

DECENT WORK AND FAIR GLOBALIZATION: A GUIDE TO POLICY DIALOGUE

How the MDG 'Decent Work' Target Can Support a New Approach to Development (Part 2)

The UN Conference on Trade and Development (UNCTAD) and other UN bodies have been calling for a substantial **paradigm shift** in international and national strategies towards poverty eradication in developing and least-developed countries (LDCs). The alternative approach suggests that the only way to reduce poverty in the LDCs while decreasing dependence on foreign aid and international migration is through more dynamic policies for the development of domestic productive capacities along with the expansion of productive employment opportunities.

This involves a paradigm shift from the current Washington Consensus approach, which targets social policy but takes a universally non-interventionist approach for the state's role in the economy, toward a much different and more *targeted economic policy approach* (that supports both production and employment) and that progressively extends universal coverage of social policy. It means also a shift from a "trade-driven approach to development" to a "*development-driven approach to trade.*"

Understanding this paradigm shift is essential for the donor community as well. Doubling or re-doubling of external development finance will not be effective if it continues to be linked to the wrong development model. While the current development paradigm starts with the *assumption* that macroeconomic stability and a competitive market economy are all that is needed, and productive employment will naturally follow from these, an alternative starting point of poverty analysis and efforts to achieve "pro-poor growth" should be focused on how people make a living. At the national level, successful economic development is determined by whether there is a virtuous circle of expanding both domestic production and the numbers of quality jobs (that is, expanding productive capacities *and* inclusive productive employment opportunities) – and whether the policies of the donor community and the overall international economic system support or undermine this process.

Supporting productive capacities for increasing productive employment

While the current model focuses on securing foreign aid, remittances flows and revenues from trade exports,

the alternative approach seeks to find better ways to utilize and build up existing domestic capacities and productive resources and to foster entrepreneurial capabilities in low-income countries that are typically underutilized, notably because of lack of consumer demand and other structural weaknesses. The challenge is to set in motion a concerted effort to catalyze and sustain a "**virtuous circle**" in which the *further development of productive capacities and the growth of demand mutually reinforce each other*. This means investing not only in the more productive and dynamic sectors of the economy but also in building capabilities *in the sectors where the majority of population (and the poor) are working*. Without that, there can be high growth, but at best low-job-intensity growth, and certainly not "pro-poor growth".

Local demand as a source of local productive investment

Productive capacities (which condition the scope for generating more productive employment) develop through the inter-related processes of: **capital accumulation**, which includes investments not just to increase machinery and equipment, but also supporting economic and social infrastructure and human capital; **technological progress** requiring new technologies, know-how and innovation; and **structural change** through creating more productive synergies and linkages within and between sectors of the economy.

However, these processes will not occur automatically by themselves or continue in some mechanical fashion forever. What the current development model has missed is the **essential role of demand**. The level and strength of consumer demand on the part on individuals and businesses is firstly what determines whether productive capacities are fully utilized or not. But even more important, the expectation of whether or not demand will grow can directly inform the likelihood of profit expectations and hence entrepreneurial decisions to invest to expand productive capacities or not. Domestic demand makes the largest contribution to economic growth in most low-income countries, yet its growth is also very weak as it has been neglected. This contributes to holding back investments in productive capacities, which in turn limit the scope for productive employment opportunities that

could raise domestic demand. In order to break this “**vicious cycle**”, a key challenge is to boost local demand in the sectors where its potential is the highest. In the majority of low-income countries, *trends in domestic demand are closely related to what happens within the agricultural sector.*

Smallholder agriculture for food security and as a key source of demand

Pro-active state policies are needed to *capitalize on the linkages between agriculture and the rest of the economy.* On the “**supply side**,” concerted efforts to raise agricultural productivity among smallholder farmers are particularly important for increasing domestic savings in very poor households and promote food security through locally-produced foodstuffs. But “**demand-side**” linkages that result from agricultural growth are also an important mechanism to stimulate the development of local manufacturing industries and local services. These inter-sectoral **forward and backward linkages** can serve as a catalytic incentive for additional productive investment decisions, mobilization of latent entrepreneurial capabilities and to ensure that economic growth is more broad-based and inclusive.

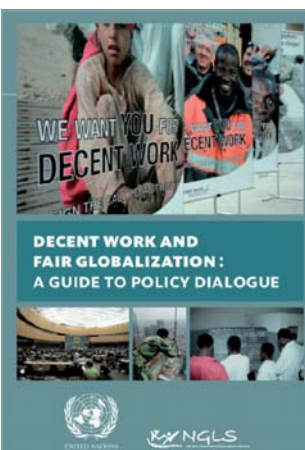
Research on agricultural demand-led industrialization has found that in low-income countries, every US\$1 of expenditure by agriculture generates US\$2.75 of induced demand for non-agricultural inputs and services, and 70 percent of this backward linkage effect is attributed to rural household demand for consumer goods and services. Adding US\$1 of new farm income potentially increases total income in the local economy – beyond the initial US\$1 – by an additional US\$1.88 in Burkina Faso, US\$1.48 in Zambia and US\$1.48 in Senegal. Research from Viet Nam has also shown how broad-based increases in agricultural labour productivity increased earnings for the majority of the poor and stimulated domestic demand for non-agricultural goods that were also produced by the poor in small and medium-sized enterprises (SMEs). This in turn led to higher earning opportunities for agricultural goods and services thereby creating a “**virtuous circle**” of growth and poverty reduction.

Along with ODA and land reform, successful East Asian economies used specific policies to induce a “**virtuous circle**” by raising domestic savings ratios that included business savings as well as household savings. The creation of a strong “**investment-profit nexus**” became the engine for further developing productive capacities. An important part of the process is to ensure that gains in productivity serve both for reinvestments and to improve incomes of small farmers as well as agricultural and non-agricultural wage earners. In contrast to the current development model, this requires policies and institutions that support income redistribution, rights to bargain for better wages or farm incomes that must be adapted to the special conditions of the informal economy.

A development-led approach to trade

The current development model places an over-emphasis on trade-led growth since the 1980s, on the assumption that fast and full integration with the world economy is the key to benefiting from globalization. In the decades since, “**global integration**” began to replace “**national development**” as major policy objective of governments. However a new approach to trade involves a paradigm shift in which developing productive capacities should not only be limited to the more dynamic sectors with export potential (tradable sectors) but policies should also support developing productive capacities within non-tradable activities (products that are sold locally) and to foster dynamic linkages between the two. This strategy is especially important for LDCs, where the majority of the population (and the poor) tend to be employed in the domestic non-tradable sectors. Additional policies must be more carefully designed to identify how international trade can support domestic capital accumulation, technological change, structural change, employment creation and poverty reduction. This paradigm shift means the goal is not to maximize *trade*, but to maximize the *beneficial effects of trade for building domestic productive capacities.*

Such strategies must also be complemented with developing regional trade linkages (essential for very small national economies) as a stepping stone and alternative pathway towards more constructive global integration.



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