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Let investment work for employment

Report on the expert meeting with IFC

Evert-jan Quak, Annemarie van de Vijsel | May 21, 2014

On 15 May, The Broker and the Dutch Ministry of Foreign Affairs co-organized an expert meeting with the International Finance Corporation (IFC). The 25 participants – a mix of researchers from knowledge institutes, civil servants and representatives of the private sector and civil society – discussed how the investments of the IFC can generate more and better jobs in developing countries. They concluded that the focus should be on making small and medium-sized enterprises (SMEs) more productive to create more employment opportunities. However, there are many challenges at the micro level, for example, in the areas of skills, finance and local governance, and even more at the macro level, in relation to the international trade regime and financial globalization.

IFC, the private sector arm of the World Bank Group, is the largest multilateral provider of financing for private enterprise in emerging markets. It provides loans, equity, structured finance and risk management tools for the private sector, mobilizes capital on the international financial markets, and offers advice on how to improve social and environmental sustainability.

As a follow-up to the World Bank's World Development Report 2013 on Jobs, IFC published a study on the need for a policy change to increase the impact of its activities and investments on employment. The impact of IFC's investments is mainly measured in terms of their contribution to economic growth. However, that is not enough to guarantee the jobs that countries need for their long-term development. What is required is a specific approach on employment.

But what does this approach look like? Answering this question was the starting point of IFC's global partnership project Let's Work, which aims to exchange information, implement new policy and build partnerships to make IFC investments in the private

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Evert-Jan is a freelance knowledge broker for The Broker on the themes 'Inclusive Economy' and 'F...

sector more beneficial for the job market. As one of the financiers of the project, the Dutch Ministry of Foreign Affairs invited the global head of Let's Work, Roland Michelitsch, to discuss the project with a small group of experts on employment and entrepreneurship. The Broker was asked to co-organize this meeting.

The private sector is the key to job creation

In his opening remarks, Michelitsch said that the private sector is the main generator of employment, creating 90% of all jobs worldwide. To give companies the opportunity to flourish is the key to more and better jobs. However, Michelitsch explained, inadequate infrastructure, limited access to finance, a weak investment climate, and insufficient skills and training restrict the scope of businesses to operate. IFC aims to remove these constraints to stimulate more and better jobs.

What can be done? According to Michelitsch business entry reforms can have substantial positive effects, particularly when combined with other reforms. In Mexico, the introduction of one-stop shops - companies or locations that offer a wide range of services - increased business entry by 5% and the number of jobs by 2.8%. Furthermore, the IFC study highlights that potential job creation is the highest for SMEs, also in informal settings. This is because gains in labour productivity tend to be positively associated more with job growth than destruction. However, firms born small grow little over the years and their labour productivity remains low.

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To change that, said Michelitsch, several things should be done. One is to improve access to finance. According to IFC, SMEs that have access to finance show significant job growth of between 3.1% and 4.2%, mainly as a result of expanding their operations and investments in technology. The study also reveals that investments in infrastructure (including energy and ICT) are important triggers for SMEs to grow. Investments in a reliable power supply could increase job growth in low income countries by at least 5%, while better skills and training would also increase opportunities within SMEs. Involving the private sector and combining education with on-the-job training produces the best results. According to Michelitsch, programmes that include both are 20% more likely to help SMEs grow.

Looking beyond micro-level solutions

IFC acknowledges that it is not only important to monitor the number of jobs created (directly and indirectly), but also the quality of the jobs and who is getting them and who is excluded, for example minorities, women or young people. According to Michelitsch, there are many assumptions on the business case for better working conditions, for example that improved labour standards increase worker satisfaction, worker retention, productivity, profits and ultimately jobs. Much more research needs to be done on this, however, and best practices must be exchanged to convince the private sector.

In the discussion that followed Michelitsch's presentation, some experts emphasized that, to create more sustainable jobs , a more holistic approach is needed than the results of the IFC study propose. Focusing too much on the private sector can also constrain job creation, especially if key local actors from government, communities and knowledge institutes are not involved or are involved too late. Furthermore, a holistic view addresses macro-level challenges to employment, while the IFC study focuses solely on those at micro level. The international trade and investment regime, tax regulations and financial globalization, for example, all have a huge impact, both positive and negative, on job creation worldwide (see The Broker's dossier on Employment and in particular the articles 'Revaluing Labour', 'Creating a Global Labour Market' and 'Profits without Labour Benefits').

According to one expert, this is particularly true of the agriculture sector, a vital sector for further development in developing countries. Many small and self-subsistence farmers need to increase their production, and rural industries and services need to be built to generate work opportunities for those who lose out as farmers. Such a development strategy calls for investments and the financial sector must be more involved in financing it. Small enterprises are the most common form of business in poorer countries and generate a lot of jobs; however, larger enterprises are more productive, pay higher wages and offer better working conditions. Michelitsch therefore replied that 'larger is more beautiful', and especially as smaller businesses must grow and become larger. But, as one participant from a Dutch bank responded, investments in SMEs are very risky, there is much more money involved than in microfinance, and the risks should be paid back in one way or the other.

Including informality and fragility

In the discussion, it was stressed that job creation also has spin-offs: when new jobs are created, there is a multiplier effect in indirect job opportunities. However, this is not always a positive development. Jobs are often lost in competing companies. When one company wins, another can lose, with all the consequences that holds for employment. This is one of the reasons why many people in developing countries still work in the informal sector (see also the articles 'Fragile Employment' and 'Job Insecurity as the Norm'). Several participants said that an approach to jobs must also focus on the informal sector. Michelitsch acknowledged this, but emphasized the importance of building an enabling environment in which formality – and thereby productivity – can be increased. However, jobs can also be created directly by allowing existing formal SMEs to grow. It is this segment in particular in which IFC is looking for opportunities to invest.

Employment in fragile states is an even more complex issue. One participant noted that, in South Sudan, the largest employers are the government and the aid sectors, rather than the private sector. In such circumstances, people are given work for a limited period, for example by United Nations' interventions or other donor programmes. This may be effective temporarily but, as one of the participants noted, once the intervention is over and they become unemployed again, they may be even more frustrated than before. With potentially serious consequences for the stability of the country.

Another cause of frustration can occur when people – often the best and the brightest – cannot find jobs in their own countries and leave to search for better opportunities elsewhere. The challenge is how to reverse this process and make sure migrants come back and invest in their countries of origin. It was suggested that IFC should commit itself to these diaspora communities.

Especially in fragile countries, data on the number of jobs and the impact of job creation policies are scarce and it is often necessary to rely on anecdotal evidence. Many participants stressed the importance of keeping this in mind when interpreting and using employment data, including on the creation of a certain number of jobs in the private sector.

The Broker invites everyone to comment on the conclusions of this report and the IFC study. Please add your ideas below, participate in our online debate , or send an email to debate@thebrokeronline.eu. You can also contribute with an expert opinion. In particular we are looking at how SMEs can grow and generate more and better jobs in the context of developing countries. Furthermore we are looking for more evidence of the business case for better working conditions. Please feel free to share your thoughts, insights, and best practices with us.

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