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Employment policy: what we know and what we need to know

The state of employment has put a spotlight on employment policy in developed and developing countries alike. In the OECD countries, unemployment has climbed from about 5 million in the mid-1960s to close to 35 million today and in some countries the real wage of unskilled workers has been falling. In many developing countries in Africa and Latin America, earnings and the quality of the work environment have deteriorated. However, there have been gains affecting large numbers of the poor in some of the mega-states including China, India and Indonesia, and in a few cases, gains have been little short of spectacular.

Research on employment and employment policy often means different things to different people. At least three sorts of work should be distinguished: (a) measurement and analysis of the conditions of work, the stability and growth of employment, employment structures, wages, unemployment and links to poverty; (b) labour markets, their imperfections and inefficiencies and impacts on the functioning of the economy in general; and (c) labour and various 'qualities' of labour (defined by skills and education) as a factor of production helping to determine comparative advantage and economic growth potentials.

Measurement issues and analysis have been helped by a gradual improvement in the data situation in many developing countries, mostly associated with the wider use of household sample surveys. Nevertheless, it is difficult to interpret employment and unemployment data in the presence of a large informal sector characterised by low-productivity, self and family employment in mini-enterprises and small firms. The difficulty is most acute in trying to measure female employment. There is also still a pronounced lack of statistical indicators and series showing changes in earnings in standardised occupations, including those in the informal sector.

Turning to the second and third topics mentioned above, much policy advice and analysis dealing with employment (recent examples are the ILO's 1995 *World Development Report* from the World Bank) is closely linked to the development paradigm described as the 'Asian miracle'. Indeed, for the few countries that figure heavily in miracle stories, there is a splendid consistency about the evidence. Rising real wages and minimal rates of unemployment can be documented over periods of up to 30 years in some cases. The combination of rapid, sustained economic growth with improved employment and poverty alleviation suggests a form of having your cake and eating it too that is hard to resist. Small wonder that country after country embarked in the 1980s on programmes of reform designed to create conditions in which East Asian style development could be pursued.

There is general agreement that the policies critical to East Asian success were much less laissez-faire than some of the earlier advocates of this approach would have us believe. Support was given to promote competitiveness in global markets and competitive pressures were used to encourage use of appropriate technologies and factor combinations. Labour market flexibility clearly was also an element. Until recently, collective bargaining has been discouraged or severely restricted by these authoritarian governments (Hong Kong is an exception) and a de minimis approach was taken to labour legislation e.g. relating to worker health and safety, and contractual rights of workers. But in the presence of other policies to ensure competitive conditions in product markets, whether or not such labour market policies made much contribution to the miracle is debatable.

On the one hand, labour markets in the first generation of manufactures exporters have adjusted smoothly to new competition in world markets, notably from China and Indonesia. Hong Kong's resilience (rising real wages, close to zero unemployment) in the face of a massive migration of labour-intensive manufacturing to China in the late 1980s is especially noteworthy.

On the other hand, there is little good empirical work in developing countries on the economy-wide cost/benefit of trade union representation of workers, for

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Towards a labour market in China

China does not yet have a labour market. The Chinese labour system, set up in the 1950s and based on the Soviet model, is characterised by state direction of labour, immobility, rural-urban inequality, lack of incentives and under-employment. Its central feature is the *hukou* (residential registration) system in the towns, which prevents rural people except from specially favoured categories from settling with their families in the cities and puts urban workers in a strongly privileged position. On the other hand it has avoided open unemployment and serious urbanisation problems, provided employees with security and achieved egalitarian objectives.

The Chinese government has begun a cautious process of reform designed to improve the mobility, flexibility, incentives and efficiency of labour. But the difficulties are immense and there are grounds to suppose that the transition to a fully functioning labour market will not be achieved.

The main changes, beginning in 1980, have been decentralisation within the state sector and expansion of the non-state sectors. The state monopoly of labour planning and job allocations was ended and replaced with somewhat more decentralised procedures. Lifetime employment, normally in the enterprise first assigned, is being gradually replaced by a 'labour contract system'; by 1992, 17% of the urban labour force was covered. Wage controls have been relaxed by allowing bonuses and piece rate payments to be introduced by enterprises; the share of

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Maximising employment gains from FDI in manufacturing

The regime governing foreign direct investment (FDI) in manufacturing in developing countries has changed dramatically over the past decade. Governments, including those formerly ideologically hostile, now welcome FDI in an unprecedented way.

Since the mid 1980s, FDI flows to developing countries have risen rapidly in absolute terms (17% annually to 1990, with an acceleration in the 1990s and as a share of the world total reaching 40% in 1993). The character of FDI is changing too, with rapid growth of debt-equity swaps and privatisations, especially in Latin America and Eastern Europe, acquisitions, especially in India, and FDI involvement in new areas of activity, e.g. utilities and infrastructure, in all regions.

Government policy towards FDI has to walk a tightrope between controlling the terms of entry and operation of TNCs, risking deterring FDI altogether, and completely deregulating FDI access, risking foreign capital domination of the production structure. Fortunately, in respect of employment effects, the dilemma is more apparent than real.

India, one of the last developing countries to liberalise its trade and FDI policies, is emerging as a large destination for FDI, but it is notable that neither Chile nor Ghana, the two countries in Latin America and sub-Saharan Africa with the longest history of liberalisation under structural adjustment, and with completely unrestrictive policies towards FDI, has been successful in attracting significant amounts of FDI into the manufacturing sector. In Chile most investment has gone into services and agro-based activities, in Ghana into gold and cocoa. China is now by far the biggest destination for investors, taking around 90% of total flows to the developing world. What seems to attract investors, even if some selectivity on terms of entry is exercised, is good or improving infrastructure, a supply of well educated workers, and the existence of government supply-side policies for improving technological capabilities through human resource development, support for institutions providing technology and market information, and promotion of investment in technologically advanced activities. Such policies, along the line of those in Singapore, Taiwan and Korea, which are directed at overcoming local market failures and apply to all enterprises, foreign or domestically owned, have proven highly effective in promoting economic growth and in increasing the overall rate of employment creation.

The direct and indirect employment effects of FDI need to be considered, in both the short and the long term. The mode of investment – greenfield or acquisition – is significant in the short term, with new plants bringing immediate new jobs but acquisitions having little or no net effect, but less important in the long term. Governments should therefore not restrict foreign takeovers on employment grounds. FDI raises productivity by using the latest technologies and its superior efficiency can drive some local firms out of production. For both reasons FDI can seem to limit job creation. But the exigencies of global competition give little or no scope for (foreign or local) firms to choose more labour intensive technology within any given sector. And in a buoyant economy it is not harmful for weaker enterprises to fail: it releases resources, including labour, for deployment in more productive uses. Similarly, FDI should not be frowned on because some foreign enterprises prefer to maintain backward supply or forward processing links with firms in other countries: tight local procurement rules are in any case increasingly disallowed under the latest GATT rules. Overseas links are an asset in a globalising world – FDI is no less vulnerable to competitive pressure than local enterprise – and so can help maintain security of employment. Foreign investors may also, once a location is found favourable, persuade some of the linked enterprises to relocate close to them, creating new jobs in the host economy, as has happened in Malaysia. Finally, the contribution of FDI to human resource development should not be overlooked: TNCs undertake more training than comparable local firms.

Developing countries need FDI, because TNCs are in the forefront of new technology and the capacity to adapt new technology is the key to competitiveness and prosperity in the global economy. FDI is not the only mode of technology transfer, but it is an effective and relatively easily managed one. Governments can maximise employment gains in the long term by implementing policies to improve the supply side conditions attractive to FDI, rather than attempting to control foreign investors' operational decisions. Because such a policy environment will also promote local enterprise, it also minimises the risk that FDI will dominate the national economy. However, it is important for countries that have reached a certain level of industrial development to undertake measures to promote indigenous technological capabilities. This enables 'higher quality' FDI to enter and also enhances the ability of local firms to compete, diversify and grow.

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Labour market regulation in sub-Saharan Africa

The design of an appropriate framework of labour market regulations is among the host of policy issues that need to be resolved if employment growth is to be accelerated in Africa.

Regulation of the labour market embraces a wide variety of measures including minimum-wage legislation, constraints on hiring and firing, and regulations regarding working hours and other working conditions. Even though in sub-Saharan Africa such legislation typically covers only a proportion of the workforce, far less than in the developing countries of Asia and Latin America, it has important ramifications for employment practice and incomes.

As part of an ongoing project, recent work in Senegal, Malawi and Zimbabwe suggests ways of approaching the issues in manufacturing industry and in plantation agriculture and furnishes some tentative conclusions.

In manufacturing, evidence from Senegal and Zimbabwe suggests that labour market regulation was too cumbersome. While the objective of regulation was to improve the livelihoods of the workers involved, over-regulation contributed to slow employment growth. In both countries, employment legislation typically favoured permanent employment contracts and imposed strict limits on redundancy. The legislation (now revised) appears to have raised the costs of employment (since managers could not use labour flexibly over the business cycle) and encouraged greater capital-for-labour substitution. Despite attempts to limit the use of temporary contracts, firms increasingly resorted to temporary workers. As a result, the average age of permanent workers has steadily increased, since very few young workers have gained permanent jobs. Young frustrated job-seekers impose considerable financial burdens on their employed relatives.

In commercial estate agriculture the available (but limited) evidence is mixed. In Zimbabwe, increased regulation of employment in estate agriculture in the early 1980s appears to have reduced employment opportunities, especially among female-headed households, many of whom are poor. But the degree to which estate employers can act as monopsonists in buying labour is important: Malawi's estates may have acted in this way and in that case, minimum-wage legislation may be appropriate. Imposing minimum wages at levels close to competitive market rates would correct the bias and reduce agricultural dualism since there is evidence that minimum rates were set too low in the 1980s.

Overall, the evidence is insufficient to permit definitive policy conclusions on the appropriate role for government in Africa's labour markets. Key questions which remain include: the impact of labour regulation on the productivity of employers (for example, how strong are

Trade and employment creation: possibilities and limitations

It is now widely believed that trade can make an important contribution to solving employment problems in developing countries. This belief, which is often advanced as an argument for more open trade policies, is based mainly on the experience of the successful newly industrialising countries of East Asia, where expansion of manufactured exports has created many jobs for comparatively unskilled workers. It is unlikely, however, that the East Asian experience can generally be replicated, because many developing countries do not have a comparative advantage in manufacturing.

In comparison to most primary production, manufacturing requires relatively little land and a relatively high level of skill – even an unskilled worker in a modern factory needs a basic education. This makes manufactures relatively cheap, and so creates a comparative advantage in exporting them, in countries with high *skill/land ratios* – or, in other words, in countries where human resources are abundant relative to natural resources.

Most East Asian countries clearly fit this description, with low per capita endowments of agricultural land and minerals, and high levels of education. South Asia also has few natural resources, but low levels of education, so that it has only a moderate skill/land ratio. Latin America has an even lower skill/land ratio, because its high level of education is offset by abundant natural resources. Sub-Saharan Africa has the lowest skill/land ratio of all the four main developing regions, because of its combination of low education and moderate natural resources.

Both across regions and across countries, variation in the skill/land ratio is highly correlated with variation in the ratio of manufactured to primary exports. Regions and countries with high skill/land ratios export a lot of manufactures, relative to primary products, while those with low skill/land ratios export few manufactures. Variation in trade policies, which used to explain a lot of these differences in the pattern of trade, now seems to be of minor importance: 'wrong' resource endowments, rather than 'wrong' trade policies, have become the most common obstacle to manufactured exports.

Even for countries with a comparative advantage in manufacturing, growing international competition is making it harder to pay decent wages. But for countries with low skill/land ratios, the options for using trade to create good jobs are particularly limited. Where the low ratio is caused by abundance of natural resources, rather than low levels of education, as in Latin America, there is scope for creating manufacturing employment through exporting processed primary products, even if not for large exports of footloose manufactures such as garments and electronic products. But where low skill/land ratios are due to low literacy rates, as in Africa and South Asia, there is little hope of large exports of any sort of manufactures, at least until, over the longer term, levels of education are raised.

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the basic wage in total emoluments of workers in state enterprises in urban areas has been reduced from 85% in 1978 to 45% in 1992. The state does not place labour in small collectives or private enterprises in either rural or urban areas, and their wages are not controlled. These have been the most dynamic sectors of the economy, and now account for 7% of both rural and urban employment compared to 0.7% in 1980. Finally, the rigid controls on rural–urban migration were relaxed a little, and more temporary (but not permanent) migration is now allowed.

As a result of these changes, wage differentials have widened compared to the earlier unreformed system, although this mainly reflects the growth of the private sector, rather than modification of outcomes in the state sector. For example, education is better rewarded in autonomous enterprises, and by 1988, the overall spread of earnings according to education among urban workers had widened to 34%. This premium remains low in comparison with most developing countries. The evidence suggests that the state, where it can, compresses the educational wage structure by comparison with a free market outcome. State enterprises show no tendency to widen the intra-enterprise wage structure where they gain more autonomy, even though they are encouraged to reward performance: a web of factory interests gives rise to distribution of bonuses unrelated to the productivity of individual workers. Occupational pay relativities are still muted, the greatest wage difference being 15% between a factory manager and a labourer.

The labour system remains unresponsive to allocative efficiency criteria in other ways too. Labour is still highly immobile: rates of voluntary separation are extremely low, estimated at 4 and 25 per 1,000 workers in state- and collectively-owned enterprises respectively in 1989.

The present labour system, even after the reforms of the 1980s, rewards individuals rather than jobs for the majority of the workforce. Wages are associated with other benefits, such as housing and health care. The establishment of a labour market – a corollary of which would be the emergence of open unemployment for the first time – would have to be accompanied by the introduction of completely new arrangements for social welfare. The reforms have not so far addressed this issue.

Another constraint on government's ability to relax the labour system lies in the probability that, if migration controls were to be loosened, population movements to the cities would greatly increase. There is a very considerable rural-urban divide in China. A great disparity of average living standards exists between workers and peasants and the gap has been widening in recent years: per capita urban income stood at 2.33 times rural income in 1992 and there are big differences in education, health and social security provision.

By comparison with other market reforms in China, labour market reform is tardy and limited. The shift from equality towards efficiency objectives for the labour market which the reforms entail, carries social and economic costs which are so high that the government may hold back from implementing the transition further within the state sector. The labour market will become more active as the non-state sector grows in importance.

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efficiency-wage arguments in favour of minimum wages?); the degree to which employers act competitively in the labour market (and how this is affected by trade and industrial reforms); and the impact of labour market regulation on the employment of women and children. Much more research is needed in these matters.

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An employment generation project in Ethiopia

In 1992, the World Food Programme started a pilot employment-based safety net scheme in Merti-Jeju, Ethiopia, a drought-prone area which had suffered severe ethnic conflict. The main elements in the project design were:

- the existence of a shelf of projects at community level, drawn up by participatory planning and using labour-intensive construction techniques;
- administrative capacity to expand and contract the level of employment according to need;
- a 'self-targeting' mechanism, through the work requirement, intended to ensure that the most needy benefited from the project;
- the creation of sustainable assets to help reduce the communities' vulnerability to future shocks.

Project activities included construction of ponds, road building, conservation activities and tree nurseries. The number of participating villages and individuals and number of days worked per month fluctuated about a strongly rising trend. By February 1994, 5,000 people were involved, working on average ten days per month. Evaluation of the project focused on the community plans and on coverage of the population.

The ability of the project to generate productive assets depended on the quality of the community plans. Project staff used an existing government system of Local Level Participatory Planning to organise the work. But plans took longer than expected to prepare, many lacked genuine participation and the level of detail was inadequate to plan materials and labour requirements.

To assess how far the project reached the most vulnerable, i.e. whether 'self-targeting' was effective; participatory (PRA) household wealth ranking exercises were done in five villages, taking account of assets, fitness to work and access to support from friends and relatives.

The conclusions were that:

- the highest level of vulnerability was experienced by female-headed households, but they had a low level of participation in the project.
- 11% of all households lacked labour which was physically able and could never benefit from this type of employment scheme. Female-headed households made up the majority of this group.
- among those able to participate, self-targeting was effective to the extent that members of 85% of households in the most vulnerable category took part in the project, compared to 62% of others, and payment records show that they worked longer and more frequently.

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impacts on levels of efficiency wages. Knight (page 1, col. 3) shows how cautiously the Chinese government is reforming the labour market, perhaps partly for this reason. Similarly, the ordering of an appropriate sequence of regulatory reform to improve worker protection and labour standards as the labour market itself evolves is not much studied. Addison (page 2) discusses some of these issues in the African context.

In respect of worker health and safety and use of child labour, market failures and abuses clearly do occur. But the experience where governments have taken a more active approach based on labour legislation is not very encouraging. A commonly-encountered combination in Africa and Latin America is one of unenforceable regulation and corrupt regulators such that market failure is transformed into even more socially expensive government failure.

There is a consensus that prosperous small-holder agriculture plays an important indirect role in labour markets. In Asia particularly, this has helped to limit the migratory pressures that might otherwise have greatly exacerbated urban tensions. The lack of a vibrant small-holder agriculture in large parts of Latin America greatly complicates the management of the urban labour market.

Turning to labour as a factor of production, despite many qualifications the weight of evidence is that the social rate of return to investment in human capital is high. Moreover, demand for educated workers increases rapidly with economic growth. Without a large investment in education and skill enhancement, bottlenecks develop and the earnings gap between more and less educated workers widens. East Asian governments invested heavily in high quality education and training. Other countries are attempting to emulate their approach, but reforming obdurate educational institutions and reorienting subsidies to the needy are not easy tasks.

It is sometimes argued that an abundance of people without education and skills can be turned to advantage, for example, through special works programmes for infrastructure and through promotion of the informal sector (a major vehicle for acquiring low level skills through on-the-job training and apprenticeship). Here, too, though, lessons of experience seem to be that institutional maturity is needed if programmes are to be effective. Again, the best examples seem to be largely Asian. Poate (page 4 above) suggests ways in which they may succeed elsewhere.

The importance of education and training is also being stressed in work focused on the developed economies. Closer global linkages through trade, technology, the movement of capital, and skilled labour in a competitive, more open world environment will probably increase the tempo of change and may add to the magnitude and frequency of shocks. However, for the countries that manage these problems well the prospects should be bright. Lall (page 2) argues that supply side labour market policies in developing countries should also help in this connection, by attracting foreign direct investment.

It is to countries at the other end of the income spectrum – the so-called marginalised and often least developed countries – that the global linkages and interactions appear to offer least. Common sense suggests a strategy that combines building up a human resource base with improvement of agriculture, in which aid could be helpful. Wood's analysis (page 3 of the factors underlying trade-related employment creation bears this out. However, the prospects do seem rather bleak for the many countries facing a combination of institutional weaknesses, lack of capital, low savings capacity, and limited human resource development. It is very clear that we need much more research on development strategies and the links to employment in the least developed countries. The gulf seems wider than ever between those sceptical about trade and market-based strategies and those sceptical about anything but trade and market-based strategies.

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