regard include:

Productive diversification involves ensuring that small and medium-sized enterprises receive bank loans on similar terms as large capital.

- Directed credit rules that require banks to devote some proportion of their lending to such priority sectors;
- Subsidies to cover the higher transaction costs associated with such lending;
- Public guarantees for certain types of credit;
- Direct provision of credit by public financial institutions (e.g. development banks);
- Encouragement of cooperative banks and community banks; and
- Refinancing of commercial loans where necessary.

C. Managing the external sector

Most LDCs need some flexibility in exchange rates for trade purposes, but find it difficult to deal with the consequences of high volatility. "Intermediate" exchange rate regimes, such as managed floats, thus work best, since they allow Governments to adjust the level of the exchange rate to external conditions and to the current policy priorities of the domestic economy. These managed floats are best maintained through a combination of capital account and banking policy measures, along with the more usual open market operations of the central bank in purchasing or selling currency in the foreign exchange market. To make such a regime successful, capital flows need to be "managed" through a range of market-based and other measures, in terms of both inflows and outflows, so as to prevent excessive volatility and possible crises.

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A competitive exchange rate can be a crucial instrument for attaining growth with employment in a global economy (Frenkel, 2004). It changes the relative prices to a point where importing goods are expensive, thereby stimulating import-substituting activities in the national economy. It also stimulates exports, especially manufactured goods, since it makes these activities more competitive on international markets. A competitive exchange rate further facilitates a creation of linkages between the export sectors and the rest of the economy by making domestically produced inputs cheaper than imported ones. However, since a cheap currency is also a way of keeping domestic incomes lower, such a strategy needs to be carefully calibrated.

A competitive exchange rate can be a crucial instrument for attaining growth with employment in a global economy.

Indeed, since LDCs still have some leeway with respect to trade policy instruments – unlike other developing-country members of the WTO – it is useful to remember that combinations of tariffs and subsidies amount to systems of multiple exchange rates. While it is not always desirable to have too many of these operating within an economy, they can allow competitive exchange rates to be delivered to particular priority sectors without making essential imports more expensive domestically. This raises the issue of managing the trade account, an area that has been inadequately explored in recent times by LDC Governments. Most trade policies have been evaluated in terms of the extent and timing of trade liberalization through removal of quantitative restrictions, reduction of tariffs and elimination of export subsidies. This process has been accelerated by changes in the multilateral trading system, and even more by the proliferation of regional trading agreements that have pushed for greater trade liberalization. It can be argued that for LDCs the process has gone far enough, and that from the standpoint of productive diversification and in the context of the need for more domestic employment generation, there is untapped potential in terms of the flexibilities still available to LDCs in global trade. LDC Governments should accordingly consider the matter of trade policy more creatively and in an integrated manner, and look to regional arrangements as a way to stimulate the development of synergies across productive sectors.

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Since capital flows are generally procyclical (Gallagher et al., 2012), their impact on developing countries is destabilizing, fuelling excessive optimism in good times and exacerbating the bust during crises. Capital account regulations can thus be a useful and at times crucial component of maximizing the benefits while minimizing the costs of free capital flows in the LDCs. Even the IMF, which for decades insisted on full capital account liberalization, has endorsed some use of capital account regulations (IMF, 2011). The successful experience with capital account management in a number of countries (Brazil, Chile, Colombia, Malaysia, Republic of Korea and Thailand, to name a few) shows that developing countries can and should shield themselves from these external shocks. Since

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a restrictive monetary policy will serve only to exacerbate the problem during booms (by exacerbating inflows of capital and appreciation pressures), the alternative is to adopt some form of capital account regulation to manage an open capital account. Where inflows are concerned, instruments can include minimum stay requirements, unremunerated reserve requirements, differential tax rates on returns to portfolio capital and taxes on new debt inflows. For dealing with capital outflows, instruments can include taxes on capital outflows and regulating the amounts of non-profit capital which foreigners can send abroad.

LDCs are increasingly buffeted by dramatic changes in global markets over which they have no control.

LDCs are increasingly buffeted by dramatic changes in global markets over which they have no control. Developing countries in general, and the LDCs in particular, suffer more from external shocks than developed countries. LDC economies are smaller and less diversified. They tend to be very dependent on external financing, so they are exposed to greater capital account shocks. They are also more open to trade than many developed countries, and their export structure is more concentrated in a few products. Finally, many of these countries are exposed to strong fluctuations in international commodity prices, either as exporters or importers. For all these reasons, economic volatility is greater and thus more damaging in the LDCs than in developed countries.

Within LDC economies, the distributive effects of external shocks tend to be adverse.

Within LDC economies, the distributive effects of external shocks also tend to be adverse. There are direct costs of income variability in the presence of imperfect capital and insurance markets, so that income smoothing over the economic cycle is imperfect and downswings are associated with consumption declines, especially among the poor. Generally speaking, in all countries the poor bear the brunt of economic fluctuations: They suffer most in slumps, through higher unemployment and lower real wages, and they gain the least from booms, which are typically associated with increases in wealth, in returns to capital and in salaries of professional and skilled workers.

The question is, as noted in chapter 4, how LDC Governments are to cope with such externally generated volatility. While fiscal and monetary policies remain the basic levers to ensure changes in aggregate economic activity over the course of a cycle, other measures can be quite effective. In particular there are some "automatic stabilizers" that LDCs can and should use. For example, progressive taxation that is more proactive during slumps reduces the negative fiscal impact on the poor. Welfare programmes and social protection policies — including unemployment insurance schemes, worker protection, special access to non-collateral-based credit, public distribution systems for food and other necessities, income support for female-headed worker households, and so on — all operate to ensure that consumption does not fall as much as it otherwise would during a downswing. Automatic adjustments of tariffs to external prices, for example through a variable tariff system within the tariff bindings required by WTO, can reduce the impact of global price volatility on domestic producers and consumers.

Taxes on capital inflows can be limited to equity and portfolio capital, as opposed to "greenfield" investment, in periods when such inflows are high.

In addition to these automatic stabilizers, there are other ways of responding to booms that can potentially dampen cyclical processes. For example, a counter-cyclical tax, such as an export tax, allows Government to generate more revenue during periods of export boom, which can then be set aside for a price stabilization fund in case export prices slump in future. Taxes on capital inflows can be limited to equity and portfolio capital, as opposed to "greenfield" investment, in periods when such inflows are high. In situations of clear overheating and build-up of speculative bubbles, it is important to restrict activities that are likely to be associated with boom/bust cycles, such as speculative real estate, through such measures as the imposition of higher capital gains taxes and bank regulations that restrict the extent of lending to the real estate sector.

In some LDCs, stabilization funds may be a particularly effective instrument for managing volatility, and particularly volatility caused by strong fluctuation in international prices, which is a typical feature of commodities. They can also help insulate economies from large, destabilizing inflows of foreign exchange, in several ways. In periods of relatively large capital inflows, they can help prevent an excessive appreciation of the exchange rate, thus avoiding the detrimental effects of the Dutch disease. They can preclude the overheating of the economy during boom periods, thus helping to control inflationary pressures. They can thwart the forming of bubbles, especially in real estate, which would ideally make the economy less prone to booms and busts. Finally, by maintaining a steady level of fiscal revenue, they can smooth fiscal expenditure, so that public investment can be maintained or even increased during a major downturn, expenditure on social services does not have to be cut, and so on. Stabilization funds are especially appropriate for the large commodity exporters among the LDCs. Many large commodity exporters — such as Chile, Islamic Republic of Iran, Kuwait, Norway, Oman, Papua New Guinea, Russian Federation and the Bolivarian Republic of Venezuela — have established stabilization funds with explicit macroeconomic stabilization objectives. When the price of the commodities they export is high, revenue is accumulated in the fund. When the price is low, the accumulated revenue can be used to smooth out government expenditure.

In some LDCs, stabilization funds may be a particularly effective instrument for managing volatility, caused by strong fluctuation in international prices of commodities.

Public investment is not just complementary to private sector investment but may also be a necessary addition.

D. State-led employment creation

Given the pervasive structural weakness of the private sector in LDCs, the State needs to play a stronger role than in other developing countries in supporting employment generation both directly and indirectly (e.g. through publicly supported investment and public employment). As argued in chapter 4, the role of the State will have to be more prominent in the short to medium term in order to kick-start a growth process that can create a strong investment-growth-employment nexus. A more dynamic approach to public investment recognizes that it is not just complementary to private sector investment but may also be a necessary addition. Griffin (1996) has noted that there are many ways in which government investment in physical capital can be made much more labour-intensive, thereby increasing employment, saving on foreign exchange and raising the overall rate of return in the economy.

Public infrastructure spending can be more directly employment-generating and can have higher multiplier effects within local economies.

The role of infrastructure development in aggregate growth is widely recognized, as the provision of such infrastructure as energy (electricity provision) and transport (roads) increases market opportunities, reduces costs and raises productivity in manufacturing and services firms (Bigsten and Söderbom, 2005; Shiferaw et al., 2012a, 2012b). Usually, however, such investments are not seen in terms of their employment effects. In fact, because they appear to be mostly heavily capital-intensive in nature, it is generally presumed that their direct employment effects are negligible and that it is only indirectly, through their impact on overall development, that they can influence job creation. Nonetheless, there are several ways in which public infrastructure spending can be more directly employment-generating and can have higher multiplier effects within local economies. Infrastructure works are doubly blessed, in that they create and sustain employment while at the same time improving living conditions and laying the foundation for long-term growth. Indeed, there is much greater scope than is generally recognized for developing infrastructure by using available surplus labour in LDCs. In urban areas, for example, labour-intensive techniques can be used for such works as improving streets and access ways, water supply, sewerage, sanitation and waste management, flood protection measures, and repair and maintenance of a range of public infrastructure. In

Infrastructure works are doubly blessed, in that they create and sustain employment while at the same time improving living conditions and laying the foundation for long-term growth.

fact, labour-intensive methods can also be effective (and cheap) in operations of large-scale infrastructure works that are typically seen as the preserve of equipment-intensive companies, such as bush-clearing and digging for the construction of dams and highways. The employment creation potential of investment in irrigation, drainage, provision of feeder channels, building, local land reclamation, afforestation and so forth is considerable.

Construction is a particularly fruitful area for encouraging more labour-intensive activities.

Construction is a particularly fruitful area for encouraging more labour-intensive activities through direct public procurement practices and fiscal incentives. Building activities that use local materials, local technologies and local small-scale enterprises have much greater potential to generate employment. If local and small-scale manufacturers of building materials are encouraged, they are likely to have larger multiplier effects than large-scale, capital-intensive technologies, because they are generally more likely to use locally manufactured tools and machinery and are typically marketed and transported by small-scale enterprises. All of this can reduce the overall costs of construction, lead to ecologically sounder and more appropriate types of buildings and also generate more employment. Studies in several countries and infrastructure sectors show that employment-intensive investment in infrastructure is significantly less costly in financial terms than equipment-intensive techniques, without compromising on quality. It can also reduce foreign exchange requirements substantially, create several times as much employment for the same level of investment; permit the employment of more people at all skills levels; and create strongly positive indirect income multiplier effects.

Building activities that use local materials, local technologies and local small-scale enterprises have much greater potential to generate employment.

Government provision of public goods and services has been an essential part of the development process in developing countries that grew in a sustained manner over long periods in the post-Second World War period. Spending in areas such as education and health has the double economic benefit of helping to strengthen the human resources base of the economy and being labour-intensive. Governments can thus contribute directly to the generation of all kinds of jobs, unskilled, semi-skilled and skilled. Emphasizing expansion and better delivery in the provision of public services, especially in nutrition, sanitation, health and education, not only allows for improved material and social conditions, but also has positive employment effects directly and through the multiplier process. Indeed, this was an important and unrecognized feature of successful Asian industrialization, from Japan and the east Asian NICs to (most recently) China. The public provision of affordable and reasonably good-quality housing, transport facilities, basic food, education and basic health care all operated to improve the living conditions of workers. Indirectly, it helped reduce the money wages that individual employers need to pay workers. This not only cut overall labour costs for private employers but also provided greater flexibility for producers competing in external markets, since a significant part of their fixed costs was effectively reduced.

Employment-intensive investment in infrastructure is significantly less costly in financial terms than equipment-intensive techniques, without compromising on quality.

Labour-intensive public works programmes (PWPs) were initially intended more as safety nets, especially in response to natural or economic emergencies (e.g. droughts, floods or harvest failure). More recently, however, they have been increasingly adopted as labour-based infrastructure programmes in response to the situation of chronic underemployment and unemployment in LDCs. In the past decade several developing countries, including LDCs, have adopted a new generation of employment creation programmes, which pay fair wages and strive to produce useful and durable assets that benefit participants directly. In many cases they also provide training to beneficiary workers and endeavour to involve local communities in decision-making and managing projects and programmes (Devereux and Salomon, 2006). Some of these programmes are envisaged as part of national (or regional) development strategies. They have also been seen as counter-cyclical mechanisms to respond to the global financial crisis, since they stimulate domestic demand even as they generate benefits from increases

In the past decade LDCs have adopted a new generation of employment creation programmes, which pay fair wages and strive to produce useful and durable assets that benefit participants directly.

in infrastructure spending and provide temporary income to those affected by the crisis.

Most PWPs in LDCs are introduced and designed by donors and funded either through donor grants or loans. There are still some domestically funded PWPs in operation that were developed independently, such as the Karnali Employment Programme in Nepal. The Vision 2020 Umurenge Programme in Rwanda, which is partly donor-funded, was jointly developed with donor inputs.

Public work programmes frequently involve the creation or maintenance of potentially productive infrastructure, which are also meant to contribute to the livelihoods of participants and the broader community.

PWPs tend to have as their primary objective the provision of social assistance for poor households with working-age members who are unable to find work or pursue their normal livelihood activities due to some form of acute or chronic disruption in the labour market, or a deficit in labour demand. They are typically designed to provide basic income to support household consumption and prevent the distress-selling of assets to meet subsistence needs. They frequently involve the creation or maintenance of potentially productive infrastructure, such as roads or irrigation systems, which are also meant to contribute to the livelihoods of participants and the broader community.

PWPs that provide a single short episode of employment are usually designed for consumption-smoothing, in response to temporary labour market or livelihood disruption which may result from natural disasters (such as droughts, floods or hurricanes), humanitarian situations (such as conflict) or short-term economic crises. These programmes are primarily concerned with the provision of what are referred to as safety nets, basic "risk-coping" social protection and the prevention of distress-selling of assets. Such programmes typically offer short-term employment – in Sub-Saharan Africa, for an average of four months (McCord and Slater, 2009) – but may be extended in humanitarian situations where normal livelihood activity has been suspended. In such programmes, the objective of ensuring a timely wage transfer (in kind or cash) is more important than that of asset provision, which may in some instances be essentially a "make-work" activity carried out primarily to satisfy the work conditionality. For this reason, the quality of assets created under such programmes is often of secondary importance to the rapid provision of wage employment for those affected by a crisis. This type of programme is typical of those implemented widely in southern Asia in response to natural disasters that temporarily affect formal and informal household income-earning opportunities and subsistence production. It is also the dominant form of PWP in SSA. In that region, however, such programmes are implemented not only in response to acute crises but also in situations of chronic poverty, underemployment and unemployment, where their short duration renders them less likely to have a significant impact on poverty.

In SSA, such programmes are implemented not only in response to acute crises but also in situations of chronic poverty, underemployment and unemployment.

Other PWPs target increasing local employment opportunities, or employment created per unit invested in infrastructure provision.

Other PWPs target increasing local employment opportunities, or employment created per unit invested in infrastructure provision, usually in the construction sector through the adoption of labour-intensive construction techniques. Such programmes do not necessarily require significant additional funding but rather a shift in the factor intensity of existing expenditure from capital to labour. Some infrastructure-based PWPs concern activities which are already predominantly labour-intensive, such as housing construction, and where there are only marginal gains to be made from further labour intensification (McCutcheon and Taylor Parkins, 2003). However, other infrastructure development can be made using either capital- or labour-intensive approaches. Studies carried out in Cambodia, Ghana, Madagascar and Thailand have found that labour-intensive techniques led to two to five times more employment creation than alternative techniques (Devereux and Salomon, 2006). In the case of Senegal, an estimated 13 times more jobs were created thanks to the adoption of labour-intensive techniques, than with conventional techniques (Majeres, 2003). In Cambodia, it was found

Labour-intensive techniques led to two to five times more employment creation than alternative techniques.

that labour-based rural road works required nearly 5,000 unskilled workdays per km, compared to 200 workdays on an equipment-based operation (Munters, 2003: 45).

PWPs can be implemented as a complement to private sector employment creation, so as to reach those least successful in gaining market-based employment.

This approach may be particularly appropriate when used in conjunction with the large-scale investment in infrastructure that has been taking place in many countries as a stimulus in response to the global financial crisis. Obviously, the efficiency of adopting this approach rather than conventional capital-intensive approaches will depend on the nature of the assets being created. Furthermore, contractors may not always comply with contractual obligations, due to the higher cost implications of shifting factor intensity. In such cases PWPs can be implemented as a complement to private sector employment creation, so as to reach those least successful in gaining market-based employment.

Youth might be the priority in contexts where youth not in employment, education or training are a major concern

If PWPs are to be part of a long-term employment strategy, there are strategic choices to be made regarding the priority group for employment. Youth might be the priority in contexts where youth not in employment, education or training are a major concern, where youth are excluded from private sector employment, and where social or political stability are key concerns. Demobilized soldiers or urban populations might be the priority in other contexts, with the poorest being selected only where poverty reduction and social protection are key policy objectives. Examples of this type of intervention include the work of the Ethiopian Rural Roads Authority, the Agence d'Exécution des Travaux d'Intérêt Public contre le sous-emploi in Senegal, the Association Africaine des Agences d'Exécution des Travaux d'Intérêt Public throughout western Africa, and ILO's Employment-Intensive Investment Programmes.

PWPs may also have as their objectives environmental sustainability and contributing to the structural transformation of the economy.

Beyond poverty alleviation and employment creation, PWPs may also have as their objectives environmental sustainability and contributing to the structural transformation of the economy. Still other objectives include skills development through work experience and on-the-job training, accumulation of financial and material assets, promotion of livelihoods, stimulation of economic growth through the promotion of demand and creation of productive assets, and maintenance of the social and political order in the context of unacceptably high levels of unemployment and poverty. While multiple programme goals relating to poverty reduction, employment creation, structural transformation and environmental sustainability are not necessarily conflicting, optimal outcomes for each may demand alternative designs.

If the processes are appropriately designed from the outset and adequately resourced, there is no necessary trade-off between factor intensity and asset quality.

It is often argued that the use of labour-intensive techniques entails a loss of quality of the assets created, but this need not be the case. The quality of assets depends on the correct identification, design, specification and implementation of the construction process, all of which differ if labour-intensive approaches are used. For example, executing capital-intensive designs using labour-intensive processes will not result in successful outcomes, so the whole process needs to be approached differently if good-quality outcomes are to be ensured (McCutcheon and Taylor Parkins, 2003). If the processes are appropriately designed from the outset and adequately resourced, there is no necessary trade-off between factor intensity and asset quality. Quality is also affected by the availability of agricultural and engineering capacities at local level and by the adequacy of resources allocated to the capital component of asset creation.

Coordination among different agents in the implementation of PWPs is also a critical issue. Such agents include various levels of government (national, regional, district and village); ministries and departments (such as those responsible for welfare, public works, transport, environment and agriculture); donors; civil society organizations, and so forth. This is a particularly acute challenge in LDCs, where government and donor harmonization and coordination are not always present. Coordination is an especially important

concern when PWPs also incorporate environmental goals in their design and implementation. One example is the Vision 2020 Umurenge Programme in Rwanda, where multi-year PWP employment of the poorest is combined with the promotion of more environmentally sustainable agriculture based on the terracing of hillsides, which potentially results in sustained productivity increases and greater environmental sustainability of agriculture (depending on which crops are adopted). Environmental goals are also part of the Productive Safety Net Programme in Ethiopia. The creation of riverine protection or bunds against inundation (as in the World Food Programme's Food for Work projects in Nepal) may also generate sustained environmental benefits that can promote livelihoods over time and hence have poverty reduction benefits that accrue beyond the period of project employment.

There are cases of immediate impacts of PWPs on local production, such as the emergence of small-scale markets on paydays.

Policymakers often hope that participation in PWPs will allow workers to "graduate" from poverty and from dependence on publicly funded jobs. However, given the structural, rather than frictional, nature of unemployment in many LDCs, it is not clear that PWP training and/or workplace experience will be sufficient to enable labour market incorporation after such employment. This is likely only where such programmes are combined with other interventions, in a broadly conducive national labour and economic context. Indeed, to the extent that such employment is well targeted at the poorest, it is less likely to result in significant graduation, while the macroeconomic and labour market outcomes are more likely to be indirect, operating through the multiplier effects of additional incomes leading to higher effective demand in the areas where the programme is implemented. There are well-documented cases of the immediate impacts of PWPs on local production; such cases involve, for example, the emergence of small-scale markets on paydays. These tend to be short-term impacts, however, since most PWPs continue for short periods. The poorer the participants and the more marginalized the area where the programme is implemented, the less likely the programme is to contribute to deliver economic spillover effects unless it is implemented on a sustained basis and a significant scale.

PWPs in rural areas have been found to contribute to rural development through public investment in agricultural infrastructure, which has generated greater agricultural production and productivity.

Even so, PWPs in rural areas have been found to contribute to rural development through public investment in agricultural infrastructure (e.g. rural roads and irrigation). This has generated greater agricultural production and productivity in the vicinity of the created assets. Moreover, improved communication and transport resulting from new or improved transport infrastructure have contributed to the creation of local markets and to better access to existing markets (Devereux and Salomon, 2006). Large-scale ongoing implementation through an employment-intensive programme (or through an employment guarantee scheme) is more likely to deliver secondary economic benefits, including an increase in the reservation wage of casual day labourers or accumulation and microenterprise development. It has been suggested that "tiny transfers equal tiny impacts, but moderate transfers can have major impacts" (Devereux, 2002: 672). Employing fewer people at higher wages for extended periods of time allows programme participants to invest in production and assets, although it may also create resentment and tension on the part of excluded community members. This means that fixing wages is a crucial aspect of PWP design and implementation.

Employing fewer people at higher wages for extended periods of time allows programme participants to invest in production and assets.

Despite their numerous advantages, there are still several constraints in adopting and implementing PWPs effectively in LDCs. One issue is finance: Labour-intensive public works tend to be relatively costly if they are sufficiently large-scale. The cost for the Ethiopian programme, for instance, was an estimated 2 per cent of the country's GDP in 2006. Of course, if this results in significant positive multiplier effects, then some of this cost may be recouped through increased tax revenues in the subsequent period. Funding sources must nevertheless be identified, especially as the lingering effects of the 2008–2009 crisis have led to generalized fiscal restrictions (or retrenchment), making

it more difficult to obtain funding for PWPs in LDCs. Institutional capacity is yet another concern, since effective implementation of such programmes requires the technical and operational capacity to choose, prepare, manage and supervise the works, organize the production process, become familiar with the techniques, access the required equipment and tools, manage small-scale contracts, coordinate the actions of different government levels and channel resources to the poor.

PWPs must be part of a broader economic policy package that combines macroeconomic, trade and industrial policies.

This partly explains why it is challenging to achieve all the intended goals. In some instances the challenge of providing mass employment through PWPs has not been met. Some of these programmes have thus become de facto cash transfer programmes, providing the wage transfer without fulfilling the work requirement. In addition to issues of financing and institutional capacity, LDCs are further constrained by the orientation of the macroeconomic and other ("development") policies they have been following for over two decades. For the most part these policies are geared domestically towards macroeconomic stability and, externally, towards international integration. Employment creation is still not at centre-stage in the national policymaking of most developing countries, including LDCs. This reinforces the argument that PWPs must be part of a broader economic policy package that combines macroeconomic, trade and industrial policies to meet the basic goal of productive employment creation and diversification to higher value added activities.

E. Enterprise development

Private activities account for the bulk of employment in LDCs today, and will clearly continue to do so in future.

Private activities account for the bulk of employment in LDCs today, and will clearly continue to do so in future. The challenge for their Governments is to enable and encourage the private sector to generate more diversified and higher value added activities which will provide sufficient productive employment to the growing labour force. Three broad policy areas are relevant in this context: industrial policies, enterprise policies and rural development policies. Each of these is considered in turn.

The challenge for LDC Governments is to enable and encourage the private sector to generate higher value added activities which will provide sufficient productive employment to the growing labour force.

1. Industrial policies

Industrial policy in general refers to government attempts to change the structures and patterns of production in an economy, and in particular to diversify production towards higher value added activities. In the late twentieth century this type of intervention was frowned on in mainstream policy circles, although industrial policy remained in use in many of the more successful developing countries, such as China. Recently, however, there has been a revival of interest in industrial policies, with more analysts arguing for their usefulness and desirability (e.g. Lin and Monga, 2010; Lin, 2011; OECD, 2013). There is greater recognition that several developing countries have improved their capacity to design and implement industrial policies (te Velde et al., 2011). At the same time, the growing marketability of a new wave of innovations in green technology, energy, water, nanotechnology and genetics (Wade, 2010) has created new possibilities. But in order to exploit these opportunities, firms must be forward-looking and prepared (Pérez and Soete, 1988; Pérez, 2001). This requires the coordination of industrial policy, especially in an LDC context. New challenges — such as those resulting from climate change — require structural changes in the economy of both developed and developing countries on a scale and speed that market forces are incapable of implementing alone, which therefore requires State action. Indeed, even some developed countries have recently become much more active in their own industrial policy (Rodrik,

Industrial policy refers to government attempts to change the structures and patterns of production in an economy.

2010), under the pressures of the international economic and financial crisis, environmental challenges and concerns about their deindustrialization.

At the same time, the implementation of effective industrial policy has also become more complex and difficult in recent years, particularly in view of the fragmentation of production due to the rise of global value chains. For LDCs wishing to benefit from positive integration into such production chains, a more nuanced but still systematic approach will be required, one that encourages domestic entrepreneurship and innovation. Industrial policy must accordingly be flexible, adapted to specific contexts and constantly responding to changing global and domestic conditions. Ideally, support should be provided in a time-bound and possibly phased manner, while ensuring consistency across different sets of policies.

The implementation of effective industrial policy has also become more complex and difficult in recent years, in view of the fragmentation of production.

The broad priorities of industrial policy in LDCs can be summarized as follows (UNCTAD, 2009: 141–179; Ocampo, 2007):

- To invest in dynamically growing sectors of the economy and encourage diversification, so that at least part of the growing domestic demand is met by domestic supply, rather than by imports;
- To develop and strengthen MSMEs, where most employment is generated;
- To build linkages that can bridge the various divides that permeate the enterprise sector: micro vs. medium and large; formal vs. informal; national vs. foreign; and modern vs. traditional;

Industrial policy instruments are usually classified as being functional or selective. Functional instruments typically aim at correcting market failures and are applied throughout an economy, for example by providing credit, education and training, and by spurring competition, research and development. Once Governments have endeavoured to correct market failures, it is the firms that will decide how far they wish to innovate and upgrade technologically. Selective or vertical measures, by contrast, aim at shifting to new and dynamic activities and/or localized technological upgrading. They are targeted at specific (sub) sectors or firms. Government provides financial support for such measures during learning periods and helps start-ups with training, export marketing and the general coordination of export activities. Obviously, an important criterion for the selection of activities to be supported by industrial policy is the labour intensity of the activities and/or their potential to generate jobs either directly or indirectly.

An important criterion for the selection of activities to be supported by industrial policy is the labour intensity of the activities and/or their potential to generate jobs.

Two different but possibly complementary approaches to using such instruments can be considered. The incremental approach builds on existing activities in the economy to seek areas where backward and forward linkages and supporting activities can be developed. Agriculture, for example, can be used as the basis for developing downstream industries, such as food processing for local, regional and global markets and processing agricultural raw materials before export. Policies to encourage more local processing include bans or tariffs on raw unprocessed exports, support to industrial clusters for such activities and industrial extension services that provide both technological and marketing support. For example, export tariffs have spurred the downstream processing of cashew nuts in Mozambique and raw hides and skins in Ethiopia (Krause and Kaufmann, 2011; Altenburg, 2010). Similar policies can be devised for such other primary activities as mining, as was done for diamond processing in Botswana. Such efforts are likely to be more successful if they are combined with the development of local production clusters based on natural resources and the development of engineering capabilities for domestic production (Ramos, 1998).

The incremental approach to industrial policy builds on existing activities in the economy to seek areas where backward and forward linkages.

In such strategies, however, care must be taken to recognize situations in which upstream and downstream industries require very different endowments. The garment industry, for example, is typically labour-intensive, whereas the industry that produces textiles, yarns and accessories is increasingly capital-intensive, with large economies of scale and scope. This makes the development of backward linkages in textiles for the garments sector much more difficult in most LDCs (Adhikari and Yamamoto, 2007). Instead, LDCs are more likely to succeed by upgrading within the garment industry itself and/or by exploiting niche markets (Altenburg, 2011). Mozambique, for instance, tried to establish backward linkages from large-scale foreign firms in mining (e.g. the aluminium smelter), but with only limited success, due to a dearth of the requisite entrepreneurial capabilities among domestic firms (Krause and Kaufmann, 2011).

LDCs are likely to succeed by upgrading within the garment industry itself and/or by exploiting niche markets.

A less traditional approach to industrial policy is more forward-looking, involving the identification of new areas of specialization, in order to enter into such activities relatively swiftly and to benefit from the rising potential in global markets for such production. In this case, because the distance in the product space between new and existing activities is large, the risk is high but the strategy potentially rewarding. Public intervention is necessary in such cases because early entrants into new products, technologies or markets have to bear all the costs of discovery but are unable to internalize all the benefits, requiring some form of State support (Hausmann and Rodrik, 2003). Government agencies typically decide what are the promising sectors or activities and concentrate their policy attention accordingly. This can, however, also be accomplished through collaboration between public and private agents, such as entrepreneurs and their representative bodies, market analysts and civil society representatives, in such forums as deliberation councils, sector roundtables and private-public venture funds, making use of internal and external expertise. This has been successfully applied in the case of the cut flower industry in Ethiopia. The initiative for exporting these products came from the private sector, but it was backed by Government, which provided low-cost access to suitable land, negotiated freight costs with the national airline and established a national horticulture development agency.

A less traditional approach to industrial policy is more forward-looking, involving the identification of new areas of specialization, in order to enter into such activities relatively swiftly.

Governments can also encourage businesses innovation (such as seeking new markets and alternative business models) through business plan competitions, coaching innovative start-up companies and offering incentives to the local business sector or the diaspora. This is the core of UNCTAD's proposal for a new international support measure for LDCs, the Investing in Diaspora Knowledge Transfer initiative (UNCTAD, 2012: 147–150), which consists of a collaborative effort between the national Government and international organizations to back the investment of the LDC diasporas in innovative and knowledge-intensive activities.

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Industrial policy formulation and execution in LDCs tends to follow a top-down approach, with Governments taking the lead on priority areas and programmes. Successful industrial policies, however, require a continuous dialogue among Governments, businesses (including MSEs) and workers. Beyond general business complaints about financing, high taxes, corruption, infrastructure services and so forth, this dialogue should highlight coordination failures that constrain enterprise development, such as the local unavailability of a low- cost input critical to a specific industry, which can in turn prompt government action to encourage production of the specific input (O'Connor, 2007). The dialogue can be especially fruitful when it is focused on specific industries and when the Government is willing to change its policies in response to specific needs. Just such continuous dialogue and interaction among the government agencies responsible for industrial policy and businesses (both sectoral chambers and

Successful industrial policies require a continuous dialogue among Governments, businesses (including MSEs) and workers.

individual firms) was crucial for structural change and upgrading in the successful industrializers of east Asia. Studies of the performance of enterprises from seven SSA countries (five of them LDCs) have found that State-business relationships enhance firm productivity by about 25–35 per cent (Qureshi and te Velde, 2012). Furthermore, some form of balance between the State and business actors is needed to avoid the State being captured by particular interests or rent-seeking (Wade, 2010). This entails ensuring that the private sector meets its commitments in exchange for receiving favourable policy measures.

Some form of balance between the State and business actors is needed to avoid the State being captured by particular interests or rent-seeking.

It is increasingly recognized that knowledge generation and dissemination must be critical features of industrial policy, and this is very much so in the LDCs. The best way to enhance the knowledge intensity of economies is through education, technical and vocational training and skills upgrading through on-the-job training. Since LDCs are still lagging behind in these areas despite recent progress, this remains a crucial focus. In secondary and tertiary education and technical and vocational training, LDCs need to expand the supply and improve the quality of services. This includes revising curricula and teaching methods in order to make the labour force more adaptable and innovative and so as to adapt educational policies to foreseeable domestic labour market requirements. Policies must also adapt the form of education and the content of curricula so as to provide students and apprentices with such skills as “learning to learn”, “learning to change” and the ability to do creative teamwork and think innovatively (Pérez, 2001; Adesida and Karuri-Sebina, 2013). Ideally, given the gestation lags in producing graduates, educational planners should have some idea of where the economy as a whole is headed over the coming 5 to 10 years in order to guide the educational system with respect to the future needs of the labour market.

The best way to enhance the knowledge intensity of economies is through education, technical and vocational training and skills upgrading through on-the-job training.

The disconnect between academic research and the private sector has frequently been highlighted as a weakness in domestic knowledge systems (UNCTAD, 2006: 246–255; Adesida and Karuri-Sebina, 2013). It is therefore important for universities and research centres to strengthen their links with businesses of all sizes. Instruments to reach this goal include:

- Adopting curricula that focus on entrepreneurship development in vocational training and universities;
- Enacting tax breaks or training levies in order to fund industry-specific training of the labour force (with such training possibly provided by dedicated training centres);
- Creating (either nationally or regionally) standard-setting bodies (e.g. for quality and sanitary certification), whether by government initiative or through partnerships between Government and industry or sectoral associations.

Policies must also adapt the form of education and the content of curricula so as to provide students and apprentices with such skills as “learning to learn”, and the ability to do creative teamwork.

The role of external donors deserves consideration as well, since multilateral and bilateral donors have traditionally exerted a very strong influence on industrial policymaking in LDCs. Since the structural adjustment era, these countries have been advised to avoid any industrial policy that called for greater, and more direct, State involvement in economic development. More recently, however, there has been more external support for industrial policy in LDCs, including the financing of programmes for upgrading technical and vocational training systems, cluster and value chain initiatives and building trade capacity. In some cases, industrial policy programmes are not only funded but also executed by donors. While this marks the beginning of a positive shift in donors’ attitudes, it is still fraught with some of the challenges that characterize official aid more generally: for example, limited alignment with country priorities; donors establishing parallel agencies and implementation bodies that weaken State capabilities by attracting the most qualified professionals; limited coordination among donors; intensive use

It is important for universities and research centres to strengthen their links with businesses of all sizes.

of donor-related experts with limited domestic capacity-building, etc. (UNCTAD, 2008: 93–134; Altenburg, 2011). In order to contribute more effectively in this regard, donors should step up their funding of capacity-building in industrial policymaking and avoid setting up parallel structures, making greater use instead of national and local administrative structures. Most importantly, donors should align their interventions with country priorities, policies and national development plans.

Donors should step up their funding of capacity-building in industrial policymaking and make greater use of national and local administrative structures.

In a sluggish world economy, LDCs have the option of relying on regional markets as potential sources of trade expansion and growth. There is considerable potential for joint action to mobilize common resources, develop common development goals, invest in regional public goods and leverage those of development partners (including multilateral institutions, bilateral donors, and partners in the South) that are in a position to assist development-focused regional integration. While there have been some moves towards such "developmental regionalism" (UNCTAD, 2011) — notably the Greater Mekong initiative that includes Cambodia and Laos in South-East Asia – such experiences are still rare among LDCs. Regional integration in the regions where LDCs are found in larger numbers has generally been weak. Although many institutions and action plans have been established, implementation has typically been very low.

LDCs have the option of relying on regional markets as potential sources of trade expansion and growth.

At the time of writing, the Southern Africa Development Community has been holding initial discussions on the desirability of a regional industrial policy, but there has been little if any concrete action (Zarenda, 2012). In June 2010 the Economic Community of West African States adopted the West African Common Industrial Policy with very ambitious targets (e.g. raising the contribution of manufacturing to regional GDP from the current 6 per cent to 20 per cent by 2030), but its implementation is still in very early stages. However, in the specific case of agro-processing industries, African countries have launched an initiative of agricultural commodity chains of production, processing and marketing (e.g. rice, maize, wheat, sugar, meat and dairy products) that could potentially meet increasing regional demand in the context of regional integration schemes (UNECA and African Union, 2009).

Another type of industrial policy strategy is intended to change the capital-labour ratio of the economy by attracting investment in labour-intensive industries.

Another type of industrial policy strategy is intended to change the capital-labour ratio of the economy by attracting investment in labour-intensive industries like garments. This has been especially effective in creating jobs and contributing to poverty reduction in some LDCs (Bangladesh, Cambodia, Haiti and Lesotho) and several ODCs (including Viet Nam). Typically, these activities have the additional benefits of raising female participation in the labour force. By providing women with better-paid jobs, these new activities free them from subsistence activities, informal low-productivity activities or inactivity. The challenge for all these countries is to ensure the survival and possibly the expansion of these industries in the face of fierce international competition. In order to do so, they have endeavoured to keep their labour costs low (e.g. Bangladesh) or to brand their country as a "socially responsible" production location (Cambodia). Another alternative has been to exploit product niche marketing, as has been done by Sri Lanka.

Apart from goods exports, tourism is another area with potential for business expansion and employment generation in rural areas.

Apart from goods exports, tourism is another area with potential for business expansion and employment generation in rural areas. In most LDCs, where international tourism is already concentrated in rural areas, the sector can be focused to develop non-farm rural activities and generate jobs, as long as attention is given to creating backward and forward linkages and to environmental sustainability (UNCTAD, 2013c). Ecotourism is a particularly promising niche sector. Uganda, for instance, has recently implemented a set of policies for sustainable tourism that includes the promotion of local linkages through domestic entrepreneurship, the participation of local communities in

both the planning and execution stages. As a result, these communities receive 20 per cent of gate fees around protected areas and are trained to act as guides and provide accommodations. Furthermore, regional cooperation is conducted by promoting the East African Community as a single tourism destination and by facilitating tourists' displacements within the region. Such cooperation also involves investment incentives for the sector (including import tariff waivers for tourism vehicles), public investment in infrastructure and close collaboration between public sectoral authorities and local stakeholders. This set of initiatives has resulted in an increase in tourist arrivals and tourism receipts since 2010, and tourism now absorbs 14 per cent of the labour force in formal employment and 21 per cent of informal sector employment (Aulo, 2013).

Some LDCs may take advantage of the window of opportunity presented by China's likely delocalization of the lower end of its manufacturing industry.

One recent development that may open further opportunities for some LDCs is the transition of China — by far the world's largest exporter of labour-intensive manufactures — to a different phase of development. Its labour costs are rising, and the composition of its export basket is moving towards higher value added and more knowledge-intensive products. At the same time there is an incipient movement to offshore production at the lower end of labour-intensive manufacturing to labour-abundant and low-labour-cost countries (OECD, 2013). These developments in China may make it possible for some LDCs to capture a part of this manufacturing activity. Some LDCs may take advantage of the window of opportunity presented by China's likely delocalization of the lower end of its manufacturing industry through a combination of attracting FDI and integrating domestic firms into global manufacturing value chains.

Several African LDCs — especially the most labour-abundant among them — can also take policy action to seize these opportunities.

The LDCs that are best placed to take advantage of these changes in the geography of international manufacturing are those that present most of the following characteristics: low wages, large workforces, and the skills needed to produce goods (especially garments) rapidly and in large quantities for global retailers (*Financial Times*, 2013), as well as good transport and communication connections to other countries. These features — and especially the last one — are an advantage for those LDCs that already possess some experience of manufacturing production and exports and that are geographically close to dynamic poles of economic growth (such as Bangladesh, Cambodia, Lao People's Democratic Republic and Myanmar). However, several African LDCs — especially the most labour-abundant among them, like Ethiopia — can also take policy action to seize these opportunities. They may exploit this potential despite the fact that most of them have limited experience in large-scale manufacturing for global markets and that significant development is thus likely to take longer. Relevant initiatives include improving communication and transport infrastructure and ensuring agricultural development, both of which help to keep labour costs low. Domestically, this strategy should be complemented by policies on clustering, export promotion and labour cost containment. Labour costs can remain competitive by ensuring an adequate supply of wage goods and services, especially food (by means of agricultural policy, as explained below), transport and housing. Enacting policy measures to foster FDI, joint ventures or technology licensing is another plausible option for LDCs whose producers lack international competitiveness in basic manufacturing but have a reasonable transport and communication infrastructure (Schmitz, 2007). Preferential access to major consumer markets may constitute another favourable factor.

Domestically, this strategy should be complemented by policies on clustering, export promotion and labour cost containment.

In the rush to seize these opportunities LDCs should beware of running a race to the bottom.

In the rush to seize these opportunities, however, LDCs should beware of running a race to the bottom. This may happen if they continue their present policies for attracting FDI — policies that have formed the backbone of the LDC growth model for more than two decades. Generous incentives, tax breaks and other incitements often turn out to be more advantageous to international investors than to host countries. The LDC experience shows that they have attracted substantial amounts of FDI, but that most of it went to export-oriented

enclaves producing primary commodities or labour-intensive manufactures. The latter type of FDI, but not the former, generates a substantial number of jobs. In both cases, however, the enclaves develop very limited linkages to the rest of the domestic economy and therefore have limited technological and productivity effects. LDCs should reorient their FDI policy to stimulate the creation of backward and forward linkages between transnational corporations (TNCs) and domestic enterprises. Such linkages would bring benefits not only in stronger employment creation, but also in technological, organizational, knowledge and other spillovers. Policymakers can enhance the benefits deriving from FDI through proper policies. They need to integrate the export manufacturing sector into national development policies and avoid the creation of export enclaves. Lall (1995) suggests the use of soft "target and guide" instruments, such as bringing in firms to make investments that fit the country's upgrading strategy and persuading them to engage in technology transfer.

The challenges for LDCs in expanding the benefits they derive from FDI are closely related to those of obtaining developmental effects from participation in GVCs.

The challenges for LDCs in expanding the benefits they derive from FDI are closely related to those of obtaining developmental effects from participation in global value chains (GVCs). GVCs are now ubiquitous in the global economy, and LDCs are increasingly a part of them. From a development and policy standpoint, the question is not *whether* these countries should participate in GVCs but *how* they should do so (UNCTAD, 2013b: 148–210). The option of joining GVCs is typically feasible for firms that have basic production skills but lack access to major markets and marketing know-how (Schmitz, 2007). Such firms tend to agglomerate in those regions within a country that are best served by infrastructure and international connections. This presupposes prior government action to ensure that these general conditions are available.

The potential benefits of participation in GVCs – employment, income, exports, technology – depend on where the country is positioned within the chain and on what type of activities it engages in.

LDCs today face three major types of risks from their form of integration into GVCs. First, some of the major benefits derived from traditional forms of industrialization (linkages, externalities, multiplier effects, etc.) are largely absent from this type of industrial growth. The potential benefits of participation in GVCs — employment, income, exports, technology and the like — depend on where the country is positioned within the chain and on what type of activities it engages in. Second, given the fragmentation of the production process and the dearth of backward and forward linkages, LDCs risk remaining locked into the lowest rungs on the GVC ladders. These are the stages that are less knowledge-intensive and that generate the least value added. Even more worrying is the fact that these stages have the least potential for upgrading. This is because the ability of local enterprises to capture value depends largely on power relationships in the chain. Since TNCs can choose suppliers from any number of countries, they are in a strong position to dictate the terms of their relationships with local suppliers in LDCs. These concerns are confirmed by an analysis of LDC export patterns, which shows that these countries do indeed remain locked into the lower levels of GVC processing and that there are very few examples of product upgrading (UNCTAD, 2007: 11–50). The third major risk of LDC involvement in GVCs is that the stages of their integration are typically labour-intensive. Although this contributes significantly to job generation, the quality of the jobs and of the associated working conditions can be appalling. The environmental and physical safety impacts have also been adverse at times. These shortcomings have been highlighted by recent accidents in firms that operate in Bangladesh and are part of GVCs.

LDCs remain locked into the lower levels of GVC processing and there are very few examples of product upgrading.

LDC policymakers can manage their country's integration into GVCs in such a way as to raise its developmental impact, by embedding GVCs in the country's overall development strategy.

LDC policymakers can, however, overcome these problems by following two parallel strategies. First, they can manage their country's integration into GVCs in such a way as to raise its developmental impact, by embedding GVCs in the country's overall development strategy, building domestic productive capacities, implementing a strong environmental, social and governance framework and synergizing trade and investment policies and institutions (UNCTAD, 2013b: 175–210). Achieving these goals is obviously difficult in view of the prevailing

asymmetric power relationships, so the role of the LDC State should be to prioritize national development objectives. Authorities need to negotiate with foreign investors in order to obtain the creation of domestic linkages and technology transfer to local firms, since international integration through GVCs and FDI have a lasting developmental effect only when they are complemented by continuous technological capability-building by participating domestic firms (so as to avoid being locked into labour-intensive, lower-productivity activities). Policies should also target the creation of linkages with other domestic firms that can learn and upgrade through these linkages.

Authorities need to negotiate with foreign investors in order to obtain the creation of domestic linkages and technology transfer to local firms.

2. Policies to foster entrepreneurship

The LDCs, even more than other developing countries, have to cope with structural weaknesses and a lack of development in the private sector, which calls for policies to enhance private capital accumulation, employment generation and technological progress. Such policies must encompass different types and sizes of enterprise, since policies for MSME development obviously differ substantially from those for attracting FDI.

a. Financial services

One major element of the required policies is to enable access to finance. The failure of commercial banks to provide adequate financing to private firms in LDCs — especially MSMEs — is a major obstacle to enterprise development in these countries, as discussed in chapter 4. The State must thus play a leading role in financial allocations, not only to regulate finance and guard against financial fragility and failure, but also to use the financial system to direct investment towards sectors and technologies at appropriate scales of production. Financial policy should be designed so that financial services reach not only MSMEs, but such excluded groups as women, self-employed workers, peasants and those without land titles or other collateral. In order to lift the financing constraint on enterprise development, several alternatives can be considered by LDC policymakers. They include:

Financial policy should be designed so that financial services reach MSMEs and excluded groups.

- *State development banks.* Such banks can provide long-term financing to domestic companies (including SMEs, start-ups and innovative firms), possibly on more favourable terms than market institutions. They can supply other financial services like short-term loans and co-financing. They can help build industrial clusters to provide synergies and economies of scale to MSMEs. Effective development banks can also work closely with domestic firms by mentoring productive activities, offering other forms of SME promotion and support and helping to reduce financial volatility.

State development banks can provide long-term financing to domestic companies on more favourable terms than market institutions.

- *Venture capital.* Government can act as a venture capitalist when it finances projects by taking a participation in the firm's equity, rather than by providing loans. The stakes can be sold on the market once the company is on a solid footing. This alternative is more appropriate for larger firms and projects than for MSMEs.
- *Commercial banks.* Government can encourage lending to MSMEs by (i) providing banks with subsidies; (ii) enacting lower asset-based reserve requirements for this market segment than for other types of lending; (iii) fostering cooperation between formal and informal financial institutions, such as rotating savings and credit societies, which typically have better information on borrowers' risks and operate with lower transaction costs; and (iv) providing official credit guarantees to encourage loans to desired sectors and categories of borrowers, with a focus on neglected sectors with high employment intensity. These options are obviously more feasible where

commercial banking is relatively well developed and spread throughout the country.

- *Microfinance*. While microfinance can have a positive short-term impact on employment in petty trade and services, and often provides a safety net and consumption smoothing, microfinance per se is not an appropriate financing model for enterprise development, as it relies on interest rates that are too high and repayment periods that are too short for long-term productive investment (Chowdhury, 2009; Schoar, 2010). As noted earlier, it does not allow for productive asset creation or enable viable economic activities to flourish.

Microfinance per se is not an appropriate financing model for enterprise development.

- *Ensuring financial access* on reasonable terms to households and consumers, especially through access to banking services, credit, and risk cover and insurance products. This is important because it feeds back by spurring demand and further output growth and by raising welfare.

b. Enterprise support services

Technical assistance to impart and enhance the managerial, technical and financial skills needed to establish and manage MSMEs can be crucial.

A second major element of policies to encourage entrepreneurial development in the LDCs is enterprise support services. The availability of public infrastructure is obviously a critical issue in this regard, and transport and communications infrastructure, as well as the provision of such basic amenities as electricity and water, are clearly important. Technical assistance to impart and enhance the managerial, technical and financial skills needed to establish and manage MSMEs can be crucial as well. Partnerships should be envisaged between State development finance institutions, the private sector and aid agencies to provide such services-building in managerial skills. Public authorities can also help businesses to strengthen MSME activities by establishing industrial extension services and firm support institutions, which provide advice on business development, management skills, technology options and choice. This can be further reflected in policies that encourage the expansion of those MSMEs with the most potential to grow either individually or in clusters, by giving them preferential access to credit and insurance and better access to technology, organizational systems and other useful knowledge.

c. Reaching critical firm size

Smaller firms are usually more effective in terms of the number of jobs they create per unit of investment, but they tend to lack the economies of scale that would allow them to compete effectively.

Smaller firms are usually more effective in terms of the number of jobs they create per unit of investment, but they tend to lack the economies of scale that would allow them to compete effectively in domestic and global markets. The creation of industrial clusters is one way of lessening this difficulty. Successful clusters have many positive effects for individual participating firms (UNIDO, 2009). First, there are the agglomeration effects through networks of suppliers, labour market effects, knowledge spillovers, external and scale economies, which also help to establish backward and forward linkages. Second, clusters make it easier to provide the required infrastructure and amenities that are essential for efficient production. Third, clusters help boost the productivity of MSMEs, as was evident in a study of manufacturing firms in Ethiopia (Siba et al., 2012). Fourth, clusters have positive effects on formalization. Finally, they facilitate collective action by participating firms.

LDC Governments have different alternatives for supporting firm clustering.

In this context, LDC Governments have different alternatives for supporting firm clustering. They can provide a superior supply of infrastructure, logistic, Customs, financial and legal services, offer preferential access to land and facilitate administrative procedures. They can ensure an enabling regulatory framework that facilitates the creation and operation of small firms (Schmitz and Nadvi, 1999). Several countries have established export processing zones

(EPZs), which provide a clear focus for government investment and institutional reform designed to encourage the location of firms in a particular area. Several such zones have succeeded in creating manufacturing employment and increasing exports, although they are often associated with fiscal losses because of the tax incentives provided. Another major shortcoming is that they have not been able to foster learning by domestic firms or to generate spillovers to other domestic firms (UNCTAD, 2007: 36–42). This calls for paying more attention to ensuring that clusters and EPZs are embedded in the national economy through linkages, labour movement and spillovers. Other mechanisms for encouraging clustering are firm incubators and science parks. Government measures can also provide support by boosting demand for these firms' output and by targeting public procurement to that segment in order to encourage their upgrading. This was successfully done for the government acquisition of school uniforms and furniture in Brazil (Tendler and Amorim, 1996). The extreme form of clustering is cooperatives, which are essentially another organizational form. If they are to function well and remain strong, they must be treated as the businesses they are (as associations of small producers/consumers/suppliers) and kept free of political or bureaucratic control.

LDC policymaker need to pay more attention to ensuring that clusters and EPZs are embedded in the national economy through linkages, labour movement and spillovers.

One way to enhance enterprise development in LDCs is to foster the creation and strengthening of linkages between firms of different types, so as to bridge the gaps and disconnects that typically exist in the business sector of these countries and which largely explain the existence of the missing middle. Mozambique, for example, has implemented policies to foster the development of local small-scale suppliers to its large-scale aluminium smelter, although these have not yet reaped the expected benefits in terms of linkage creation and enterprise development (Krause and Kaufmann, 2011). Clearly, targets must be realistic in view of the currently limited entrepreneurial capabilities of small businesses and other constraints on their operations.

Box 4. Focusing on smaller-scale projects to foster job creation: the case of Mozambique

Mozambique has been one of the fastest-growing LDCs of the past 20 years. Its average GDP growth has exceeded 7 per cent since 1993. Structural reforms, sound macroeconomic policies, an opening to the global economy and political stability have contributed to this growth by attracting large foreign investment projects. A major breakthrough occurred in the mid-1990s, when a consortium of investors decided to establish the large-scale aluminium smelter Mozal. More recently, other mega-projects, mostly in mining, have generated large FDI inflows.

Despite the positive contribution of these large projects, which directly and indirectly generated less than 5,000 jobs for a labour force of about 9 million people, Mozambique's development challenges remain formidable. To overcome them, UNCTAD's Investment Policy Review (IPR) of Mozambique advised looking beyond mega-projects as a source of growth, economic diversification and job creation. Promoting investment on a more modest scale, attracting smaller TNCs and building linkages with national investors were suggested as strategic priorities.

While acknowledging the importance of large projects, the IPR recognized that smaller investments can contribute more meaningfully to such social objectives as creating employment and distributing economic activity more widely. To this end, it recommended addressing the inherent regulatory bias against smaller investors. They should, for instance, have access to the same incentives as those currently reserved for mega-projects. Moreover, time-consuming and burdensome regulatory procedures should be streamlined to create a more competitive environment for smaller operators. This can be accomplished, among other things, through a review of licensing procedures and the introduction of e-governance tools.

Mozambique has a large untapped development potential for investment projects in a wide range of activities, such as agriculture, agro-processing, tourism, selected manufacturing and services, infrastructure and logistics. Placing the development of smaller projects at the heart of the investment policy debate can go a long way towards achieving the country's development goals.

Source: Based on UNCTAD (2012). *Investment Policy Review of Mozambique.* (UNCTAD/DIAE/PCB2012/1). United Nations publication, Geneva and New York. Available at http://unctad.org/en/PublicationsLibrary/diaepcb2012d1_en.pdf (14 October 2013).

d. Regulation and formalization

Economic growth on its own need not and has not reduced high informality rates, and so most employment in LDCs tends to be in informal activities. But there are high costs of informality, including the high cost of finance, less access to utilities, lack of social and legal protection and limited bargaining power or competitive edge. Formalization is often proposed as a way to assist enterprise development in LDCs, as in other developing countries. Its benefits include enforceable contracts; access to formal financial and other services; legally recognized rights; better access to public utilities, infrastructure, services, social protection; and membership in formal associations, providing "voice" (Sundaram, 2007). Ideally, formalization should help increase the productivity and competitiveness of informal firms, while offering the protection and rights that most workers in the informal sector do not have.

The best way to achieve formalization of informal enterprises is to offer them support by simplifying the path to formality.

Rather than taking a punitive approach to suppressing informality, the best way to achieve formalization of informal enterprises is to offer them support by simplifying the path to formality. Strategies can include the requirement of gradual and progressive compliance with rules and regulations, encouraged by inspections, instead of sanctions; improving business accounting; simplifying bureaucratic procedures; extending legal protection; recognizing labour relations and promoting better practices; and ensuring better access to institutional credit. In this context, a general policy orientation worth emphasizing is the need to simplify regulatory frameworks in the LDCs. Onerous procedures for setting up firms, importing machinery and intermediate goods, paying taxes and the like, discourage business activity of small and medium-sized enterprises alike. While there have been many recent efforts to improve the business and investment climate for large foreign firms, such efforts should be extended to all types and sizes of firms and not just the large ones.

While there have been many recent efforts to improve the business and investment climate for large foreign firms, such efforts should be extended to all types and sizes of firms.

e. Rural development policies

Rural development is one of the main pillars of policies to create more and better jobs in LDCs, given the high proportion of the population still living in rural areas and whose livelihood depends on the opportunities they provide. Developing the rural economy is not limited to agricultural production and productivity: Expanding RNF activities plays a substantial complementary role. Despite the importance for present and future economic and development outcomes, both agriculture and other rural economic activities have been relatively neglected in LDCs over the past 30 years. This has contributed to declining agricultural productivity, feeble agricultural production growth and depressed rural incomes (UNCTAD, 2009: 91–140). This situation must be reversed if LDCs are to promote structural change. Overturning the widespread urban bias that led to the neglect of investment in rural areas has to be a starting point for policy intervention. In recent decades, such countries as China, Viet Nam and Indonesia have reversed the previous urban bias, and all of them have benefited in terms of lifting the overall GDP growth rates. Similarly, among the LDCs, recent successful initiatives to improve agricultural productivity in Ethiopia, Malawi and Rwanda have demonstrated how agriculture can be effectively revitalized in relatively short periods of time (ILO, 2011: 27–51).

Rural development is one of the main pillars of policies to create more and better jobs in LDCs, given the high proportion of the population still living in rural areas.

Recent successful LDC initiatives to improve agricultural productivity have demonstrated how agriculture can be effectively revitalized in relatively short periods of time.

Agriculture is not a "bargain sector" in which high returns can be secured with little expenditure. Rather, as is true of industry, investment is crucial, and in the LDCs public investment is especially important in this regard. The Comprehensive Africa Agriculture Development Programme, led by NEPAD, has agreed that a targeted 10 per cent of government budgets should be allocated to agriculture. However, setting the right priorities for productive spending is equally critical, as investment in agricultural research and development, rural

infrastructure and education have the greatest impact on productivity and growth.

Programmes to subsidize fertilizers and seeds have been effective in raising fertilizer use, average yields and agricultural production.

Since the late 1990s several African LDCs have introduced programmes that heavily subsidize input price (fertilizer, and in some cases seeds) to producers, targeting smaller-scale farmers (in Malawi, Rwanda, United Republic of Tanzania and Zambia) or all farmers (in Burkina Faso, Senegal and Mali). Based on the available evidence, such programmes have been effective in raising fertilizer use, average yields and agricultural production, but their success is highly dependent on implementation. In the case of seeds, the programmes have attracted additional seed growers and expanded the number of varieties supplied. This varied experience suggests that these subsidies should not be prolonged over the long term (because of their high fiscal cost), but can and should play a role in boosting rural earnings and helping markets take off over the medium term. Procurement and distribution of subsidized fertilizers should be market-friendly, so as to enhance and not inhibit input market development. Moreover, the new generation of input subsidies ("smart" subsidies) brings innovations in design (e.g. targeting and vouchers) to support the most constrained farmers and encourage the development of input markets (Druilhe and Barreiro-Hurlé, 2012; Chirwa and Dorward, 2013). Governments may also organize bulk purchases of (imported) fertilizers in order to achieve economies of scale and reduce the price of this input.[3]

Public investment must provide the lead in the development of rural transport, irrigation, warehousing, energy, marketing and communications.

In terms of improving rural infrastructure, it is increasingly evident that public investment must provide the lead in the development of transport, irrigation, warehousing, energy, marketing, communications and so forth, especially in remote areas. This is warranted on two grounds. First, it has multiplier effects, since it increases overall productivity in agriculture and thus facilitates overall structural change. Second, it develops the externalities described in chapter 4 of this Report, thereby contributing to employment generation, enterprise development and capacity-building.

As for micro- and small agricultural enterprises, access to institutional finance on reasonable terms is perhaps even more crucial to making cultivation viable. Policies are needed to make institutional credit available to all farmers, including tenants, women farmers and those without clear land titles (if necessary with some subsidies to cover the higher risks and transaction costs associated with such lending). Some strategies for expanding credit access in farming include:

Policies are needed to make institutional credit available to all farmers, including tenants, women farmers and those without clear land titles.

- Providing seasonal and long-term finance to farmers and RNF economic agents by agricultural development banks, State banks, postal banks, community credit cooperatives (which are more familiar with borrowers' creditworthiness) and, in some cases, commercial banks. These institutions are also an instrument for mobilizing rural savings, and may sometimes establish specialized rural / microfinance units;
- Rehabilitating existing rural development banks and the creation of such institutions where none exists, in order to offer financial services not provided by commercial banks and other financial institutions;
- Encouraging the provision of financial services (credit) and extension services by means of contract farming and outgrower schemes to both smallholders and large-scale producers;
- Providing subsidies for and underwriting seasonal finance; and
- Initiating insurance and warehouse receipt schemes, which make it possible to turn agricultural produce into collateral.

A major factor in the viability of cultivation is the effective use of available agricultural technologies, which means that extension services are extremely important. In order to achieve higher agricultural yields and stronger productivity growth, farmers need to learn and adopt innovations in their cultivation techniques, water management, choice of seeds and/or crops, warehousing, etc. This calls for Governments to provide support services, such as rural extension services, which diffuse new knowledge to farmers and help them learn and adopt innovations. Ideally, such services should actively involve local communities and use traditional or indigenous knowledge systems that are appropriate to smallholder farm sizes, including scale-neutral technologies. Extension activities should also encompass environmental management, which includes paying attention to conditions of land quality and water access, particularly with regard to the equitable spread of irrigation and avoiding soil degradation. However, not all technologies are developed with the specific concerns of local farmers in mind, and extension services should thus be combined with an emphasis on stronger research activities that are sensitive to local problems and requirements. To the extent possible, LDC Governments should seek to create and/or increase funding for national or regional research centres created on the basis of agro-ecological zones or strategic food commodities, and indeed many of these need not be so expensive to develop.

Agricultural extension services should actively involve local communities and use traditional or indigenous knowledge systems that are appropriate to smallholder farm sizes, including scale-neutral technologies.

LDC Governments should seek to create and/or increase funding for national or regional research centres created on the basis of agro-ecological zones or strategic food commodities.

In addition, agricultural policies should foster stronger backward and forward linkages of the sector. Such linkages should encompass backward linkages between agriculture and input markets, including access to appropriate inputs, so as to encourage cheaper and more sustainable input use, with better regulation and monitoring of private input supply. Forward linkages include development and proliferation of better post-harvest technologies, such as warehousing and storage, transport and preliminary processing of agricultural items. More efficient marketing channels improve access to markets and protect farmers from high volatility in output prices. This points to the need for partnerships between the State, farmers' organizations and NGOs to carry out some of the functions previously performed by agricultural marketing boards (e.g. finance and technological extension services as well as marketing). It is a mistake to believe that large corporate retail can provide an effective substitute, as the experience of several developing countries suggests otherwise. Where institutions for marketing agricultural products are missing or inefficient, and/or where local traders exert detrimental market power over small producers, Government can establish public trading facilities and market data systems, promote public cooperatives and set up warehouses in order to limit the traders' power. Some possible strategies in this regard include:

There is a need for partnerships between the State, farmers' organizations and NGOs to carry out some of the functions previously performed by agricultural marketing boards.

- Encouraging farmers' groups and other local cooperatives to organize the supply of inputs, machinery and credit;
- Developing local markets for the marketing of agricultural produce by investing in the physical installations and liaising with local economic agents;
- Prioritizing activities that target local and international regional markets;
- Improving the access of the rural population to product and factors markets;
- Fostering the development of common-interest producers' associations and cooperatives;
- Devising and implementing flexible and innovative cross-sectoral institutional arrangements;
- Where natural gas is present, providing industrial policy incentives for the production of fertilizers, and where it is not, organizing bulk purchase of (imported) fertilizers; and

- Using input supply and subsidies to provide credit or subsidies for seed and fertilizer acquisition.

Some of the challenges faced by agricultural development in LDCs are the security of tenure, conflict management, excessive centralization of land administration and lack of access to land. Several LDCs have tackled these challenges through such programmes and measures as decentralization of land administration to subnational levels, improved land registries and titling, establishment of institutional mechanisms to solve land tenure conflicts, and land reform. For example: The Ugandan Constitution of 1995 transferred titles from the State directly to landholders. Malawi and Mozambique both adopted land redistribution policies favouring the landless and de facto occupants, while Niger's 1986 rural code provides for mechanisms to resolve land tenure conflicts. Decentralization was achieved through land boards in Uganda, rural councils in Senegal, land commissions in Niger and land committees in Lesotho (UNECA, 2005: 129–166). Wider access to land through land reform and/or more secure rights (whether individual or collective, proprietary or not) creates better incentives for agricultural investment and is therefore likely to result in increased employment in agriculture. The mix of measures to be enacted naturally needs to be adapted to local conditions, the local institutional setting and local traditions. Nevertheless, since the mid-2000s several LDCs have been entering into lease or sale agreements involving large patches of land for commercial agriculture development by foreign investors (so-called "land grab" operations), without fully privatizing land markets. In order to reduce the conflicts and insecurities these might engender, it is important to establish new, decentralized bodies that bring local communities and customary leaders together with Government in the management of land, land rights and land disputes.

Some of the challenges faced by agricultural development in LDCs are the security of tenure, conflict management, excessive centralization of land administration and lack of access to land.

LDCs with the potential for developing cash crops for export can exploit niche markets for agricultural goods — including biofuels, "fair trade", "organic", certified timber and sustainable products — that enjoy a growing market, especially in developed countries. Coffee growers from Latin America, Africa and Asia are benefiting from this trend. One such example is the Oromo Coffee Company, from Ethiopia, which exploits ethically conscious niche markets in developed countries (Newland and Taylor, 2010). Similarly, enhancing regional cooperation in some agricultural commodity chains of production, processing and marketing (such as rice, maize, wheat, sugar, meat and dairy products) can potentially meet increasing regional demand (UNECA and African Union, 2009).

LDCs with the potential for developing cash crops for export can exploit niche markets for agricultural goods that enjoy a growing international market.

As noted earlier, the development of non-farm activities is crucial for the LDCs not just to provide other means of productive employment but also to improve the quality of life of the rural population. Employment creation in RNF activities was a crucial labour absorber during the structural transformation process in such Asian countries as Bangladesh, Viet Nam and India (Khan, 2007). Typically, government and donor interventions to support RNF employment have emphasized self-employment (Davis, 2004). The empirical evidence shows, however, that in rural Latin America and south Asia, non-farm wage employment is equally, if not more, significant (Barrett et al., 2001; Haggblade et al., 2007; Carlo Azzarri, 2009). The excessive focus on self-employment may result from perceptions of its less exploitative nature and its strategic importance for poverty reduction, but these perceptions can be debated. Greater balance between the promotion of self-employment and support to SME development has implications for the spatial focus of government interventions – for example, making greater use of rural town centres as an entry point, since SMEs tend to be located in centres where they can benefit from improved access to services, economic infrastructure, markets and labour.

Non-farm wage employment is equally, if not more, significant than RNF self-employment.

F. Summary and conclusions

Policies for employment-rich growth in LDCs should have two complementary objectives: expanding the number of jobs so as to absorb the growing labour force and the youth bulge, and raising the incomes generated by these jobs (by means of productivity gains) so as to combat the generalized prevalence of poverty and underemployment. Reaching these objectives involves implementing a range of mutually supportive policies aimed at building productive capacity and fostering structural transformation. Policy interventions should cover three broad areas: macroeconomic policies, enterprise development, and public-sector investment and actions for job creation.

Policies for employment-rich growth in LDCs should have two complementary objectives: expanding the number of jobs and raising the incomes generated by these jobs.

Inclusive development calls for a macroeconomic policy approach that goes beyond the narrower goal of macroeconomic stability. This broader approach requires expanding the number of instruments and coordinating macroeconomic policies with other policies to stimulate the development of productive capacities. In this context, fiscal policy becomes more important than monetary policy. It should target financing public investment in physical and human capital by accelerating public investment in infrastructure and raising spending on education and training. To do so requires strengthening government capacity to mobilize and manage fiscal revenues, whether domestic or external. At the national level, this can be done initially through domestic resource mobilization, which entails changes in fiscal policy and tax administration.

For resource-rich LDCs, fiscal revenue can be increased by modifying the extremely favourable terms currently offered to foreign investors in agriculture and mining.

Tax administration and collection can be made more efficient, by streamlining information management, cross-checking statements and declarations and setting up a special unit for high-income taxpayers. For resource-rich LDCs, fiscal revenue can be increased by modifying the extremely favourable terms currently offered to foreign investors in agriculture and mining. This may involve imposing a tax on land leased for large-scale investment projects, raising existing land taxes or revising the taxation of activities undertaken by those projects. Governments with mining resources can raise their revenues by adopting higher levies, royalties, income taxes or export taxes. LDC authorities should also boost the mobilization of external resources from both traditional and non-traditional aid donors and from multilateral and regional financial institutions.

LDC authorities should also boost the mobilization of external resources from both traditional and non-traditional aid donors.

Although fiscal policy may be more important than monetary policy in developing productive capacities, monetary policy is still critical. It should, however, be less fixated on attaining an inflation rate in the low single digits than on targeting full employment of productive resources and providing reasonable macroeconomic stability. Credit policy is also of crucial importance in the LDCs, particularly for MSMEs, which are typically credit-constrained in these countries.

Private sector development is a sine qua non for large-scale employment generation in LDCs.

Private sector development is a sine qua non for large-scale employment generation in LDCs, since it generates the bulk of jobs, both now and in the future. The main policies for developing the LDCs' private sectors are industrial policy, enterprise policy, rural development policies, and education and training policies. *Industrial policy* is designed to steer the economy towards structural transformation, by moving to higher-productivity activities both among and within sectors. There are two types of strategies that LDCs can pursue to bolster the employment intensity of growth. The first is to build on activities of existing comparative advantage, by fostering backward and forward linkages and technological upgrading in these sectors. This typically means focusing on natural resource-based activities. Agriculture can be the basis for developing downstream industries, such as food processing, geared mainly to domestic and regional markets, but also global markets.

A second type of industrial policy strategy aims at changing the capital-labour ratio of the economy, by attracting investment in labour-intensive industries. In this respect, some LDCs will be able to take advantage of the window of opportunity opened by China's likely delocalization of the lower end of its manufacturing industry, through a combination of integrating domestic firms into manufacturing GVCs and attracting FDI. Domestically, this strategy should be complemented by policies on clustering, export promotion and labour costs.

Some LDCs will be able to take advantage of the window of opportunity opened by China's likely delocalization of the lower end of its manufacturing industry.

Effective *enterprise policy* measures for stimulating the development of urban-based MSEs include facilitating their access to capital and helping them upgrade into formal status. Policymakers need to expand the financing made available to these firms through national development banks or commercial banks. These financial institutions should select those MSEs with high growth potential, based on current profitability and entrepreneurs' profiles.

Rural development policy is a special challenge, given the dismally low level of productivity of rural areas, and requires action on infrastructure, technology and financing. The State needs to invest heavily in rural infrastructure, especially irrigation, electricity, transport, storage (warehousing) and communication (ICTs) in order to boost rural productivity and foster backward and forward linkages of farms. Rural extension services must be established or rehabilitated to provide advice and training on cultivation techniques, water management, choice of seeds and/or crops, warehousing, conditions of land quality and water access, avoiding soil degradation, and techniques for meeting market requirements.

Rural development policy requires action on infrastructure, technology and financing.

Providing rural producers with access to capital and finance involves offering both seasonal and long-term finance to farmers and rural non-farm economic agents. This should be undertaken by agricultural development banks, State banks, post office financial services, community credit cooperatives (which have better knowledge of borrowers' creditworthiness) and commercial banks.

Most of the above-mentioned instruments of industrial, enterprise and rural development policy are targeted policies. They need to be complemented by horizontal policy measures aimed at increasing the knowledge intensity of the LDC economies, so as to make them more adaptable and better prepared to meet the requirements of a modern economy. This brings us to *education and training policy*. In primary education, the priority is to improve quality. In secondary and tertiary education and in technical and vocational training, the priority is to expand the supply and improve the quality of services. This includes revising curricula and teaching methods in order to make the labour force more adaptable and innovative, and adjusting education policies to meet future domestic labour market requirements.

Education and training policy should make the labour force more adaptable and innovative.

Finally, in addition to involving the private sector, the State itself must play a role in generating jobs, either directly and indirectly, especially in the earlier phases of development. Since infrastructure work is a non-tradable type of activity, and since it finances the bulk of projects, the State can influence the choice of technique so as to ensure the adoption of labour-intensive production processes. These have several advantages over capital-intensive technologies: They generate more jobs, have lower costs, can contribute to local enterprise development and capacity-building, provide more readily available maintenance and repair services, and can generate foreign exchange savings.

Labour-intensive production processes generate more jobs, have lower costs, contribute to local enterprise development and capacity-building, and generate foreign exchange savings.

G. International support measure: Bolstering youth employment in LDCs through private sector development

According to the current and future demographic trends in the LDCs — analysed in chapter 2 of this Report — the working-age population in these countries will increase by 15.7 million people every year, and 225 million new jobs will have to be created by 2030 to productively employ newcomers to the labour market. Even more worrying is that the LDCs youth population (aged 15–24 years), which is becoming better educated and growing fast, is increasingly seeking job in rapidly growing urban centres. The main responsibility for creating these jobs rests largely with the LDCs themselves. Nevertheless, the international community can also play a role in helping to ease the constraints faced by these countries in creating sufficient jobs.

225 million new jobs will have to be created by 2030 to productively employ newcomers to the labour market.

Indeed, the international community has pledged to help implement the IPoA, which is a consensus programme aimed at transforming the LDC economies during the decade 2011–2020. One of its pledges focuses on the employment of youth and their participation in the economy. More specifically, the LDCs' development partners have committed to "provide financial and technical assistance to support least developed countries' policies and programmes that provide economic opportunities and productive employment to youth" (IPoA, para. 81 (2a)).

The international community has made a pledge on the employment of youth and their participation in the economy.

In line with this undertaking, the Report is proposing a new international support measure to create employment opportunities for youth in the LDCs. The support measure would involve a catalytic use of ODA for employment creation through private sector development.

The objective is to create a financing facility for private sector development in LDCs, aimed specifically at providing seed capital and training for young entrepreneurs. The ultimate goal is to create favourable conditions for the growth of local enterprises so that more employment opportunities are generated for the millions of young people who join the labour market each year. This proposal is based on the recognition that the lack of financing and entrepreneurial capabilities is one of the most critical constraints on private sector development in these countries. Investment will provide seed capital for start-ups. Training will equip young people with the requisite skills for successfully managing these new enterprises.

The objective is to create a financing facility for private sector development in LDCs, aimed specifically at providing seed capital and training for young entrepreneurs.

The financing facility would be based on a cost-sharing partnership between the international community and LDC Governments. Creating productive employment for young people in the LDCs is in the interests of the international community and of traditional donors in particular, as it would reduce the incentives for emigration from these countries. International assistance of this nature would enhance the development of productive capacities and generate desperately needed employment for LDC youth. It would have the additional benefits of improving the technical and skills base of the LDCs and of creating new forms of innovation. As such, it could be a win-win proposal for both the international community and the LDCs.

The financing facility would be based on a cost-sharing partnership between the international community and LDC Governments.

The facility would have two valuable impacts on LDC economies. First, it would enable the creation of enterprise incubators to strengthen their private sector. Unlike public works programmes, it would provide a long-term and sustainable solution to the employment challenge by fostering the development of productive capacities.

Second, it would support the creation of enterprises in the formal sector of the economy. Creating formal firms would not only provide better employment opportunities for young people, but would also contribute to domestic resource mobilization by broadening the tax base.

In the first phase, organizational and managerial training would be provided to those candidates that complied with certain requirements.

Ownership of the scheme by the LDCs themselves is critical. It should be embedded in the national development strategy and have verifiable indicators of success. These could be specified in terms of the number of jobs created, the share of young people in the total number of employed in enterprises supported by the facility, and the like.

Financing the facility may require innovative solutions, such as a "matching fund" approach. Donors would agree to match (or exceed by a margin) the funds mobilized by LDC Governments to finance the facility. Such matching funds would provide an incentive to recipient Governments to raise more revenues for employment creation for young people. Non-traditional donors might also find the matching fund approach appealing, since the facility would be based on risk-sharing and a balance of resources.

The screening would be based on the commercial benchmarks typically used by private banks, plus an additional condition that new firm's employees should come from the targeted age group.

The facility would work as follows. In the first phase, organizational and managerial training would be provided to those candidates that complied with certain requirements (such as age and educational background). After finishing the training, candidates would prepare project proposals for enterprise development in the second phase. These proposals would be screened, and the most promising would receive seed capital for concretizing their business proposals. Alternatively, funding "windows" could be provided, in which competitive bids would be offered with proposals submitted for funding under more discretionary terms, involving joint ventures and riskier capital (venture) fund approaches.

Some form of support for new firms would have to be provided for the first three to five years.

The screening would be based on the commercial benchmarks typically used by private banks, to which an additional condition could be added – namely, that a given percentage of the new firm's employees should come from the targeted age group (for example, those aged 15 to 24 years). The facility, which could be managed by a national development bank or an authorized government entity, would also fund technical and vocational education and training for new employees, enabling an ongoing increase in their skills and knowledge and increased productivity for the new enterprise.

Given the high failure rate of start-ups in most economies — a simple rule of thumb is that half of all start-ups fail during their first operating year — some form of support for new firms would have to be provided for the first three to five years. The facility could be the main source of financial and managerial support for the first two to three years (the second phase of the programme). Later on, in the third phase, Governments could provide some additional form of support, for example through financing by a State financial institution, under preferential conditions. After the last phase of the programme, enterprises would have to survive on their own.

Donors could provide not only financing for the facility, but also technical cooperation to establish enterprise incubators, as well as different types of training.

Donors could provide not only financing for the facility, but also technical cooperation to establish enterprise incubators, as well as different types of training using their own expertise in these areas (e.g. SME support and entrepreneurship policy). In principle, the facility could finance start-ups in activities that could potentially result in the largest effect on employment creation, although Governments could gear the projects towards activities and sectors based on their national priorities and specificities (e.g. regional or sectoral development targeted by industrial policy).

LDCs might want to tape the considerable knowledge, skills, networks and other resources of their diasporas.

When possible, LDCs might want to tape the considerable knowledge, skills, networks and other resources of their diasporas (UNCTA, 2012: 147—150). Participating countries could network to share best practices, particularly in monitoring the impact on the economy.

Notes

1 The effectiveness of improving tax collection is shown by the example of Ecuador, where better access to information and monitoring of company accounts and more determined implementation of existing laws, led to a doubling of corporate income tax receipts in just five years.

2 LDC Governments can consider negotiating with these development partners on the use of local labour force in the execution of South-financed infrastructure and public works projects.

3 LDCs endowed with natural gas have a comparative advantage in the production and trading of fertilizers, and may consider adopting industrial policy measures to establish the industry.

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