

The labour market in developing countries



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**SARNET LABOUR ECONOMICS TRAINING FOR
YOUNG SCHOLARS, 27 OCTOBER, 2015, IHD,
NEW DELHI**

Key issues



2

- How well do labour markets perform in developing countries?
- To what extent does the structure of the labour market shape such performance?
- What guidance can iconic labour market models provide?
- What are the salient policy implications?

A positive view

- Labour markets perform well in terms of real wages and employment because they reflect the competitive norm
- Poor performance results from institutional factors – unions, collective bargaining, minimum wages etc
- Removal of institutional factors will improve performance
- Labour market reforms to increase flexibility a key element of policy agenda



A positive view...cont'd

- Classic models of economic dualism (Lewis) also support the 'positive view' – more discussion on this later
- Labour market reforms as part of structural reforms is core part of the G20 agenda
- Now, let us proceed to an alternative, less benign view of labour markets in developing countries



A less benign view

- Rural-urban migration is excessive relative to job creation
- Open urban unemployment a key challenge
- Reflects segmented urban labour markets (formal/informal)



A less benign view...con'td

- Growth inhibiting structural transformation in many parts of the developing world
- Jobless growth
- Skills mismatch
- Policy agenda needs to go beyond labour market reforms



The basic neoclassical labour market model and its relevance to developing countries

7

- Full employment prevails
- $W=MPL$. Hence, wages paid to workers both efficient and fair
- Involuntary unemployment due to minimum wages, union bargaining power
- Voluntary unemployment can be significant if social protection system generous



The basic neoclassical labour market model and its relevance to developing countries

8

- Relevance of model limited, despite its prevailing influence on development policy agenda
- Enterprise surveys reveal that institutional factors not as significant as other issues
- Unemployment is not a robust indicator of labour market performance in developing countries
- Global indicators focus on *quantity* and *quality* of employment



Global indicators of labour market performance in developing countries

9

- Quantity of employment: (1) employment rate (%)
- Quality of employment (three indicators):
 - (2) Labour Productivity
 - (3) Working Poor (%)
 - (4) Vulnerable employment (%)
- Trends are encouraging, but levels suggest considerable scope for improvement
- Discussion of (1) to (4) for South Asia

Iconic labour market models for developing countries: Lewis vs Harris-Todaro

(10)

Lewis (1954, 1979)	Harris-Todaro (1970)
Rural surplus labour $W = APL$	No rural surplus labour $W = MPL$
Unitary urban labour market, $W = MPL$	Segmented (formal/informal) urban labour market, $W > MPL$ relative to full employment benchmark
Urban job creation rate aligned with rural-urban migration	Urban job creation below rate of rural-urban migration
Process of structural transformation proceeds at constant real wage (horizontal labour supply curve) until surplus labour exhausted	Adjustments occur through changes to urban unemployment
Maintain constant real wages by removing institutional impediments. Hence, rather similar to labour market reform agenda	Wage subsidy; restrictions on rural-urban migration; rural development



- Based on Rodrik and Macmillan (2011)
- Use decomposition analysis of aggregate labour productivity to distinguish ‘between sector’ and ‘within sector contributions’
- If ‘between sector’ contribution is significant and negative, structural change can be growth inhibiting
- Evidence suggests this to be the case in Latin America and Africa, but not Asia
- Consistent with ‘premature deindustrialization’



- Labour markets can be associated with ‘premature deindustrialization’
- This happens when workers move from low productivity activities in rural areas to low productivity informal activities in urban areas
- Updated evidence does not support the view that structural change has been growth inhibiting in Latin America and Africa



- This notion has been around for a long time
- Example?
- Pearson Report(1970)
- Also motivated the ILO's World Employment Programme (WEP) that lasted between 1969 and the mid-1990s
- Both the Pearson Report and the WEP led to some useful policy proposals



Responding to jobless growth: some examples

14

- Regional decentralization supporting light, labour-intensive industries drawing on local materials
- Public works
- Removal of factor price distortions
- Greater integration of informal sector with formal sector
- Reform of education and training system
- Reducing income inequality

- There is renewed commitment to a global jobs agenda
- New global reports, e.g. World Bank (2013), IMF (2013), IFC (2013)
- Focus on macroeconomic stability
- Private sector-led growth



The market for skilled labour: the importance of employability

16

- Investment in human capital a core element of growth theory as well as labour economics
- Not reflected in Lewis and Harris-Todaro
- One should not neglect the importance of 'employability'
- Need to ensure adequate supply of workers with relevant skills, that is, 'employable' workers
- Skills mismatches a constraint on employability



Critique...

- Evidence from ‘returns to schooling’ studies do not suggest overinvestment in education
- Skills mismatches not independent of wages and working conditions
- Skills mismatches not independent of business cycle
- Avoid ‘vocational school fallacy’
- But... case for reform of education and training system to support broad-based and transferrable skills



- There is a G20-driven agenda to promote structural and labour market reforms to promote growth and employment
- G20 leaders proclaim that such reforms will create millions of jobs
- Shaped by OECD experience
- Long-run impact on growth and employment modest
- Short-run costs can be high if reforms pursued during periods of downturns and slow growth



- Need to pay attention to evidence on binding constraints on private sector-led growth
- Global surveys of more than 135,000 firms in more than 100 countries show only 12% of enterprises regard labour regulations as a major constraint on growth
- Key constraints pertain to poor governance, access to finance, poor supply of electricity and inadequately educated work-force

Major constraints on business operations as perceived by firms (2009-2014: average, World Enterprise Surveys, World Bank)

20

Variable	(%)
Corruption	36.8
Crime, theft and disorder	25.5
Access to finance	30.8
Electricity	36.3
Inadequately educated work-force	27.4
Others (transport, tax administration, business regulations etc)	19.4
Labour regulations	12.3



Final slide

21

- Thank you!
- Please contact islami@ilo.org for further information on these slides

