DCED

The Donor Committee for Enterprise Development

Business Environment Working Group Policy Brief

Business Environment Reform and Labour Productivity

Labour productivity matters

Labour productivity is key to economic development. Gains in productivity lead to more goods and services being produced, which contributes to lower prices benefiting consumers and down-stream firms. Productive firms are more competitive, increasing returns, profits and employment. Productive employees enjoy better working conditions and earn more. More profit and income leads to higher tax returns, which boosts the capacity of governments to deliver services. All of which lead to a reduction in poverty.

The large differences in national income per capita mostly reflect differences in labour productivity. Indeed, the Organization for Economic Cooperation and Development (2015, *The Future of Productivity*) suggests productivity will be the main driver of economic growth and well-being over the next 50 years. Similarly, the International Labour Organization (2016, *World Employment Social Outlook*) argues that a one percentage point increase in the contribution of labour productivity to Gross Domestic Product per capita growth reduces poverty by around 0.18 percentage points.

Analysing labour productivity at the sector level

Many economies are experiencing a slowdown in productivity. Some of the general reasons put forward for this are the fallout from the global financial crisis, less innovation, a boost in the supply of labour based on population growth and migration, and stagnating wages leading to lower demand and a reduced motivation for productivity improvements. However, it is important to go beyond these general explanations to consider the changes occurring to productivity at the sector level.

A sector level analysis shows staggering differences between industries. For example, agriculture, which still employs the largest share of workers in low and middle-income countries, exhibits no employment growth, but shows particularly high productivity growth. This is likely due, at least in part, to the rise in agricultural prices. Financial services on the other hand has high employment growth, but negative productivity growth.[1]

[1] Data stems from the 2006-2011 period (source: Groningen Growth and Development Centre). This dataset systematically covers industries and countries around the world.

At a glance

Improvements in labour productivity can reduce poverty. Particularly promising are interventions linked to training, innovation, employee engagement, incentives and safety.

Donor and development agencies should customise their interventions based on a clear analysis of the drivers of labour productivity and allow sufficient time to ensure the implementation of these reforms.

Good partnerships with key market actors are essential when applying market system development approaches to enhancing labour productivity. Where possible, build on the importance and influence of such actors to champion reforms.

Engage public and private partners to co-design and co-implement interventions.

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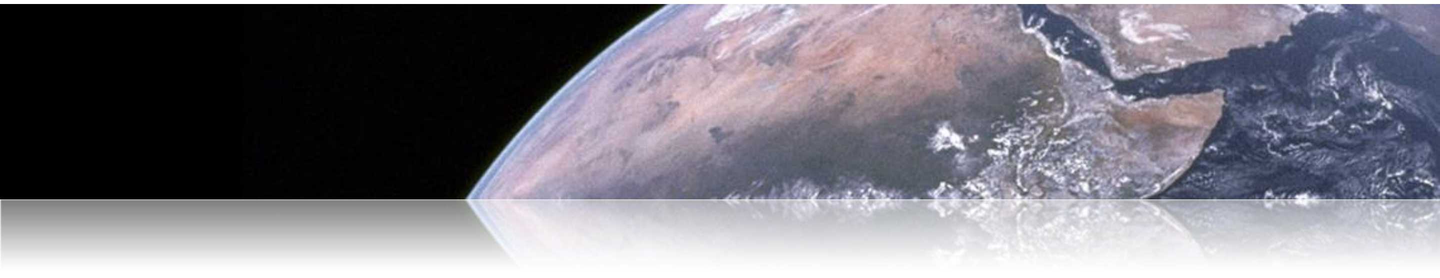

Focusing donor support for business environment reforms

Donor and development agencies must consider which industrial sectors to focus their business environment reforms on: those where growth is high or those where growth is low? While data on past performance is only one consideration, it is important to ask *why* productivity is low in one sector and not in another. This question can only be answered on a case-by-case basis. Keeping in mind the differences in industry performance between countries, it is crucial to use up-to-dated local industry data for such an assessment.

What influences productivity?

Many business environment factors influence productivity. This Policy Brief focuses on a subset of five 'framework conditions' that are both workforce and productivity related. These conditions encompass the legal framework and collective agreements among public and private stakeholders, as well as their implementation through policies, institutions and processes. The table below shows that labour productivity is influenced by a number of workforce related drivers. [2]

Table: Labour productivity drivers

Framework conditions		Strong driver	Weak driver	Inconclusive evidence
1	Recruitment and retention	—	—	Employment protection legislation
2	Workforce skills, knowledge, capacities	Training (some types or settings)	Training (some types or settings) Actions to overcome the skills mismatch	—
3	Productive workplace technology	Innovation (some types or settings)	Innovation (some types or settings)	—
4	Motivation	Employee engagement Incentives High performance workplaces	Employee participation Working time Work-life balance, family friendly programs	Minimum wage and collective bargaining
5	Workplace risk	Occupational safety and health (safety)	Occupational safety and health (health)	—

[2] Data This table lists drivers identified in a broad review of the literature. The drivers are classified based on their estimated effects on labour productivity according to the following crude rules: When the evidence predominantly points in one direction (i.e., either to a positive or to a negative effect) and the estimated effects are substantial and statistically significant (or in the absence of quantitative results, the studies themselves discuss the effect as 'strong'), they are classified as strong drivers. If the effects are smaller and frequently statistically insignificant, but predominantly still point in one direction, the driver is 'weak'. Otherwise it is 'inconclusive'.

While donors may wish to focus on 'strong' drivers, this may not guarantee success. For example, while relevant, high quality training, innovation, employee engagement initiatives, and safety measures often have a positive influence on labour productivity, it is necessary to address the factors that hinder productivity improvements in a given context. Whether or not a positive impact can be generated also depends on the implementation design.

Labour productivity drivers can be addressed by single firms or by a group of firms (e.g., through their business associations), or by public policy, legal and regulatory reforms. However, this is a complex task and it is important to ensure reforms create an equal playing field for all firms. Reforms should boost competition through improvements in productivity.

Success factors in donor interventions

The table overleaf provides a summary of the success factors and constraints to donor-supported business environment reform interventions. The main success factors identified are:

- Longer and more customised interventions;
- Good partnerships with key market actors; and
- Market system development approaches.

The main constraints to success are:

- Insufficient access to beneficiaries;
- Low levels of trust among market stakeholders; and
- The difficulty of scaling up and influencing broader policy

Key lessons learnt are:

- Leverage important and influential key market actors (e.g., well-known brands) to champion improvements and reform;
- Design interventions that yield immediate benefits for key actors;
- Engage public and private partners to co-design and co-implement interventions; and
- Focus on a particular sector and the entire value chain to increase the depth of an intervention and reap the benefits of engaging multipliers along the entire value chain (i.e., a market systems development approach).

Donors are increasingly supporting initiatives designed to improve skills through private sector partnerships. Training is a potentially strong driver of labour productivity, while private sector partnerships are critical to success.

Table: Success factors and constraints of BER interventions on labour productivity

Project phase	Success factor	Constraints
Project Design	• Longer-term project durations (with follow-up phases) acknowledge that systemic change requires time. • Customise interventions, methods or approaches fit the economic, social and cultural country context. • Top-level government support for the intervention, including financial support or contribution. • Ensure good project governance (e.g., regular meetings of a steering committee).	• Innovative or complex productivity growth methods require resources to being adapted to cultural, country, development context. • Complex and overly sophisticated measurement and assessment tools (not ‘customised’ to MSME enterprises) • Political cycles may be shorter than the entire project implementation time. • Engage with political champions for change
Project implementation	• Make use of change agents. • Build strong relationships with market actors. • Share best practice in ‘safe spaces’ among market actors who are not in direct competition. • Support collaborative implementation between different stakeholders. • Support intra-governmental and public-private partnerships. • Use practical first-hand experience to feed the policy dialogue. • Invest in awareness, information and media campaigns. • Promote women’s empowerment and participation in dialogue. • Ensure buy-in and the identification of market stakeholders (private sector partners, civil society and governmental partners). • Deploy experienced, technically and personally versatile consultants.	• Lack of, or insufficient or incomplete, access to beneficiaries. • Low levels of trust among market stakeholders. • Inadequate skills of market stakeholders to work with foreign enterprises. • Weak enterprise culture. • Costs and limited access of enterprises to finance • No up-scaling or changes at the policy or systems level, limited influence on this level. • Weak local enforcement. • Infrastructure and customs challenges. • Time needed to change mentalities. • Time needed for visible impact.

This Policy Brief is based on a technical report prepared by Michael Morlok and Harald Meier. The report was based on a review of academic literature, data from the Groningen Growth and Development Centre and the World Bank Enterprise Surveys, a review of ten selected project documents, and interviews with selected BEWG members. The full report is available here: www.enterprise-development.org/implementing-psd/business-environment-reform/#Other_DCED_publications_on_BER

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