Chapter V

REVISING THE POLICY FRAMEWORK FOR SUSTAINED GROWTH, EMPLOYMENT CREATION AND POVERTY REDUCTION

A. Introduction

Widespread unemployment in the global economy over the past 30 years has become the most pressing social and economic problem of our time, because it is closely related to poverty, on the one hand, and social peace and political stability on the other. Observers generally agree that the fallout from the global financial and economic crisis has further aggravated the labour market situation in most countries, as millions of workers have lost their jobs or suffered wage cuts. There is a particularly close link between unemployment and poverty in developing countries, where public social security systems are rare and workers are forced into more vulnerable jobs and into informal sector activities for fear of descending into poverty.

The employment performances of different groups of developing countries discussed in chapter IV of this *Report*, the theoretical considerations presented in chapter III, as well as the risk of a deflationary trend in the global rebalancing process discussed in chapters I and II, all suggest that for employment-creating development strategies to succeed, it will be necessary to go beyond the policy prescriptions of the past, which relied primarily on market liberalization and on exports for development and employment creation. This chapter argues for an alternative public policy approach to solve the pressing employment problems, based on the premise that output and demand expansion is a precondition for employment generation, in developed and developing countries alike. It suggests that labour markets do not function in the same way as goods markets: in principle, price flexibility causes demand to match supply on individual markets for goods and services, but wage flexibility does not prevent a rise in unemployment. This is because wages are not only a cost factor but also a key determinant of the level of domestic demand in any economy.

Therefore faster employment creation, particularly in developing countries which have a large amount of surplus labour, requires appropriate macroeconomic policies and development strategies for accelerating growth of productive capacities and domestic demand. This, in turn, calls for a reassessment of priorities in macroeconomic policies. Monetary policies geared to keeping the inflation rate low and attracting foreign capital inflows, and fiscal policies aimed at balancing budgets, combined

with liberalization of goods, financial and labour markets, have not yielded the results hoped for in terms of growth and employment. Achieving more satisfactory outcomes for employment creation – and thus also for poverty reduction – therefore requires widening the scope of policy instruments beyond what was deemed appropriate under the development paradigm of the past 30 years.

A promising strategy for rapid employment generation would be one that focuses more on the investment dynamics that drive growth of productive capacity, while at the same time ensuring that productivity gains are distributed in a way that leads to a commensurate increase in domestic demand. Such a strategy would use fiscal policy as an instrument of demand management and support for private fixed capital formation. In the design of monetary policy, the exclusive focus on inflation control would be replaced by a greater emphasis on growth and employment creation. Such an employment-friendly monetary policy would aim at maintaining low costs of credit for investment in fixed capital and avoiding currency overvaluation.

In addition, an incomes policy that links increases in labour income to productivity growth in such a way that the wage share does not fall and domestic demand expands at more or less the same rate as domestic supply capacities will ensure that a sufficient number of new jobs are created to compensate for the labour-saving effects of productivity growth. The policy will also provide incentives for further investment in fixed capital, thereby helping to establish a virtuous cycle of productivity growth, domestic demand expansion and enlargement of productive capacity.

By shifting the emphasis of monetary policy to growth and employment creation, the scope for central banks to control inflation will be reduced. However, an incomes policy can serve not only to generate greater domestic demand, but also to prevent labour costs from rising faster than productivity, thereby helping to control inflation. Together, monetary, fiscal and incomes policies would then provide considerable scope for demand management to fight unemployment – both structural and cyclical – while controlling inflation.

Section B of this chapter first reviews how policy approaches to employment creation have changed since the immediate post-war era. It examines the shifting priorities in the economic policy goals of developed countries based on the policy experiences and the changing theoretical propositions of the 1970s and early 1980s. During this period, the economic policy regime moved from interventionism, involving an active role of the State, to broad deregulation and liberalization with a diminished role of the State. The priority of macroeconomic policy shifted from employment creation to achieving and maintaining a low level of inflation. Section C offers recommendations, including reviving proactive fiscal and monetary policy instruments in support of development, and introducing a new kind of incomes policy. It emphasizes that such a policy should aim at reducing the dependence of developing countries on export markets for employment growth, as these markets are likely to be more sluggish in the foreseeable future. Instead, employment growth should be based on a steady increase of domestic demand in line with productivity growth. Section D highlights the need for creating and strengthening institutions to support an incomes policy aimed at faster employment creation, bearing in mind that such institutions have to be adapted to the specific conditions of each country. It also discusses the need for measures to link the expansion of the modern sector and successful export industries with the rest of the economy, including the informal and rural sectors. Examples of such measures include appropriate forms of taxation and public spending, as well as agricultural support institutions. These measures are of particular importance in countries where formal wage employment constitutes a relatively small share of total employment. Finally, section E briefly discusses how a new assignment of national macroeconomic policies in favour of faster employment creation can be supported by appropriate exchange-rate policies and capital-account management.

B. Employment creation as a goal of economic policy in retrospect

1. *Full employment in the "golden age of capitalism"*

In response to the experience of high unemployment during the Great Depression in the 1930s and the subsequent long period of instability and war, many major industrialized countries established full employment as a goal in law, and committed themselves to implementing proactive macroeconomic policies. In the post-war era up to the mid-1970s, a period often referred to as the "golden age of capitalism" (Marglin and Schor, 1990; Singh, 2009), unemployment in developed countries was at historically low levels. In Japan as well as several Western European countries that even absorbed a large number of migrant workers from Southern Europe, it was a period of what is considered full employment (table 5.1).

During the "golden age of capitalism" unemployment was historically low, even though labour markets were more regulated than they are today.

During that period, governments actively guided the growth process through fiscal and monetary policies which aimed at preventing a repetition of the catastrophic economic downturn of the Great Depression. Equally important was cooperation between workers, employers and governments according to certain rules which ensured high rates of investment and parallel growth of productivity and earnings (Glyn et al., 1990; Singh, 2009). This cooperation was based on strong labour-market and social-security institutions, which had been part of the structural change that accompanied the process of industrialization. In this process, collective bargaining on wages and labour conditions helped to ensure that productivity gains from investment in the fast-growing economies were distributed in such a way that the share of wages in total income remained fairly stable. Trade unions, employers' associations and government guidance played an important role in this process.

Proactive fiscal policies to maintain high employment were justified on the grounds that employment was a crucial determinant of prosperity, and was therefore too important to be left entirely to an inherently unstable market of decentralized private agents. With the experience of the Great Depression in mind, and influenced by Keynesian theory, which attributed rising unemployment to insufficient aggregate demand, policymakers focused on maintaining robust aggregate demand through income stabilization policies and public expenditures. The willingness of governments to pursue countercyclical fiscal policies, and to incur budget deficits if necessary in order to stabilize demand and employment, created a macroeconomic environment of relatively low uncertainty. It also fostered incentives for private investment and consumption. This in turn contributed to an employment-generating growth process (Glyn et al.,1990: 62; and Epstein and Schor, 1988: 22).

Table 5.1

UNEMPLOYMENT RATES, SELECTED ECONOMIES, 1956–2008

(Average, per cent)

	1956–1973	*1974–1985*	*1986–2000*	*2000–2008*
Developed economies	2.9	5.9	7.2	6.6
United States	5.0	7.5	5.7	5.1
Japan	1.4	2.2	3.1	4.6
EU-15	2.5	6.8	9.7	7.7
of which:				
Germany	1.3	4.9	7.5	9.1
France	1.7	6.0	9.8	8.3
United Kingdom	1.8	7.2	8.3	5.1
Developing economies	..	5.2	6.0	6.7

Source: UNCTAD secretariat calculations, based on *Annual Labour Force Statistics*, ALFS Summary tables in *OECD.Stat Extracts* database; ILO, *LABORSTAT* and *KILM* databases; ECLAC, *CEPALSTAT* database; and Taiwan Province of China, *Labor Force in MacroEconomics* database.

Equally important, monetary policy was used as a tool of macroeconomic management to foster growth and to achieve the goal of full employment. In the aftermath of the Second World War, central banks in nearly all developed countries were given the responsibility not only for ensuring price stability, but also for contributing to stable and satisfactory output growth and maintaining a high level of employment. This created the monetary conditions necessary for rapidly rebuilding their economies and expanding productive capacities through an enlargement of the fixed capital stock and productivity increases. Besides low interest rates, direct measures (e.g. credit controls and credit allocation techniques) were temporarily employed to influence the allocation of resources and to channel finance to key economic sectors. This model of central banking gave governments a high degree of leverage over the financial system and facilitated the pursuit of their priorities (Epstein, 2005: 13–14).

Central banks were responsible not only for price stability but also for ensuring a high level of employment.

For the major industrialized countries, the quarter century following the Second World War was a period of strong and sustained growth accompanied by high employment rates. Especially for Western European economies, the period of the Bretton Woods system until 1973 was associated with virtually full employment. Growth was centred on the domestic market. Capital accumulation boosted productivity growth that was paralleled by an equally fast growth in real wages, which in turn strengthened aggregate demand (Singh, 2009: 59–61).

The objective of keeping unemployment low became a more serious challenge for economic policy during the 1970s. With the breakdown of the Bretton Woods system and the first oil price shock in 1973, the macroeconomic environment changed dramatically, at both national and international levels. Higher oil import costs accelerated the increase in the general price level. At the same time global economic growth slowed down sharply for various reasons. First, the oil-price-related shift in the terms of trade and redistribution of incomes led to a net decline in aggregate demand, as the imports of oil-exporting countries did not immediately compensate for the fall in effective demand by the oil-importing countries.

Other factors contributing to the economic slowdown were the response of trade unions in some major industrialized countries to the initial price shock and macroeconomic policy reactions to the newly emerging "stagflation". The price shock intensified the conflict over income distribution as rising import prices led to higher consumer prices that squeezed real wages. Trade unions were unwilling to accept this fall in real wages and successfully fought for nominal wage increases rising in line with past inflation rates, based on the assumption that this would restore real wages to the level they had been before the price shock. But as these nominal wage increases by far exceeded productivity growth, unit labour costs were pushed up, a process that ushered in an inflationary wage-price spiral without ever restoring workers' real wages.

Stagflation in turn, provoked overly restrictive monetary policies. Of course, central banks could do nothing about rising import prices, but growing unemployment weakened the power of trade unions in wage negotiations and helped to bring the rise in unit labour costs under control. With interest rates and unemployment rising, public finances deteriorated sharply and governments were increasingly reluctant to apply expansionary fiscal policies. Nonetheless, in the late 1970s, G-7 countries agreed on a coordinated effort to revive global growth, but the resulting recovery was only brief. It was derailed once more by a second oil-price shock, which pushed inflation rates even higher. This time the policy response was led by the United States in the form of ultra-tight monetary policy.

> In the mid-1970s macroeconomic policies started to focus on price stability and balanced budgets.

The 1970s produced a decisive break in the post-war process of capital formation in the leading industrialized countries. Investment rates plummeted, and have never recovered to the levels of the "golden age". It should be borne in mind that by reducing fixed capital formation and output growth, tight monetary policy itself contributes to stagflationary forces by squeezing productivity growth. Furthermore, if high unemployment is allowed to persist, the resulting budgetary pressures can have similarly adverse effects on growth to the extent that rising tax rates and falling public investment worsen supply conditions.

2. *Paradigm shift in the 1980s*

The radical shift in the orientation of macroeconomic policies in the late 1970s and early 1980s had a massive impact on the future course of the world economy. In the United States it provoked a double-dip recession in the early 1980s, in Western Europe it led to a severe recession and record high unemployment rates together with budget crises, and in developing countries it triggered the debt crises of the 1980s.

The policy responses to the global slump as well as the longer term economic consequences differed widely across countries. Developing countries, especially those in Latin America, found their policy space highly constrained, as discussed in chapter IV. The United States economy experienced long periods of expansion in both the 1980s and 1990s, with low unemployment rates, and monetary policy took precedence over fiscal policy in managing domestic demand. By contrast, most governments in Western Europe began to move away from macroeconomic demand management beyond what automatic stabilizers would do.

In the policy debate the "Phillips curve" featured prominently. The curve was originally a record of empirically observed combinations of rates of inflation with rates of unemployment in the United Kingdom (Phillips, 1958). Subsequently, it became associated with Keynesian thought through its influential application by Samuelson and Solow (1960) to show an inverse relationship between unemployment and inflation in the United States. To many observers, this result suggested the existence of a stable trade-off that could guide Keynesian policymakers in choosing their policy priorities. Critics led by Friedman (1968) and Phelps (1967) argued that expectations of inflation would adapt to changes in actual inflation, and the supposed trade-off would therefore disappear "in the long run".

With unemployment and inflation rising simultaneously in the 1970s, Keynesianism seemed at a loss to explain the phenomenon of stagflation. Reflecting the gradual rise of "monetarism", Friedman (1968) had reasserted the pre-Keynesian vision of an

economy that, if left to its own devices, would tend towards full employment. He employed the theoretical notion of the "natural rate of unemployment", which he defined as the level of unemployment that would exist in equilibrium given agents' preferences and labour market imperfections. In order for the alleged tendency towards full employment to run its course, it would be necessary, in particular, to reduce the discretionary element in monetary policy. This was to be done by subjecting central banks to the famous "k-per cent rule" of steady expansion of the monetary base, irrespective of business cycles, while letting financial markets freely determine all interest rates. The "rational expectations revolution" took these monetarist ideas to their "new classical" level in asserting that any systematic stabilization policies would be ineffective, since agents that formed the "rational expectations", guided by the "true model" of the world, would fully anticipate the impact of such policies and could only be fooled by policy surprises. These results were shown to be true in models based on a set of highly unrealistic assumptions, including perfect price flexibility.

The idea of an inherent tendency towards full employment was supposed to be captured by research on the concept of the "non-accelerating inflation rate of unemployment" (NAIRU). In this context, full employment was considered to be solely dependent on labour-market institutions and beyond the reach of macroeconomic policies (Palley, 2007). However, NAIRU estimates would vary over time together with actual unemployment levels, which are undeniably related to macroeconomic policies.

There was a widespread belief that full employment was beyond the reach of macroeconomic policy ...

Stark contrasts in practical policy-making have been observed between the United States and European experiences. When actual unemployment levels fell well below the prevailing NAIRU estimates in the United States in the second half of the 1990s, policymakers ignored the supposed inflation threat and allowed the boom to continue. The NAIRU estimates were reduced accordingly, and prominent critics rejected the concept altogether (Galbraith, 1997; Stiglitz, 1997). In the European context, researchers coined the term "hysteresis" to describe the finding that NAIRU estimates had been adjusted upwards as actual unemployment rose in the absence of policies to counter the trend towards high unemployment.

The influence of the paradigm shift in economic theory on practical policy-making differed among countries. In the United States, it primarily meant replacing regulation by trust in free or self-regulating markets, but it also meant the continued flexible application of macroeconomic policies to stabilize domestic demand growth. In Western Europe, neoliberalism signified enthusiasm for deregulation to varying degrees, but it was combined with a more far-reaching retreat from demand management, with macroeconomic policies becoming focused on price stability and balanced budgets.[1] Perhaps the greatest impact of the rise of neoliberalism was in the developing world, where policy prescriptions for structural adjustment, in line with what came to be called the "Washington Consensus", meant a sharply reduced role of the State together with an excessive focus on competitiveness and export orientation.

... and that jobs could be created only by reducing the price of labour.

The new approach, which considered the experience of stagflation in the 1970s as proof of the distorting effect of State discretion, promoted a post-golden age economic model. This model advocated the abandonment of State intervention in order to prevent the consequences of government failures. By the end of the 1970s, almost all developed countries adopted that model of economic thinking, including reducing government intervention aimed at maintaining high levels of employment. The change in the priorities of macroeconomic policy in the late 1970s and the declining role of government for stabilizing the business cycle are also reflected in the shift to money supply and inflation targeting in all major developed economies, thus subordinating fiscal policy to monetary policy (Epstein and Schor, 1988: 44).

Since then, most governments have relied on the hope of a self-stabilizing market, based on the

belief that unemployment is an inevitable outcome of structural transformation, involving changes in production techniques, consumer demand and the location of production, and that the only way to create jobs is through changes in relative factor prices (i.e. by reducing the price of labour). Thus, increasing labour market flexibility and reducing labour regulations was combined with informal or formal inflation targeting by central banks, which abandoned their previously active role in supporting growth and employment creation in the hope that economic growth and employment creation would result as a by-product of the fight against inflation (IMF, 2006; Epstein, 2009: 1–3).

Nevertheless, except for a short period in the early 1980s, monetary policy in the United States followed a clearly accommodative approach involving fine-tuning the interest rate. Whereas the Federal Reserve System of the United States is responsible for both inflation and employment, monetary policy in the EU followed a monetarist approach for much longer, focused on inflation control. As a result, output growth and employment creation were slower than in the United States (see also chapter III, charts 3.1 and 3.2).

In developing countries, before the 1980s, engaging in a developmental role was widely seen as an important aspect of the mission of the central banks. Consequently, these banks employed a wide range of instruments in support of growth and investment, including keeping real interest rates low, financing government deficits and using capital controls to prevent currency overvaluations. They also used direct tools such as credit allocation and interest ceilings (Epstein, 2005 and 2007). Control over the financial sector and regulation of credit allocation were also deemed essential in the absence of an efficient system of financial intermediation and sufficiently deep financial markets, as well as to ensure that the financial sector served the needs of the real economy and conformed to national objectives. Governments assumed a central role in driving the development process towards outcomes perceived as responding to prevailing social and human needs and the requirements of long-term development. They pursued these objectives using a variety of price controls and intervention in resource allocation. Many governments also considered public ownership of enterprises necessary in the absence of a critical mass of private capitalist entrepreneurs.

IMF conditionality did not adequately address the question of how to increase productive capacity and employment.

3. Structural adjustment and globalization

Since the early 1980s, development policies and macroeconomic policies in developing countries have been shaped largely by the policy prescriptions of the international financial institutions. As the current-account deficits of developing countries widened as a result of sharply rising interest rates on their external debt and weakening exports – both largely due to the marked shift in United States monetary policy aimed at combating inflation – the number of IMF-supported stabilization programmes rose from an annual average of 10 during the 1970s to 19 in 1980 and to 33 in 1985 (Jespersen, 1992).

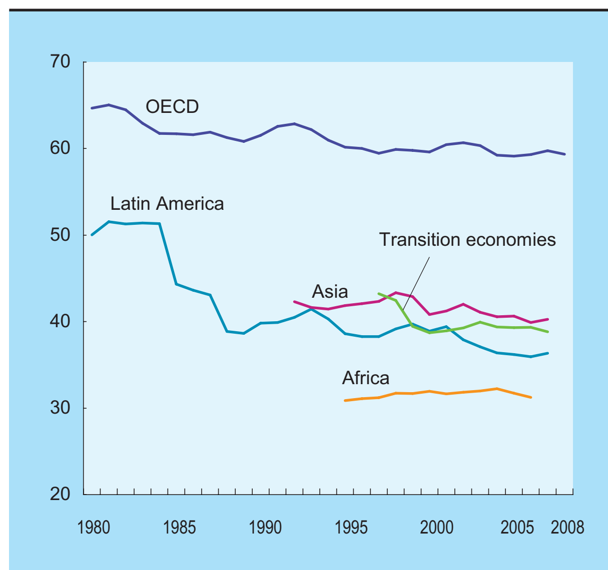
Subsequently, a Structural Adjustment Facility (SAF) and later the Enhanced Structural Adjustment Facility (ESAF) for low-income countries that faced protracted balance-of-payments problems were created, which provided a longer time horizon for IMF support. Through them the role of the IMF was extended beyond that of financing external deficits of its members to one of becoming increasingly involved in development policy issues. Loans provided under the SAF/ESAF were accompanied by stringent conditions, generally including cuts in public spending, restrictive monetary policies and exchange-rate adjustments; in many cases, they also included structural conditions, such as import liberalization, privatization and deregulation of the domestic economy. Their main objectives were to reduce government interference in the allocation of resources and to contain inflation (Schadler et al., 1993: 9). However, the conditionality did not adequately address the questions of how to increase productive capacity and generate employment, which would have required a more balanced mix of monetary and fiscal measures.

Similarly, World Bank lending for structural adjustment placed emphasis on price stability, limited

Chart 5.1

SHARE OF COMPENSATION OF EMPLOYEES IN NATIONAL INCOME, SELECTED COUNTRY GROUPS, 1980–2008

(Per cent)



Source: UNCTAD secretariat calculations, based on UN/DESA, *National Accounts Official Country Data* database, table 4.1; *OECD.Stat Extracts* database; and Lindenboim et al., 2010.

Note: Unweighted averages. Data refer to net national income for OECD countries and to gross national income for other country groups.
Latin America comprises: Argentina, Brazil, Chile, Colombia, Mexico and Peru; Asia comprises: Bahrein, China, Hong Kong (China), the Philippines and the Republic of Korea; Africa comprises: Egypt, Kenya, Mozambique, Namibia, Niger, Senegal, South Africa and Tunisia; Transition economies comprises: Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, the former Yugoslav Republic of Macedonia, the Republic of Moldova, the Russian Federation, Serbia and Ukraine; OECD comprises: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and the United States.

intervention – including through fiscal instruments –, reduced State involvement, greater reliance on market forces and a rapid opening up to international competition as key to unlocking an economy's growth potential. This orientation of structural policies, and the policy programme that came to be known as the Washington Consensus approach to development, represented a shift away from the previous focus on capital accumulation to an almost exclusive reliance on the efficiency-enhancing potential of improved factor allocation generated by market forces. Moreover, with the general shift to export-led growth strategies and the accelerated pace of trade liberalization, output growth and employment creation became increasingly dependent on external markets. At the same time, productivity growth had to rely more on foreign direct investment (FDI) rather than efforts aimed at strengthening domestic demand and domestic investment.

While in several countries these policies were successful in bringing down inflation, they did not live up to expectations with regard to their impact on growth and diversification (see, for example, Muqtada 2010). While inflation was brought down considerably, growth and investment remained weak, with attendant effects on employment. The failure of the reform programmes was due in large part to the fact that they were typically initiated during a crisis situation, when, in a context of slow global expansion, fiscal and monetary policies were tightened to bring down inflation, rather than adopting an expansionary stance to stabilize domestic demand and employment. There were sizeable cuts in spending on productive infrastructure and the provision of social services. Contrary to expectations that the cuts in public sector deficits would "crowd in" private investment and that a reduced State presence in economic activity would unleash a fresh wave of private entrepreneurial initiatives, private investment remained depressed. In most cases the process of capital accumulation came to a halt, and in some net investment even became negative.

Data on the long-term evolution of the share of wages in national income in developing countries is scarce. Nevertheless the data that is available suggests that this share has been on a declining trend over the past three decades in both developed and developing countries, except in Africa, where it has traditionally been the lowest in the world (chart 5.1). According to van der Hoeven (2010), based on research by Harrison (2002), the wage share has been falling in many countries since the 1960s; this trend accelerated and occurred in more countries since the 1990s: the share of labour fell, on average, by more than 0.3 percentage points annually between 1993 and the early 2000s in a group of poorer countries and by 0.4 percentage points in a group of richer countries. This is explained partly by a trend towards greater export orientation, which tended to limit increases in wages to boost international competitiveness, and partly by the fact

that the share of labour in gross national income recovers more slowly in an upturn when overall GDP increases than it falls in a crisis situation (van der Hoeven and Saget, 2004; ILO, 2008). A study of the manufacturing sector in a large sample of developing countries revealed that the decline in real wages and in the wage share of value added in most non-Asian developing countries in the 1980s and the 1990s was due to wage compression, with workers having to bear the burden of manufacturers losing competitiveness in international markets (Amsden and van der Hoeven, 1996). This loss of competitiveness was the result of an inappropriate monetary policy of high interest rates to attract foreign capital, which led to currency overvaluation while at the same time discouraging domestic investment.[2]

Workers had to bear the burden when manufacturers lost international competitiveness.

By 1994, the World Bank officially recognized that the removal of distortions in product and factor markets alone would be insufficient to "put countries on a sustained, poverty-reducing growth path", and that this would require "better economic policies and more investment in human capital, infrastructures, and institution building, along with better governance" (World Bank, 1994: 2). The Bank did not, however, revise its definition of "good economic policies" by giving more weight to macroeconomic and sectoral policy measures aimed at strengthening productive private investment for faster growth and accelerating employment creation for poverty reduction. Thus, monetary conditions for private investment remained unfavourable in many developing countries, resulting in the lack of both infrastructure investments and the provision of public goods and services, both of which create important positive externalities for a wide range of productive activities (*TDR 1993*, chaps. II and III).

In the late 1990s, given the disappointing results of almost 20 years of policy reforms in developing countries, an enlarged policy agenda, sometimes called the "post-Washington Consensus" or "second-generation reforms" (Kuczynski and Williamson, 2003), emphasized poverty reduction and the mitigation of its effects as immediate objectives of development policies, which required direct government involvement. It was accompanied by a new emphasis on supply-side measures in health, education and infrastructure improvements to reduce poverty. However, macroeconomic policies that would promote fixed investment, productivity growth and employment creation continued to be neglected. Similar to structural adjustment programmes, reforms undertaken in the poorer developing countries in connection with Poverty Reduction Strategy Papers (PRSP) starting in 1999 continued to focus on price stabilization (Khan, 2006; Muqtada, 2003; UNCTAD, 2002), while emphasizing the need for reallocation of public expenditure to areas such as primary health care and education. Such measures were destined to fail in their attempt to achieve sustained poverty reduction in the absence of accelerated structural change and sufficient capital accumulation, which could have boosted growth and created productive employment (World Bank, 2005).

Since the end of the hyperinflation phase in the second half of the 1980s and the early 1990s, most countries in Latin America and Africa adopted a "sound" monetary policy that sought to prevent inflation by keeping real interest rates consistently higher than growth rates, with the result that output growth remained subdued (chart 5.2). Consequently, the development gap widened and the catching up of these two regions lagged behind East and South-East Asian countries that had started industrializing from similar or even lower levels of development. It was only by drawing lessons from the experience of the Asian financial crisis in the late 1990s and the Argentinean debt crisis in 2001–2002 that the majority of Latin American countries adopted more accommodative and even expansionary monetary policies which led to stronger overall growth. A notable exception was Brazil, where monetary policy continued to resemble the orthodox approach, but the negative impact of high interest rates on development and structural change in that country was at least partly compensated by interest subsidies for loans from the national development bank for financing fixed capital formation.

Thus, over the past 30 years, adherence to the dogma of a flexible labour market, combined with a focus on keeping inflation rates low, prevented many developing countries from pursuing development strategies aimed at promoting investment in productive capacities and employment creation. And

Chart 5.2

REAL INTEREST RATES AND REAL GDP GROWTH RATES, SELECTED COUNTRIES IN AFRICA, ASIA AND LATIN AMERICA, 1990–2009

(Per cent)

Source: UNCTAD secretariat calculations, based on table 1.1; IMF, *International Financial Statistics* database; and ECLAC, *CEPALSTAT* database.

for the same reason, they did not establish effective labour-market organizations and institutions.

4. Experience with heterodox policies

The most successful cases of economic catching up, all of which were in Asia, never strictly adhered to the principles of "sound macroeconomic policy" as advocated by the Washington Consensus. In practically all these countries private sector development and dynamic growth processes were bolstered by investment-friendly macroeconomic policies, a broad array of fiscal and regulatory instruments in support of capital accumulation and technological upgrading, effective institutions to coordinate private and public-sector activities, as well as redistributive policies and considerable investment in education (Chang, 2002; Amsden, 2001; Onaran and Stockhammer, 2005). Fiscal policy was used pragmatically to stimulate demand whenever that was required by cyclical developments. No doubt, their economic policies also gave importance to price stabilization, but it was pursued through various instruments other than high interest rates, the preferred ones being a government incomes policy and/or direct government intervention in the goods and labour markets.

Low interest rates are a key policy factor contributing to the dynamics of investment in fixed capital, growth and catching up (*TDR 2003*). Distinct from Africa and Latin America, in both real and nominal terms the lending interest rates in East and South-East Asia over the past 20 years, except during the Asian financial crisis, have been consistently lower than the GDP growth rate. As a result, they have acted as a driver of the strong investment dynamics in those two subregions (chart 5.2).

In addition to fiscal and monetary policies more favourable to domestic capital formation and productivity growth, the principles governing the functioning of labour markets in most countries in East and South-East Asia, beginning with Japan and the Republic of Korea, were also quite different, and often just the opposite of the "hire-and-fire" principle. The principle that employers assume responsibility for their employees and that employees enter into a lifelong relationship with "their" company served as the cornerstone of a sustained investment-led growth path, but was contradictory to the Washington Consensus. Furthermore, the East Asian form of labour-market organization has involved a process of participatory wage determination that could also serve development elsewhere.

C. Reassignment of macroeconomic policies for employment creation

1. The need for a new policy approach

As discussed in the context of the theoretical considerations in chapter III, a successful strategy for growth and employment depends on investment in fixed capital. In a market economy with a dominant private sector, such investment is strongly influenced by growth of demand for the goods and services that are produced with that capital, on the one hand, and on the conditions to finance such investment on the other. Public policies can support investment on both sides.

The experience with the reform agendas of the 1980s and 1990s has shown that capital accumulation, productivity enhancement and more jobs do not automatically result from a purely market-determined allocation of resources; successful strategies for economic growth, catching up and sustained improvements

in welfare for all groups of the population require much more than integration into the international division of labour.

Widening the scope of policy instruments beyond those that were deemed acceptable under the development paradigm of the past 30 years would not only allow the pursuit of additional goals, potentially it would also increase the number of combinations of instruments. In many cases this will be decisive in determining the success or failure of a strategy. For example, productivity-enhancing measures in agriculture will not translate into significant acceleration of growth and alleviation of poverty if rural workers that eventually become redundant cannot be absorbed into industrial production due to unfavourable conditions for investment in real productive capacity. Most frequently, it is excessively high interest rates for investment loans or an overvalued exchange rate that put domestic firms in the tradables sector at a disadvantage. Similarly, higher government outlays for education will not be sufficient for reducing unemployment if the better educated cannot be employed productively due to a lack of demand for higher skilled labour in a stagnating economy. And public expenditure for research and development related to activities in the manufacturing and services sector is unlikely to fuel growth if the results of these activities are not translated into innovation at the production level because financing conditions for investment are unfavourable. However, good financing conditions alone may not lead to the desired take-off led by private fixed capital formation if the demand expectations of potential investors are unfavourable or if essential public infrastructure is lacking. These examples illustrate that a key aspect of successful catch-up experiences seems to have been "the connection between macropolicy and structural policy, in which the links between sectoral policies, trade and macroeconomic growth contributed significantly to economic dynamism" (Bradford, 2005: 14).

It is necessary to reassess the priorities of macroeconomic policies and to enlarge the range of policy instruments.

Mainstream economic thinking and policy-making over the past few decades has focused almost exclusively on the conditions that determine behaviour on the supply side of markets. However, stabilizing employment at a high level and creating new jobs in the growth process require a macroeconomic approach that gives greater attention to conditions on the demand side. In such an approach, monetary and fiscal policy instruments again aim to serve the employment objective. The need for such a reorientation has been emphasized by many authors (see, for example, Epstein, 2005, 2007 and 2009; Muqtada, 2010; Pollin, Heintz and Githinji, 2007; Weeks, 2010), but the discussion has largely remained confined to the existing choice of policy instruments, and has argued mainly for a reassessment of the priorities in using those instruments.

In this section, it is argued that while such a reassessment of priorities is essential if faster growth and employment generation are to be achieved in developing countries, it is also important to enlarge the range of policy instruments. There is a need not only for appropriate fiscal and monetary policies, but also for an incomes (or wage) policy that will influence wages and the demand for wage goods in support of employment creation. Together, monetary, fiscal and incomes policies would then provide considerable scope for demand management to fight unemployment – both structural and cyclical – while keeping a lid on inflation. What matters from the employment perspective is that sufficient demand should be generated for goods and services to be produced in new activities that employ the same amount of labour as becomes redundant in the process of technological upgrading. This reassignment of macroeconomic policy should be part of a more fundamental reorientation in economic thinking based on an overall philosophy of capitalism, where capital serves the well-being of the society at large (the majority of which lives on incomes from labour) rather than the other way around.

During the latest crisis, countercyclical fiscal policy has been rediscovered.

2. *Fiscal policy and the role of the public sector*

Public finances, through variations in the levels of spending or taxation, can help stabilize aggregate demand, and, in times of recession, compensate for a shortfall of private demand relative to production potential. While reducing public spending is a direct way to curb excess demand in times of fast overall demand growth, debt-financed increases in public spending are essential to revive a stalling economy and protect employment in times of economic slowdown.

In the midst of the financial crisis, most governments have rediscovered the role of countercyclical fiscal policy in stabilizing aggregate demand, as reflected in the unprecedented stabilization packages that were launched to prevent another Great Depression. It would be highly beneficial for growth and employment if the principles underlying these policy decisions continued to serve as a basis for a revised approach to fiscal policy. By contrast, if public finances are governed by the same principles as the financial behaviour of private agents, it amplifies economic fluctuations and crises of confidence.

In an effort to attract foreign capital flows, governments of emerging-market economies often curtailed government spending to demonstrate their "fiscal discipline" to participants in financial markets and rating agencies. But the curtailment of government spending under the Washington Consensus concept of fiscal discipline has been partly responsible for output growth and employment falling short of their potential owing to insufficient investments in infrastructure. Such investments are often a precondition for private investment to become viable. Similarly, public expenditure on education and training can influence the quality and skills structure of the labour force and the potential of labour to contribute to productivity growth. This in turn allows the payment of higher wages that feed back into output growth and employment creation.

It should also be pointed out that fiscal balance per se is not a useful indicator of the effects of fiscal policy on employment creation: the same fiscal balance can have different effects, depending on how public revenue is raised and spent. For example, on the revenue side, tax income from high-income groups, and changes in the tax rates for these groups, typically have a small impact on domestic demand, as these income groups save a larger part of their income and spend a greater share of their household incomes on luxury goods, most of which are imported. On the expenditure side, public investment in transport infrastructure or credit subsidies for private investment in real productive capacity will have a much greater impact on employment creation than the bailing out of banks or spending on imports of military equipment and sophisticated vehicles used to transport officials.

The public sector, typically the largest purchaser of goods and services and the largest employer in an economy, has a significant influence on the expansion and functioning of goods and labour markets. Public sector employment can therefore play a major role in employment policy, especially in developing countries with a large amount of surplus labour. Taxation and public spending are potentially key instruments for establishing linkages between companies in the modern sectors, export industries and the rest of the economy. These aspects of the role of the State for employment creation are discussed further in section D.

3. *Monetary and financial policies*

Insufficient investment in fixed capital is often attributed to low savings, given the macroeconomic identity between savings and investment. According to this view, the scope for increasing savings, particularly household savings, is very small in most developing countries, so that there is also very little scope for increasing investment unless a country has access to "foreign savings". In this line of reasoning, foreign capital has to be attracted by high interest rates. However, this view is not supported by a comparison of the actual experiences of countries where monetary policy was tight but the economy stagnated, as in Africa and Latin America, and countries where monetary policy was expansionary and growth and employment creation were fast, as in East and South-East Asia. The combination of expansionary monetary policy and fast growth in developed countries in the "golden age of capitalism" also leads to the same conclusion.

An increase in household savings at a given level of income implies a decline in the demand for

consumer goods and services, which discourages investment in additional productive capacity. On the other hand, fixed investment will result from positive demand expectations combined with favourable financing conditions. For sustained income and employment growth, proactive and permanent short-term management of monetary, financial and overall demand conditions is needed to ensure that planned investment exceeds planned savings. In such an environment, savings will rise even if the propensity of households to save remains unchanged (see also Gordon, 1995; Pollin, 2002). The higher savings, which correspond to the higher investment in the macroeconomic equilibrium equation, are eventually generated by higher profits. The initial real investment can be financed by bank credit if the central bank allows credit expansion through an appropriate monetary policy. Higher profits resulting from the temporary pioneer rents of innovative investors provide the funding for the investments and for repayment of the initial bank credit (see also *TDR 2006,* chap. I, annex 2).

Central banks can do more for stabilizing growth than keeping inflation low – they can establish favourable conditions for investment and employment creation.

The central bank, through its provision of liquidity and determination of the short-term interest rate, can provide an important expansionary stimulus, and at least indirectly influence long-term interest rates according to its assessment of the economic situation. Thus the positive effect of its expansionary monetary policy on investment in fixed capital supports employment creation. Monetary policy that is permanently and exclusively used for fighting protracted or inertial inflation, a priori, hampers employment creation and sustainable income growth. Therefore the macroeconomic policy instruments recommended to developing countries over the past three decades as the only rational choice, in line with the Washington Consensus, need to be revised in the light of the greater priority now being given to employment creation.

Central banks can do more for stable growth than keeping inflation low; they can function as agents of development by shifting their focus to employment. Moreover, monetary and financial policies have a bearing on the exchange rate, and thus on the competitiveness of domestic vis-à-vis foreign producers and employers. There are numerous examples of successful experiences in this respect in countries such as France, Germany, India, Japan, the Republic of Korea, the United Kingdom and the United States, where central banks played an essential role in public policies in support of growth and structural change by maintaining low interest rates, exerting capital controls to help stabilize exchange rates at competitive levels and sometimes engaging in direct lending for selected projects (Epstein, 2007). More recently, several proposals have been made for “employment targeting” in various countries, including Kenya, the Philippines and South Africa (Lim, 2006; Pollin et al., 2006; Pollin, Heintz and Githinji, 2007).

A monetary policy that focuses on creating favourable conditions for the financing of private investment can be complemented by the promotion of investment lending by private financial institutions and by the provision of credit through public financial institutions. State investment banks have played an important role in providing cheap credit to investors and channelling capacity creation in a socially desirable direction, for example in Argentina, Brazil, Malaysia, the Republic of Korea and Taiwan Province of China (Amsden, 2001 and 2007).

4. *An incomes policy for wage-led growth*

Supportive monetary, financial and fiscal policies are required to achieve a strong growth dynamic based on fixed capital formation that provides the additional employment opportunities required to absorb surplus labour. But the task of monetary, financial and fiscal policies to support employment growth can be greatly facilitated by the additional use of an incomes policy that builds on certain rules for determining mass incomes in a growing economy. A well-designed incomes policy

An incomes policy can pave the way for a steady expansion of domestic demand.

can make a major contribution to employment growth by paving the way for a steady expansion of domestic demand.

When unemployment rises, and many workers that lose their jobs in the formal labour market shift to the shadow or informal labour market, the power of employers tends to strengthen, forcing the laid-off workers to accept much lower wages than they would have if unemployment had not risen. This would be acceptable if the fall in wages was the right remedy for redressing the labour market disequilibrium. But the downward flexibility of wages causes a fall in demand, leading to even further wage cuts without stimulating employment creation through investment. Thus, unlike price flexibility in goods markets that causes demand to match supply for individual products, wage flexibility does not stop the rise in unemployment (see also chapter III, section B). Indeed, the outcome is just the opposite: the fall in wages increases the number of unemployed and underemployed, reduces the incentives to invest in productive capacity and results in a downward spiral in the overall standard of living of the society, as experienced by many developing countries during the era of the Washington Consensus, as discussed in chapter IV.

In this context, it is important to realize that if labour income does not rise in line with productivity growth, it does not mean that profits will automatically rise more. Profits are residual incomes, and will rise only when demand expands sufficiently, which is unlikely to happen when mass incomes do not rise in line with production. Moreover, increases in profit incomes tend to contribute less to employment growth than increases in labour incomes, because profit earners, on average, have a higher propensity to save than wage earners, and they tend to consume more imported luxury goods. Therefore, development strategies based on wage-led growth have a potential to maximize increases in output, productivity and employment.

Thus, in order to attain a sustainable trajectory, productivity gains need to be distributed in a way that allows labour income to grow at the same pace as productivity. As these income increases are largely spent on consumption, any job losses resulting from productivity gains at the level of the individual firm through the use of technologically more advanced production processes will be compensated by an additional demand for labour in the economy as a whole. As demand would grow at a similar rate as the supply potential, it would also serve as an inducement to additional fixed investment, and as a stimulus for industrial growth and the creation of jobs to absorb the surplus labour in the economy.

Productivity gains need to be distributed in a way that allows labour income to grow at the same rate as productivity.

The incentive for dynamic entrepreneurs to invest in fixed capital and product or process innovation is even stronger when wages follow the average productivity growth of the entire economy, rather than the wages in every firm following the productivity growth in that same firm. The former would result in a greater differentiation of profits between capitalist firms. More dynamic entrepreneurs would be rewarded for their investments or innovations by greater pioneer rents than in a situation where they pass on the gains from their firms' enhanced productivity either to their own workers or to their customers through price cuts.

In a market economy, the implementation of such an incomes policy requires an institutional framework adapted to the stage of development, economic structure and cultural and historical specificities of each country, as discussed further in section D below. Such an institutional framework is all the more important as an incomes policy can serve not only as an instrument for employment generation, but also as a means to control inflation.

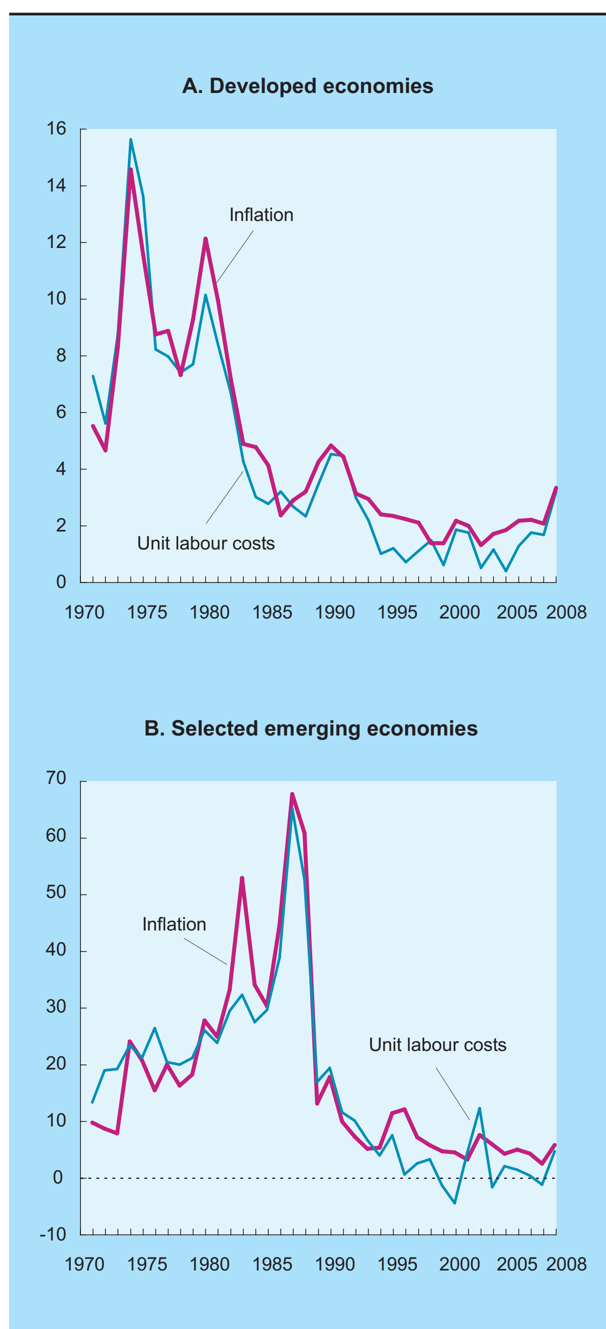
5. Incomes policy and inflation control

A frequently made argument against a monetary policy that aims at the provision of investment financing at low cost is its alleged inflationary impact. Undoubtedly, low inflation is critical for macroeconomic stability. Countries that are prone to high and accelerating inflation will find it more difficult to start and sustain a process of development and catching up because of the frequent need to tighten monetary and

Chart 5.3

ANNUAL GROWTH RATES OF UNIT LABOUR COSTS AND INFLATION RATES, 1970–2008

(Per cent)



Source: UNCTAD secretariat calculations, based on United States Bureau of Labor Statistics, *International Labor Comparisons* database; *OECD.Stat Extracts* database; IMF, *International Financial Statistics* database; OECD database; and ILO, *LABORSTAT* database.

Note: Selected emerging economies comprises Argentina (2000–2006), Brazil (1996–2006), Mexico (1975–2006), the Philippines (2001–2007), the Republic of Korea (1971–2008), Singapore (1991–2008) and Taiwan Province of China (1991–2007).

credit conditions. It is also true that monetary policy will be overburdened if it has to simultaneously keep inflation low and provide low-cost finance for investment in real productive capacity that would create new employment opportunities. This would amount to pursuing too many objectives with too few policy instruments. Here too, the application of incomes policy instruments can provide a solution.

Wage growth based on the productivity rule would contribute to keeping inflation low by preventing a rise of unit labour costs and an increase in demand in excess of the supply potential. For example, in the aftermath of the oil price hikes of the 1970s, nominal wages in many countries were adjusted by applying some form of backward-looking indexation: they were increased in line with past consumer price inflation, based on the erroneous assumption that this would give workers quick compensation for the negative real income effect of the falling terms of trade. But, as mentioned in section B above, this practice led to long disputes about income distribution as employers tended to react to the higher labour costs by raising prices, which caused an acceleration of inflation and higher unemployment. Inflationary risks were managed better in those oil-importing countries where nominal wages were not adjusted to past inflation but grew more in line with productivity growth. Although the immediate fall in real wages was larger, the medium- to long-term impact on growth and employment was positive since an acceleration of inflation could be avoided.

As wages are the most important determinant of the overall cost of production in a vertically integrated market economy, the importance of avoiding excessive nominal wage increases for stabilizing the inflation rate cannot be overestimated. In developed economies, where the share of labour in total income typically exceeds 60 per cent, the growth rates of unit labour costs (i.e. wage increases exceeding productivity growth) are very closely correlated with price level movements (chart 5.3A). The data coverage is much less comprehensive for developing countries, but to the extent that comparable data is available, it suggests that the correlation is very similar in a number of emerging-market economies (chart 5.3B). Unless there is broad acceptance throughout the economy that an increase in the wage share is desirable, inflation can be kept in check only if wages rise at a rate that corresponds approximately to the rate of productivity growth augmented by a target rate of

inflation that is deemed acceptable, thereby anchoring inflationary expectations.

In developing countries, a rule for growth of labour income to be consistent with such an inflation target may be of particular importance for stabilizing the economy, on both the real and nominal side. Many developing countries have a history of very high inflation, or even hyperinflation, due to bouts of accelerating inflation spilling over into nominal wage increases through indexation mechanisms. This has proved to be extremely costly, because for central banks to bring inflation down to their target level against permanent upward price pressures from the cost side, they are obliged to apply shocks to the economy time and again through interest rate hikes. This implies sacrificing real investment and employment for the sake of nominal stabilization. In this case, anchoring nominal wages to the productivity growth trend is extremely important.[3]

Inflation can be kept in check if labour compensation rises approximately in line with productivity.

Applying the rule of increasing labour compensation in line with average productivity growth plus a targeted rate of inflation implies that the share of labour in total income remains unchanged. However, there may be situations when it is desirable to change a given distribution of income between capital and labour in an effort to redress inequities and national inequalities. In this case, more far-reaching adjustments of labour compensation should be subject to explicit negotiations as part of a social compact (van der Hoeven and Saget, 2004).

D. Institution building and the role of the State in developing countries

1. *Collective bargaining and the role of labour and employer organizations*

The recognition that labour compensation is not only a cost factor but also the most important single determinant of domestic demand, and that, consequently, real wages rising in line with productivity are a precondition rather than a hindrance to successful development, points to the importance of building appropriate institutions that support an incomes policy (as outlined in subsections C.4 and 5 above). In this regard, some lessons can be learned from the policy experiences of developed countries during the golden age of capitalism between 1950 and 1973, when very low rates of unemployment were achieved while labour markets were much more regulated than today (Epstein and Schor, 1988; Singh, 2009).

An important institutional development in this context is the creation and empowerment of trade unions. While their primary mission is to represent the interests of workers, their role in collective bargaining and wage formation is also in the interests of the economy as a whole, including the owners of capital. As one side in collective bargaining negotiations – with employer associations on the other – trade unions can be instrumental in nurturing a process of domestic-demand-led growth.[4]

Trade unions have often been criticized for their exaggerated attempts to stabilize or increase the purchasing power of workers even in periods of supply

shocks, as discussed in the previous section. Such attempts are indeed counterproductive, as they fuel inflation and unemployment instead of protecting workers. But at the other extreme, the current dogma of labour market flexibility, which aims at minimizing the role of trade unions and at getting "prices right", overlooks the important role that workers' and employers' associations can play in stimulating a dynamic process of investment, productivity growth and employment creation. This is provided that collective wage negotiations are conducted within a framework of rules designed to ensure that wage growth neither substantially exceeds nor substantially falls short of a rate that ensures stability of both prices and employment. Tripartite arrangements involving government representation in collective wage negotiations, or government recommendations or guidelines for an incomes policy, have helped many countries in the past to focus economic policy on investment in fixed capital and to preserve their overall international competitiveness.

Workers' and employers' associations can be instrumental in promoting domestic-demand-led growth.

It is undoubtedly difficult to expect the establishment of sophisticated labour-market institutions in poor developing countries where governments are often not even able to protect the poor against hunger and sickness. But the laissez-faire approach of the past has failed the test, and in many developing countries the share of wages in national income has been extremely "flexible" downwards without solving investment, employment and poverty problems. Thus some appropriate form of labour-market institutions may be the only way to solve the unemployment problem, and therefore deserves to be given much greater priority in institution building and governance reforms in developing countries than in the past.

2. *Minimum wages*

The realization of an institutional framework for a dynamic investment-productivity-employment nexus is especially difficult in developing-country environments where the degree of labour protection and organization of the labour force and employers is very low, and where structured negotiations for determining wages and employment conditions are rare or absent. Since the creation of responsible institutions representing workers and employers may require considerable time, the establishment of minimum wages is a tool that governments can activate more rapidly. It may also serve as a complement to collective bargaining (ILO, 2008).

The problem here is to determine the right level of the minimum wage from the perspective of the macroeconomic relevance of wages as a determinant of private consumption. In many countries, it has been observed that, as a consequence of structural adjustment and liberalization policies and the declining power of trade unions and labour-market institutions, minimum wages have been set at very low levels. Making formal labour cheaper in this way has been part of efforts to create additional formal employment and reduce informal employment. However, apart from the fact that extremely low minimum wages do not contribute to poverty reduction, they are also unlikely to help job creation because they do little to raise mass purchasing power.

In other countries, minimum wages are relatively high – sometimes referred to as "maxi minimum wage" (Saget, 2008) – which is often attributed to poorly developed collective bargaining. This may result from the fact that minimum wage consultations are the only forum where trade unions can make their demands known. In these cases, the legal minimum wage is closer to the actual wage earned by most formal workers. In such a process, several goals are pursued with a single policy instrument: the minimum wage is used as a reference to fix wages, to get a grip on inflation and to promote social dialogue.

It has been argued that minimum wages that are excessively low or high are an indication of malfunctioning labour markets (van der Hoeven, 2010), in the sense that they do not fulfil the function of ensuring the participation of labour in overall income growth that would contribute to poverty reduction without jeopardizing employment and economic growth. Indeed, whether minimum wages help employment creation and macroeconomic stabilization by supporting wage-led growth is best judged by their relationship with productivity growth and inflation.

If they are adjusted regularly in line with the actual average productivity growth of an economy and the targeted rate of inflation, rather than arbitrarily in response to the varying influences of interest groups on political decisions, they can have a positive effect on the investment-productivity growth dynamic. Poverty will then be reduced not so much by lifting the income of those that actually earn the minimum wage, but much more by the additional employment that is created in response to higher demand and higher profits in those firms where productivity growth exceeds the average.

Minimum wages and public employment schemes can be effective tools of an incomes policy.

3. *Public employment schemes*

It is well known that in most low-income developing countries, informal jobs and self-employment constitute the bulk of employment in a context where a large reserve of surplus labour exists. Competition between the employed and the unemployed and underemployed tends to drive down earnings and worsen other conditions of work. Thus, while the long-term effort in such contexts must be one of expanding the share of formal employment in total employment, the emphasis for the foreseeable future must also be on mechanisms to improve both earnings and conditions of work in the informal sector and in the "self-exploitative" segment where workers are self-employed.

One way of doing this is to implement public employment schemes, such as those introduced in Argentina and India (see box 5.1), which establish an effective floor to the level of earnings and working conditions by ensuring the availability of "on demand" jobs that offer the minimum employment terms. These terms should be improved over time at a rate that appropriately reflects the average growth of productivity in the entire economy and the increase in tax revenues in a growing economy. There are a number of benefits to such a scheme. First, to the extent that it is successfully implemented, it would ensure that employment outside the scheme would be on terms that are better than the minimum standards set by the scheme. Second, the demand for goods and services generated directly and indirectly – through a multiplier effect – by the scheme would help expand markets and drive output growth, so that the restraining effect of productivity increases on employment are neutralized by an enhanced pace of demand growth. Third, the scheme itself would tend to be self-selecting, since only those unable to obtain this minimum level of wages and working conditions would demand and be provided with such employment. Fourth, since the operation of the scheme would expand domestic demand and increase employment elsewhere through multiplier effects, it would, ideally, reduce workers' demand for such employment over time, so that there would be endogenous limits on the budgetary outlays needed to implement this policy. Fifth, the scheme would act as an automatic stabilizer of consumption demand in periods of recession or downswing, and therefore serve to moderate the economic cycle, which is extremely important given that such stabilizers are relatively few in most developing economies. Finally, over time, by eroding the ability of firms to compete based on low wages and poor working conditions, it would help increase the share of formal sector employment in total employment, reduce the differential between the formal and informal sectors with respect to terms of employment, and improve the average terms of employment in the system as a whole.

Public employment schemes can be successfully implemented even in very low income countries.

Public sector employment schemes can be successfully implemented even in very low income countries. In Sierra Leone, one of the poorest countries in the world, a World Bank supported public works programme after the disastrous civil war prevented thousands from suffering starvation. In 2008–2009 the government extended this programme as a measure to counter the international recession that reduced demand for export crops. The success of this programme demonstrates that emergency and countercyclical public employment schemes can play an important role even when administrative capacity is limited (Weeks, 2009).

Box 5.1

EMPLOYER OF LAST RESORT PROGRAMMES IN ARGENTINA AND INDIA

The National Rural Employment Guarantee Scheme in India

Under this scheme, launched in February 2006, every rural household is guaranteed up to 100 days of unskilled manual wage employment per year, at the statutory minimum wage for agricultural workers. This is a demand-driven scheme that recognizes the legal right to employment. If employment is not provided within 15 days, the applicant is entitled to an unemployment allowance. The scheme, with a budgetary provision of around 0.6 per cent of GDP, has been extended to all rural districts in India. It aims to provide work on labour-intensive projects focusing on rural infrastructure at the local level. Nearly 4.3 million public works have been undertaken so far, about half of which were for water conservation, 15 per cent for rural connectivity and 12 per cent for land development. Thus far, it has provided some employment to more than 50 million households, and nearly 2.6 billion person days of employment have been generated.

The enhanced wage earnings have contributed to strengthening the livelihood resource base of the rural poor in India, reduced distress migration, and become an extremely important buffer against both the employment shocks generated by the economic crisis (as migrant workers returned home to their villages) and the drought that swept across large parts of the country in the summer of 2009. In 2008 and 2009, nearly 70 per cent of the expenditure under the scheme was in the form of wages paid to the labourers. The programme is affecting the labour market in some parts of the country quite significantly. It has raised the de facto minimum wage by 10–15 per cent in some areas and changed seasonal migration patterns to some extent. It has reduced the migration of unskilled workers in the agricultural sector within India, and there is evidence that the remuneration of construction work has risen, as rural workers are able to find some gainful employment during the lean season (Chandrasekhar and Ghosh, 2010).

Another effect of the scheme is that it raises agricultural incomes as the demand for food rises. At the same time it contributes to productivity gains in agricultural and other rural activities, albeit with some time lag, as the public works projects help to improve irrigation, water harvesting, soil quality and transport infrastructure.

A support programme for household heads in Argentina

In 2002, in the midst of a deep economic crisis, when 21.5 per cent of the labour force was out of work and the income of more than 50 per cent of the population was below the poverty line, the Government of Argentina launched a programme for providing a subsistence income to unemployed heads of households (Programa Jefas y Jefes de Hogar) with at least one child. In exchange, these persons work for a minimum of 20 hours a week in small projects that help improve local and community infrastructure. Another condition is that children attend school and enrol in a vaccination programme. As in India, the programme is implemented by local and regional administrations.

In May 2003, when resort to the programmes was at its peak, its fiscal cost amounted to about 1 per cent of GDP. About 2 million households, more than 70 per cent of which are headed by women, have benefited from the scheme. The impact on poverty and economic recovery has been very significant. As the beneficiaries consume most of the income derived from the programme, and their consumption has a relatively low import content, the programme has had a huge multiplier effect. According to an estimate by the Ministry of Labour based on 2003 data, the programme's contribution to GDP was 2.5 times the amount of the initial expenditure on the programme (Tcherneva and Wray, 2005). With faster growth of the national economy in the subsequent years and the reduction in unemployment to 8 per cent in 2008, the number of beneficiaries fell to 500,000 at the end of 2008. Some of the former beneficiaries found more stable jobs, while others are now covered by new programmes designed to facilitate their insertion into the labour market through education and vocational training.

Another approach to stabilizing employment and income is the Argentinean Programme for Production Recovery. Under this programme, the Government assumes, for a period of one year, part of the wage bill paid by private employers in difficulty, who present a plan for redressing the economic problems of their firms and make a commitment not to lay off their workers. This has helped to preserve tens of thousand of jobs, mainly in small and medium-sized enterprises, and to avoid not only the social costs of higher unemployment, but also the economic costs of losing human capital and depressing domestic demand, which would have made the labour market situation even more precarious.

In most developing countries there is a pressing need to increase public sector provision of essential social services, especially those concerned with nutrition, sanitation, health and education. This is important not only for the obvious direct effects in terms of improved material and social conditions, but also for macroeconomic reasons. The public provision of such services tends to be labour-intensive, and therefore also has considerable direct effects on employment.

4. Improving incomes of small producers

In many developing countries, informal employment and self-employment account for large shares of total employment. It is therefore important for these countries to complement employment-enhancing policies and institution building as discussed in the preceding sections with measures to raise incomes and purchasing power of the informally and self-employed.

Measures to strengthen the capacity of small-scale farmers to purchase productivity enhancing intermediate goods and equipment are needed in any case to raise food security and to gradually improve the living conditions of the rural population (Mittal, 2009). But mechanisms that link agricultural producer prices to the overall productivity growth in the economy would also contribute to an increase in demand by those segments of the population who tend to purchase consumer goods that can be produced locally. Such mechanisms have been applied successfully in all developed countries for decades. Productivity in the agricultural sector could be enhanced through public investments in agricultural research and rural infrastructure and with the help of publicly assisted agricultural support organizations. Such organizations were frequently dismantled in connection with structural adjustment programmes in the 1990s. If they are revitalized with appropriate governance structures, they can play an important role in raising agricultural productivity and incomes, for example by providing extension services, disseminating information about productivity-enhancing investments and efficient marketing, and facilitating access of small farmers to affordable credit. Ensuring the participation of the agricultural sector in overall productivity growth may also require protecting farmers against the impact of competition from highly subsidized agricultural products imported from developed countries.

But the development of rural areas cannot rely on the agricultural sector alone (Nkurunziza, 2007; Davis and Bezemer, 2003), and informal and self-employment is also widespread in urban areas. Small producers in non-agricultural activities often cannot raise their productivity due to difficulties in obtaining credit to finance even small investments that would improve their supply capacity and access to markets. Private micro-finance schemes can meet these financing needs only partially, since they charge very high interest rates. Small-scale farmers and the self-employed pursuing non-farm activities in both rural and urban areas are therefore particularly dependent on financial support schemes such as credit subsidies and guarantees, and the provision of public credit for selected projects through national development banks (see also McKinley, 2009).

5. Taxation: finding the right balance

As mentioned above, taxation and government spending are key instruments for establishing important linkages between export industries – be they traditional extractive or modern manufacturing industries – and the rest of the economy, where such linkages are not created by market forces. For example, effective taxation of extractive industries' profits may often be the only way to ensure that huge gains from an increase in international commodity prices are channelled into domestic demand and into greater investment in diversification of production and job creation.

(a) Distribution of rents from the extractive industries

Natural resources on their own are neither a curse that perpetuates underdevelopment of a country, nor a blessing that helps its rapid economic development. But their exploitation generates rents (i.e. the difference between the sales value and the cost of exploitation of these resources) which, if effectively used, can serve as a basis for structural change

and fixed capital formation, and hence the creation of employment opportunities. Thus, managing the distribution and use of the rents generated by the extractive industries needs to be integrated into the national development strategies of the producing countries, so that they contribute to the process of diversification out of the natural resources sector, as these finite resources will eventually be depleted (Sachs, 2007; Auty, 2007; Pineda and Rodríguez, 2010).

Taxation may be the only way to ensure that the huge gains from commodity price increases are channelled in ways that boost domestic demand.

From the point of view of employment generation it is important that the use of this income either increases imports of capital goods for the creation of productive capacity in other sectors of the economy or generates demand for locally produced goods. To this end, where the extraction companies are not State-owned, appropriate fiscal treatment of their income is an important instrument.

The boom in prices of oil and mineral and metal products between 2003 and 2008 led governments in the developing countries producing these commodities to increasingly re-examine the fiscal treatment of companies in the extractive industries (UNECA-AfDB, 2007; UNECA, 2009). There were growing concerns that while the returns on investment of these companies were soaring as a result of higher prices, the share of the rents that stayed in the country remained unchanged, or even fell.

The analysis of the distribution of these rents is complicated due to the scarcity and fragmentation of data on government revenues and the costs of production in this sector. But the data available for a number of countries may give an approximate idea of the magnitudes involved, and enables drawing some conclusions (table 5.2).[5]

There are large variations in the distribution of the rents from extractive activities across countries and sectors, reflecting differences in the role of State-owned enterprises and fiscal regimes. In countries where State-owned enterprises play a major role in the extractive industries, such as Angola, the Bolivarian Republic of Venezuela, Chile and Mexico, the share of the rents captured by the government is much higher than in countries where these companies have been privatized and where the fiscal treatment is relatively liberal, such as Peru, the United Republic of Tanzania and Zambia. In particular, government revenues in the form of income taxes have been low as a percentage of the total rent from oil and mining.

The distribution of the rents, especially in mining, tends to be biased in favour of transnational corporations (TNCs). This is because many governments offered very favourable fiscal regimes in order to attract FDI in mining, particularly during the period of privatization of the sector in the 1980s and 1990s. It was also due to the imbalances of bargaining power in the negotiations of the contracts between the governments of poor countries and powerful TNCs. The latter often enjoyed low royalty rates,[6] and benefited from lower tax rates and shorter depreciation periods than domestic firms. In addition to these advantages, TNCs can also reduce their taxable income by using certain accounting practices, such as transfer pricing. Since all these factors bear on investment decisions taken with a relatively long time horizon, the contractual arrangements between governments and TNCs are often difficult to adjust to changing market conditions (see, for example, OSISA et al., 2009). In general, therefore, a significant proportion of the sharply rising proceeds of the extractive industries, as a result of the commodity boom since 2002, was mostly repatriated to the TNCs' home countries or reinvested in the same mines; only a small share would revert to the country in the form of government revenues to be used for the development of other industrial activities and domestic employment creation.

Countries should avoid a race to the bottom in offering fiscal incentives to FDI.

Only since 2006 have the governments of a number of countries partly been able to revise their fiscal regimes and renegotiate contracts with TNCs in the extractive industries.[7] Such renegotiations have been an issue especially in Africa (Custers and Matthysen, 2009), but also in Latin America and Australia.[8]

Table 5.2

SHARE OF GOVERNMENT REVENUES IN RENTS FROM THE EXTRACTIVE INDUSTRIES, SELECTED COMMODITIES AND COUNTRIES, 2002–2009

(Per cent)

	2002	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
Oil								
Angola	72.7	76.1	72.8	61.7	69.3	66.3	62.4	48.7
Azerbaijan	..	41.5	30.0	27.6	29.6	31.6	58.2	..
Bolivarian Republic of Venezuela	59.0	62.0	62.0	58.0	69.0	67.0	75.0	..
Chad	..	28.8	19.6	16.2	36.5	43.1	55.9	31.3
Copper								
Chile	43.2	72.8	49.0	53.3	50.2	44.3	62.6	..
Indonesia	46.0	44.0	42.0	45.0	42.0	..	..	..
Zambia	..	..	..	1.0	3.0	7.9	12.0	..
Gold								
Mali	..	..	20.9	18.3	11.1	34.4	33.3	..
Peru	21.8	27.9	26.3	30.0	28.5	29.7	27.4	..
United Republic of Tanzania	19.2	13.1	18.7	32.0	10.1	13.2	16.3	10.3

Source: UNCTAD secretariat calculations, based on annual reports of producing companies; UNCTAD, *Commodity Price Statistics Online* database; IMF, *Country Reports*, various issues; IMF, *International Financial Statistics* database; World Bank, *Global Commodity Markets*, various issues; *United States Energy Information Administration* database; BGS, 2010; Mpande, 2009; Curtis and Lissu, 2008; Thomas, 2010; and national sources.

Note: Rent is defined as the difference between the sales value and the cost of production, including capital depreciation. 2008 data for Chad include anticipated 2009 payments to the Government.

But the recent global economic crisis and downturn in commodity prices at the end of 2008 again reduced the bargaining power of governments in producing countries. In some cases they were forced to go back on their decisions to introduce fairer regimes for sharing the rents from the extractive industries, as mines were closing down and laying off workers.[9] Indeed, the global financial crisis took a heavy toll on employment in the mining sector in many developing countries, particularly countries such as Bolivia, the Democratic Republic of the Congo, the United Republic of Tanzania, and Zambia (SARW, 2009; and ODI, 2010).

Prices of oil and minerals and metals recovered in 2009 and 2010, and may remain relatively high on account of continuously growing demand from emerging developing countries, particularly China. In this context, and quite independently of short-term price developments, there is a fundamental need to achieve the right balance between the objective of generating income from the exploitation of natural resource endowments with the help of FDI, on the one hand, and government appropriation of a fair share of the rents accruing from the higher prices in the extractive industries on the other. In particular, governments should avoid engaging in a “race to the bottom” in fiscal as well as environmental rules in order to attract FDI (see *TDR 2005*; and UNCTAD, 2007).

An equitable distribution of the rents from the extractive industries between governments and TNCs is a necessary, but not sufficient, condition for the benefits from the exploitation of the natural resources to be translated into higher incomes and improved employment conditions for the population, especially in highly commodity-dependent economies. It is equally important that the revenues accruing to governments from these activities, in the form of either profits of State-owned enterprises or royalties and taxes paid by private companies, are used efficiently.

Strategic spending of these revenues could create a link between the extractive industries, which often operate in enclaves, and the rest of the economy.

Government revenues from the extractive industries could be used not only for public investments in infrastructure, health and education, but also for the provision of fiscal incentives and improved public services under industrial policies aimed at diversification of economic activities. This would reduce countries' dependence on natural resources – which are finite and the prices of which are volatile – while enabling an expansion of activities in manufacturing, services and agro-industry, where employment elasticities are much higher (UNECA, 2010).

High profits of TNCs based on low labour costs should be taxed sufficiently to create linkages between a successful export sector and the rest of the economy.

(b) Rents from FDI in manufacturing industries

A large part of FDI by TNCs is attracted to developing countries because of low local labour costs. Such FDI typically implies the transfer of more advanced technology and the introduction of more capital-intensive production techniques than are available in the host country. Such investment may thus contribute substantially to raising the average level of productivity in the low-wage country.

From the perspective of the TNC, the relocation of production to a developing country will normally result in a dramatic drop in its unit labour costs, since differences in the wage level between the host country and the TNC's home country are large. The TNC combines advanced foreign technology with cheap local labour. Unit profits can therefore be many times higher than those realized in the home country. Alternatively, the TNC can substantially reduce the sales price and thereby gain market shares. In both cases, most of the host country's "comparative advantage" of abundant cheap labour will be captured by the foreign investor in the form of higher profits, or by foreign consumers in the form of lower purchasing prices.

The policy challenge for countries that have manufacturing industries with a strong presence of TNCs producing for the world market is comparable to some extent to that of countries that host TNCs in extractive industries. They need to ensure that an appropriate share of the "rent" remains in the country, and that some form of linkage is established between the advanced export industry and the rest of the economy. In some countries that pursue a coherent industrial policy, the market mechanism may lead foreign companies to purchase intermediate inputs for their production from the local market, and thereby generate some output growth and employment in the economy of the host county. In many cases, however, the market mechanism may not generate such linkages, in which case local content requirements in investment agreements might help, provided that the necessary supply capacities exist. If this is not the case, or in addition to those requirements, adequate taxation of high profits resulting from the low labour costs – which attracted the TNCs in the first place – can be instrumental in ensuring that linkages are created with the rest of the economy. Those linkages can lead to the creation of domestic demand, which in turn can generate additional employment.

As unit labour costs are the most important determinant of competitiveness between regions with relatively immobile labour, the rents or the gains in market shares that the investor is able to realize by cutting prices up to the full extent of the cost reduction can be extremely high in most cases of FDI in low-wage countries. Even in China, with its robust economy, where FDI is an important contributor to the huge jumps in productivity and induces sharply rising nominal and real wages in manufacturing, the quasi-monopoly positions of foreign investors will taper off only slowly. This is because the process of catching up takes many years, or even decades, given the low original level of wages and capital stock in China, as in many other developing countries, compared with the developed countries.

The absolute competitive advantage gained by the foreign investor that is able to combine high technology with low wages in a low-wage environment is an advantage vis-à-vis those competitors with the same level of capital equipment in developed economies and vis-à-vis those competitors that benefit from

low prices of labour in developing economies but have less, if any, access to advanced technologies.

Consequently, the catch-up strategy of some successful industrializers in Asia (i.e. Japan and the Republic of Korea) was to combine the advantage of a well-educated domestic labour force with imported advanced technology, thereby allowing domestic producers to gain most of the quasi-monopoly rents. This strategy, which had strong government support, proved to be very effective. A similar effect could be achieved if governments in developing countries were to adequately tax quasi-monopoly rents appropriated by TNCs and use the proceeds to increase domestic demand for domestically produced goods, either directly through purchases by the public sector or indirectly through wage subsidies, public employment programmes and/or financial support for local private investors. However, appropriation of a large share of the rent can only be successful if such a strategy is applied by most countries with similar levels of wages and well-educated workforces. If developing countries compete with each other by offering lower taxes to attract FDI, footloose foreign investors may move to the lower tax locations. This would be at the expense of all the countries that entered into such tax competition, an effect similar to that resulting from international wage competition.

E. The external dimension

Strengthening domestic demand to drive employment creation and relying less on exports for growth than many countries have done in the past must not be equated with a retreat from integration into the global economy. Developing countries need to earn the foreign exchange necessary to finance required imports, especially of capital goods and their embedded advanced technologies. Moreover, international competition among firms can also spur innovation and investment in tradable goods industries. However, in many countries, export-oriented strategies have made growth performance and employment creation overly dependent on global growth and on the ability to gain global market shares while reducing policy options to boost domestic demand based on increases in productivity-related growth of labour compensation.

In some developing countries the strategy of strong dependence on external markets has succeeded because they have been able to maintain lower costs of production than their competitors by keeping wages and domestic consumption low. But not all countries can simultaneously generate demand for their growing output by improving the international competitiveness of their producers in this manner. When productivity gains are used to reduce prices, it may temporarily help a country's firms to successfully compete in external markets, but this will be at the expense of other countries' products, and thus adversely affect the level of employment in these latter countries. The latter may therefore respond by reducing unit labour costs through wage cuts in order to remain or regain their competitive position internationally, thereby leading to an unsustainable race to the bottom in terms of wages. This is a systemic problem that could be mitigated through a multilateral framework for exchange-rate management that aims at keeping the real exchange rate relatively stable. Under such a system, nominal exchange rates would be adjusted according to differentials in the changes in unit labour costs (or inflation rates), so that there would be less incentives for firms to engage in international wage competition. The incentive for

speculative capital flows would also be reduced, thereby alleviating pressures from capital markets on the exchange rate. Monetary policy can then focus primarily on domestic objectives, in particular that of achieving a high and stable level of investment in fixed capital (*TDR 2009*: chap. IV, sect. E; see also Frenkel and Taylor, 2006; and Epstein, 2007).

In the absence of effective multilateral arrangements for exchange-rate management, post-crisis policies in many developing countries whose growth and employment performance suffered in the past from currency overvaluation have shifted to an exchange-rate policy that aims at avoiding a repetition of that experience. They are intervening in foreign exchange markets and seeking to accumulate foreign exchange reserves, not only as a means of maintaining or improving their international competitiveness, but also to keep domestic interest rates low in order to foster investment and employment creation.

Not all countries can simultaneously improve their international competitiveness.

In principle, policies in support of employment creation are possible under a regime of open capital markets as long as interest rates can be kept low so that there is no incentive for speculative capital inflows aimed at arbitrage profits. This is possible if inflation control is facilitated by appropriate incomes policies. But it is also true that a number of emerging-market economies have been able to regain greater autonomy in macroeconomic policymaking through the use of capital controls. Chile, for example, resorted to capital controls to reduce the share of short-term capital inflows in total inflows (Gallego, Hernández and Schmidt-Hebbel, 1999; and De Gregorio, Edwards and Valdés, 2000). In some countries, controls on outflows were imposed, which in the case of Malaysia appear to have enabled the stabilization of exchange rates and interest rates during the East Asian crisis and a faster recovery from that crisis, while limiting the decline in real wages and employment (Edison and Reinhart, 2001; Kaplan and Rodrik, 2001). Moreover, since global finance favours a deflationary rather than an expansionary fiscal stance, retaining the policy space needed to adopt the latter stance requires reducing dependence on global finance. To this end, capital controls not only help better management of exchange rates and monetary policy, they also prevent excessive inflows of capital that erode policy space of the kind needed to improve labour market conditions. ■

Notes

1 The practical application of the neoclassical theory in macroeconomic policy can be illustrated by a statement of then British Prime Minister James Callaghan to the Labour Party Conference in September 1976: "We used to think that you could spend your way out of a recession and increase employment by cutting taxes and boosting government spending. … [T]hat option no longer exists, and in so far as it ever did exist, it only worked … by injecting a bigger dose of inflation into the economy, followed by a higher level of unemployment" (Labour Party Annual Conference Report 1976: 188, at: http://en.wikiquote.org/wiki/James_Callaghan).

2 Currency appreciation was even seen as a positive outcome because it contributed to disinflation and forced governments to advance with their "pro-market" reforms, which were expected to restore the international competitiveness of their domestic tradables sector.

3 It has also been suggested that in developing countries a higher rate of inflation may be acceptable when central banks provide more favourable

financing conditions for investment and growth than are often advocated in standard policy prescriptions. This is based on empirical research over the period 2000–2006 which has shown that, particularly in developing countries with underutilized capacities, growth can be compatible with – or even supported by – a moderate rate of inflation (Muqtada, 2010). It is estimated that the threshold rate of inflation for developing countries (i.e. the rate above which real GDP growth could be compromised) is 11–13 per cent (Khan and Senhadji, 2001), but it is bound to differ across countries depending on their specific circumstances.

4 For an account of recent developments in collective wage bargaining, see ILO, 2008.

5 The data has been compiled in connection with an ongoing project by the UNCTAD secretariat on the distribution of rents from the extractive industries. Initial results of this research and the methodology used were discussed in *TDR 2005*.

6 An IMF study on mineral taxation in developing countries found that royalty rates varied between 2 per cent and 30 per cent; the most common range was 5–10 per cent (Baunsgaard, 2001). A number of countries in Africa applied rates that were well below that common range.

7 For instance, the Democratic Republic of the Congo revised its mining licences and renegotiated contracts which did not meet required standards. In Zambia, in 2008 the Government raised the effective royalty rate paid by TNCs from 0.6 per cent to 3 per cent of the value of production, and the income tax from 25 per cent to 30 per cent (Ley, 2010; and Lungu, 2009). It also introduced a windfall tax and a variable profit tax, and reduced the capitalization allowance from 100 per cent to 25 per cent. In the United Republic of Tanzania, in April 2010 royalties payable on minerals were raised from 3 per cent to 4 per cent, and in new projects the Government will become a shareholder. In Ghana, the Government passed new mining laws that double royalties on mining to 6 per cent. In Madagascar, the new Government moved to suspend all mining contracts and in 2009 announced a review of all tax and royalty arrangements. Sierra Leone also passed new laws in December 2009 which increased royalties and community benefits. In Namibia, the Government established a State-owned company to take advantage of the mineral wealth. In South Africa, profit-based royalties were introduced only in 2009, and there is even an ongoing political debate on the nationalization of the mining sector (see *Mining Weekly*, 2010; *Mining Journal,* 2010; OSISA et al., 2009; UNCTAD, 2007; Custers, 2008; Johnston, 2008).

8 The Chilean Government established a royalty-like fee in 2006, of 0.5–5 per cent of the production value (depending on the volume of production); and there has been a recent proposal to increase this tax for funding reconstruction from the earthquake in early 2010. In Ecuador, the Government plans to renegotiate oil contracts to convert them into service arrangements (see La Hora, El Gobierno de Ecuador prevé comenzar renegociación contratos petroleros en julio, 10 May 2010; for a more detailed account of mineral tax reforms in Latin America, see Christian Aid, 2009). In early May 2010, the Government of Australia announced the introduction of a new Resource Super Profits Tax of 40 per cent to be applied from 2012 (Commonwealth of Australia, 2010), while in South Australia, royalties have been doubled to 7 per cent (Roubini, "Australian Mining Enters the Crosshairs of Tax Authorities", 11 May, available at: http://www.roubini.com).

9 For instance, in 2009 the Government of Zambia removed the windfall tax that had been introduced the year before, and reintroduced the 100 per cent capitalization allowance (Christian Aid, 2009). However, it also announced intentions to increase its shareholdings in foreign-owned mining companies to 35 per cent, and drafted a revised mineral empowerment policy to encourage greater participation by Zambians in the mining industry (Ernst & Young, 2009). The United Republic of Tanzania might also be rethinking its plans to increase taxes on mining operations. In Ghana, most companies reported that they were protected by stability agreements and did not expect to pay the new 6 per cent royalty rate (*Financial Times*, Mining fails to produce golden era for Ghana, 22 March 2010).

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