

Master PPD M1

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Lecture 13

Labour market policies in developing economies (role of the informal sector)

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Outline of the lecture

- Labour markets in developing countries: stylized facts
 - **Informal sector is crucial**
 - Employment and economic activity
 - Employment and demography
 - Wages and urban-rural transition
 - Policies
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“Dual” labour markets

- Big share of manpower in agriculture (mainly self-employed)
 - In emerging countries and LICs, the non-agricultural informal sector plays a big role (a very big role in the case of LICs)
 - Mainly self-employed (North Afr. 62% of non-agric employment, SS Afr. 70%, Latin Am 60% and Asia 59 %) (ILO, 2002, figures for 94/00)
 - Share of the informal sector in output is much lower than the share in employment
 - Big share of the modern (formal) sector is public (and public wage is seen as a benchmark for private sector wages)
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Source: ILO, 2002 (J. Charmes)	Informal employment as % of non- agric employment	Women's informal employment as % of women's NAE	Men's informal employment as % of men's NAE
North Africa	48	43	49
Tunisia	50	39	53
SS Africa	72	84	63
Benin	93	97	87
South Africa	51	58	44
Latin America	51	58	48
Bolivia	63	74	55
Brazil	60	67	55
Asia	65	65	65
India	83	86	83
Thailand	51	54	49

Informal sector

	% non agric employment	% of non agric GDP	% of GDP
Burkina Faso (92)	77 %	9 %	25 %
Tunisia (95)	49 %	38 %	20 %

Incomes

- ❑ Incomes in the informal sector are usually quite low.
 - ❑ But inequality is very high. Some entrepreneurs of the informal sector are very rich (and some are women, like so-called Mama Benz in Benin or Togo)
 - ❑ It is unclear if earnings are lower in the informal sector everything else being constant (skills, etc.)
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Incomes by institutional sectors (WAEMU) (main job of the household) (1€=656 FCFA)

Revenu mensuel moyen par secteur institutionnel (1.000 FCFA)	Cotonou	Ouagadougou	Abidjan	Bamako	Niamey	Dakar	Lomé	Ensemble
Administration publique	89,5	94,7	221,0	89,4	90,1	149,7	82,3	139,2
Entreprises publiques	122,2	100,0	255,8	140,2	111,8	134,6	69,2	148,3
Entreprises privées formelles	65,6	73,5	143,6	92,6	79,4	111,0	47,6	111,4
Entreprises privées informelles	26,5	20,4	39,3	37,5	28,8	38,4	17,6	33,1
Ensemble	37,0	37,3	71,1	50,8	45,4	58,2	25,6	54,2

Source : Enquêtes 1-2-3, phase 1, 2001-2002, sept agglomérations UEMOA, PARSTAT, nos propres calculs.

Le secteur privé formel regroupe les entreprises privées formelles et associatives.

Source: Brilleau, Roubaud and Torelli, 2002, WP DIAL

Unemployment

- ❑ The concept of unemployment is not very helpful. Unemployment is defined as follows (ILO 1982) (1) The "unemployed" comprise all persons above a specified age who during the reference period were:
 - ❑ (a) "without work", i.e. were not in paid employment or self-employment,
 - ❑ (b) "currently available for work", i.e. were available for paid employment or self-employment during the reference period; and
 - ❑ (c) "seeking work"
 - ❑ What do we mean by unemployment in countries where there is no unemployment schemes and benefits? What if unemployed persons benefit from solidarity inside the "large" family (A "Spanish story" in OECD)
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Example: WAEMU (ILO's definition of unemployment)

Agglomérations	Genre		Classe d'âge			Ensemble	
	Homme	Femme	10-29 ans	30-49 ans	50 ans et +	%	Effectif
Cotonou	6,3	4,9	7,3	4,2	3,7	5,5	20.400
Ouagadougou	14,6	16,4	22,4	9,2	5,9	15,4	56.500
Abidjan	13,1	14,0	17,4	10,0	7,3	13,5	205.400
Bamako	7,1	7,0	10,7	4,6	2,9	7,1	28.000
Niamey	12,1	15,0	18,7	8,7	11,1	13,1	29.900
Dakar	9,9	14,1	14,4	10,0	6,7	11,7	87.000
Lomé	10,9	5,7	10,4	5,8	7,7	8,2	33.300
Ensemble	11,2	11,7	15,2	8,3	6,5	11,4	460.500

Source : Enquêtes 1-2-3, phase 1, 2001-2002, sept agglomérations UEMOA, PARSTAT, nos propres calculs.
Les critères du BIT sont appliqués dans la définition des chômeurs.

Source: Brilleau, Roubaud and Torelli, 2002, WP DIAL

Information and policies

- ❑ Information about employment and informal sector is usually scarce, and hardly reliable. Namely in LICs.
 - ❑ Labour markets are highly regulated (and “trade unionised”), but regulations are not enforced in the informal sector. In Bamako (2002), 43,9 % earn less than the minimum wage (€33), 61 % in Ouagadougou (€41).
 - ❑ Labour market policies are often non-existent, or just wish lists. Employment reacts to other policies (trade, budget, education, industrial, etc.)
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Income, not unemployment

- ❑ Income of self employed informal sector workers is crucial
 - ❑ Some estimates in surveys, but no continuous monitoring
 - ❑ Increasing incomes in the informal sector: the role of property rights (H. De Soto)
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Employment and economic activity

- ❑ In emerging countries: Okun's law does not work : no clear relationship between the rate of output growth and the unemployment rate. (See Agénor & Montiel, p. 57)
 - ❑ Because of self-employment, public employment?
 - ❑ Shocks result in people fired from the formal sector employed in the informal, so unemployment does not increase, productivity decreases (Agénor & Aizenman, 1994, chap. 17)
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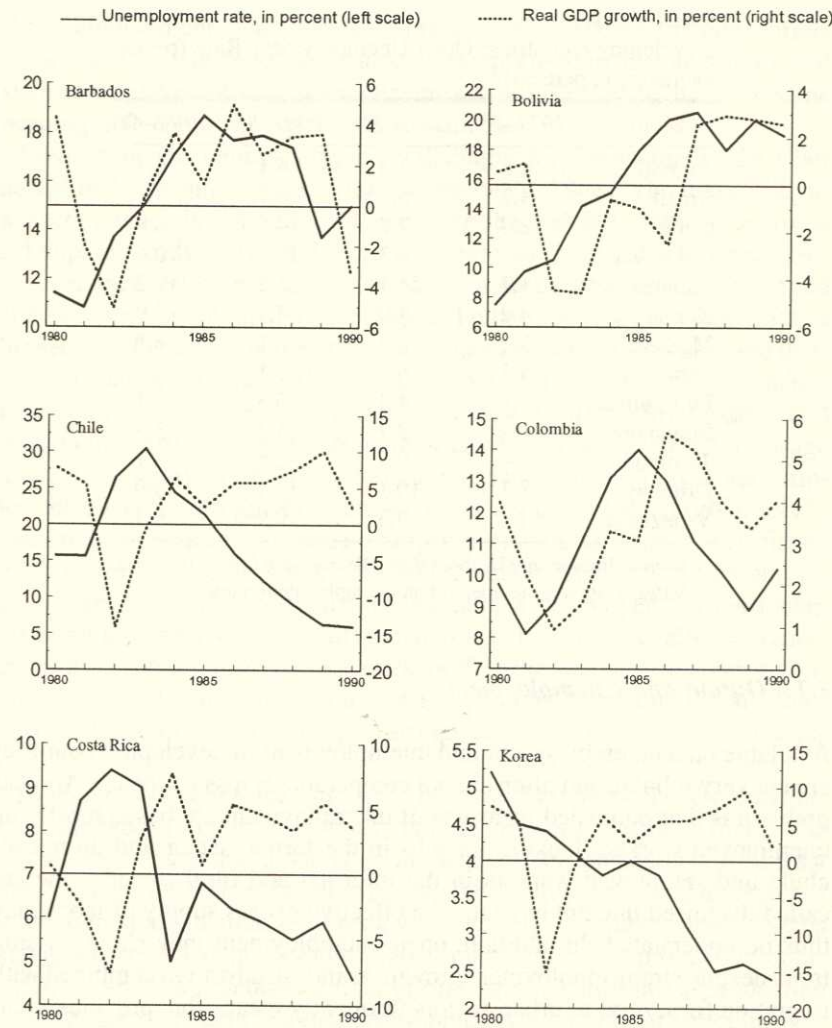


Figure 2.4 Output and Unemployment in Developing Countries

Sources: International Labor Office, *Yearbook of Labor Statistics*, and *International Financial Statistics*.

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Supply of labour and demography

- ❑ Demographic transition. Phase 2: mortality rate decreases –Phase 3: decline in the birth rate.
 - ❑ During Phase 2, mortality decreases (namely infant mortality, so birth rate may increase)
 - ❑ It results in an increase in the youth dependency ratio. So job creation for young people becomes crucial.
 - ❑ Concerns about phase 3 in LICs.
 - ❑ During the period between the decline in youth dependency and rise in population aging there is a demographic window of opportunity (an increase in the ratio of working age to dependent population: the demographic dividend).
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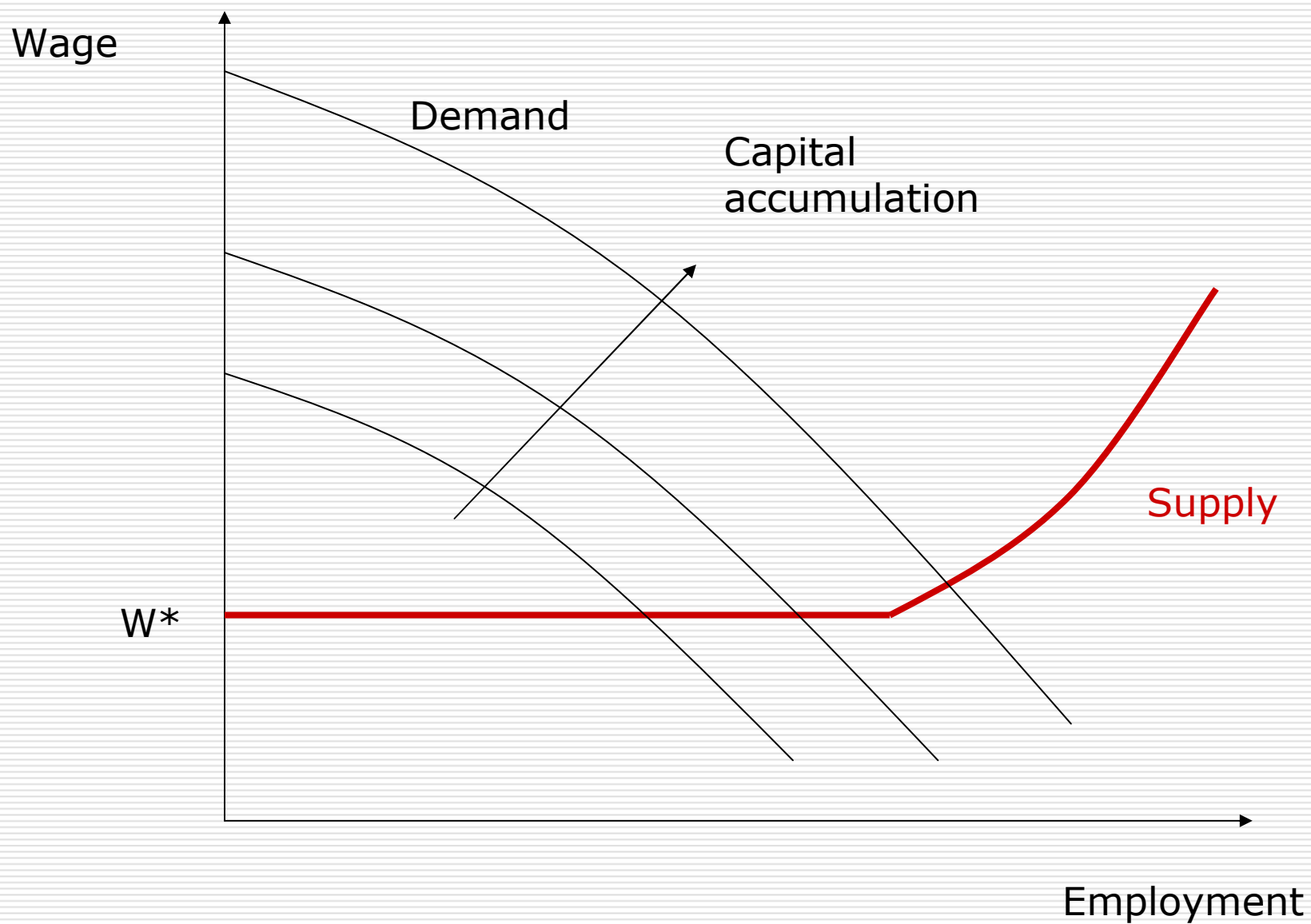
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Labour market: Lewis

- Lewis (1954): Economic Development with Unlimited Supplies of Labour, MS:
 - Wage in modern sector is likely to remain constant during the transition period because of a surplus labour in the traditional sector (underemployment or hidden unemployment).
 - The transition period ends at turning point (there is no surplus labour in the traditional sector anymore)
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Labour market according to the Lewis model



Example: China

- Surplus labour in rural areas is estimated between 52 and 150 million people. Final migration from the migrant to the urban sector is largely constrained by the *hukou* (residential registration system)
 - Wages have been fairly stable, but began unexpectedly to increase in 2006 : +17 % in 2006 in the Senzhen special economic zone; McDonald's (45000 employees) increased wages for the first time in 17 years in China in Sept. 2007, between 12 to 56%.
 - Now economic growth has slowed, 1 point growth less is estimated to result in a loss of 1 million jobs (Fu Jing, *China Daily*, 2008-08-14)
 - "China's labor market is in the princer grip of dwindling surplus labor on one hand and growing unemployment on the other as a result of mass closures of outdated factories" (shortage of skilled workers)" (Fu Jing, *China Daily*, 2008-08-14)
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Labour market and rural-urban migrations: the Harris Todaro (1970) model

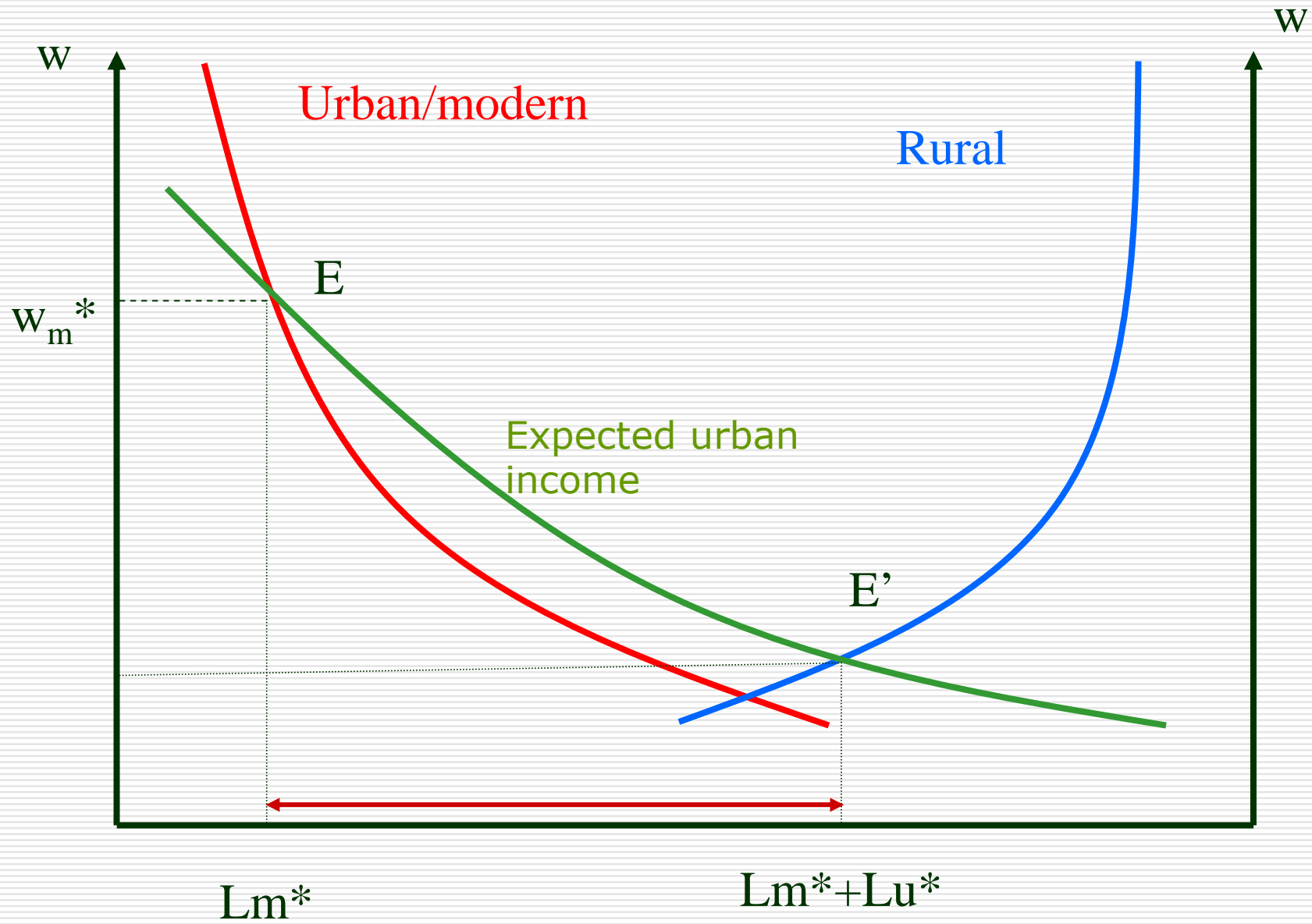
- ❑ Criticism of the Lewis approach: the rural (traditional) sector is not a pool of labour to draw on. Migrants are rational.
 - ❑ Origin: job creation and employment in Nairobi in the 70s
 - ❑ Migrants take into consideration:
 - The **expected** income in towns (urban wage, probability of finding a job linked with unemployment rate in towns)
 - Rural income (opportunity cost) (depending also on urban-rural remittances)
 - Cost of migration (opportunity cost, cost of living, transport, etc.) (meaning that the poorest are not likely to migrate)
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Harris Todaro

- The « extended » Harris Todaro model takes the informal sector into consideration (Fields), as a « buffer stock ».
 - Equilibrium is reached when the expected urban wage (w^e) is equal to the agricultural (traditional) wage (w_a)
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Agriculture, Informal and Modern

- Assuming wage in the informal (u) sector is zero for simplicity:
 - $w_m^e = w_m^* L_m / (L_m + L_u) + 0$
 - At equilibrium:
 - $w_a (L_a) = w_m^* L_m / (L_m + L_u)$
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Lessons (according to Todaro)

- ❑ Imbalances in urban-rural employment opportunities must be reduced
 - ❑ Urban job creation may result in higher urban unemployment and lower agricultural output
 - ❑ Indiscriminate educational expansion will lead to further migration and unemployment (rationing in the selection of new employees, education as a rationing device)
 - ❑ Scarcity in job opportunities will exert pressure on proceeding further on the educational ladder. Will result in idle human resources
 - ❑ Wage subsidy for increasing employment? May result in induced migration
 - ❑ Policies of rural development are crucial if the urban unemployment problem is to be solved.
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Status of informality

- Informal sector as a waiting room (transitional)? In many cases, reforms resulted in growing informalisation (Vietnam, Burkina Faso, See Bernabè and Krstić, 2005)
 - Or informal workers as entrepreneurs (microfinance)?
 - Or informality as a rational choice?
 - What about reverse migrations?
 - Modern sector and informality may be linked in the same household
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Why is nominal wage sticky in the modern sector (and flexible elsewhere)?

- Competing explanations:
 - Public sector regulation (minimum wage)
 - Trade Unions (insiders-outsiders)
 - Or efficiency wage?
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Efficiency wages

- ❑ Leibenstein (1957): nutrition, effort and output.
 - ❑ According to the efficiency wages approach, it makes sense for employers to pay more than the market-clearing wage.
 - ❑ This may explain involuntary unemployment
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Rationale for efficiency wages 1

- **Effort** (avoid shirking). Efficiency wage, maximising the profit of the firm is not linked with supply and demand of labour. Real wage is rigid, shocks result in change in employment.
 - **Turnover**; paying higher wages than “market-clearing” wage gives an incentive to the employees not to quit and seek jobs elsewhere (but it would be optimal for firms to pay lower wages during training – a reality for apprentices in Africa). This may explain dual labour markets: Split between low skill, labour intensive, high turnover (with lower turnover costs) sector and high wage, high effort, low turnover sector.
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Rationale for efficiency wages 2

- **Adverse selection** (if employers are not able to screen applicants and there is a costless self-employment available). High wages may attract the best workers. Screening is too costly, it may result in “statistical discrimination” (ethnic, see Fafchamps)
 - **Fairness** (Akerlof 1982) some employees work more than the norms, employees that work less are not fired. Cooperation among workers increases, and so average productivity. Each worker takes into account the well-being of the group and a reference. Partial Gift exchange model.
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 - **Structural adjustment**
 - Education
 - Flexibility vs norms
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Structural adjustment

- Removing distortions in the labour market.
 - Decreasing public employment in order to increase private employment: problems of skill mismatches.
 - And increasing public wages? (or lowering wage bill) (or reaching MDGs)?
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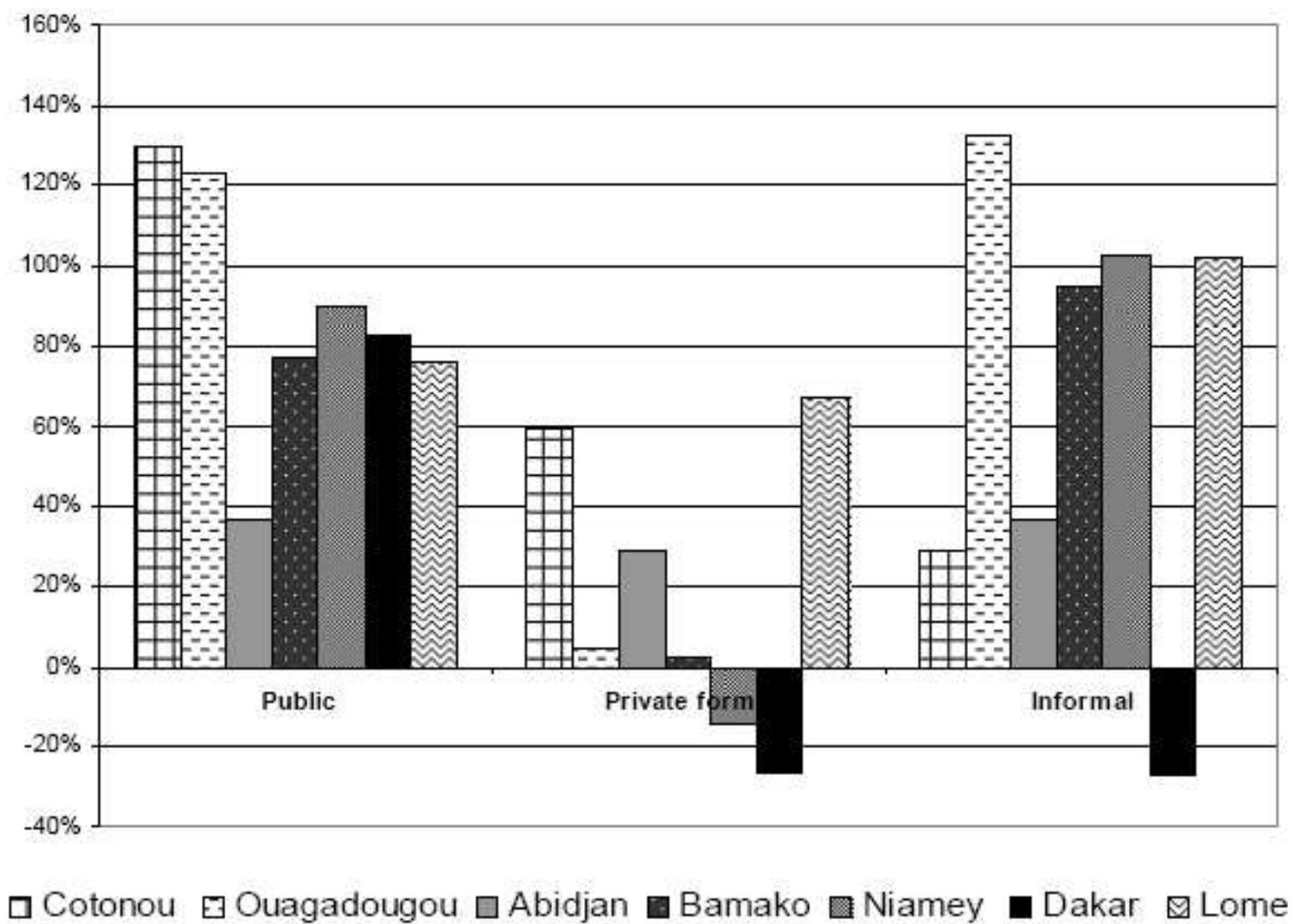
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- Unemployment of highly educated young people (Africa)
 - Brain drain: Example physicians, nurses in Malawi
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Education earnings and employment

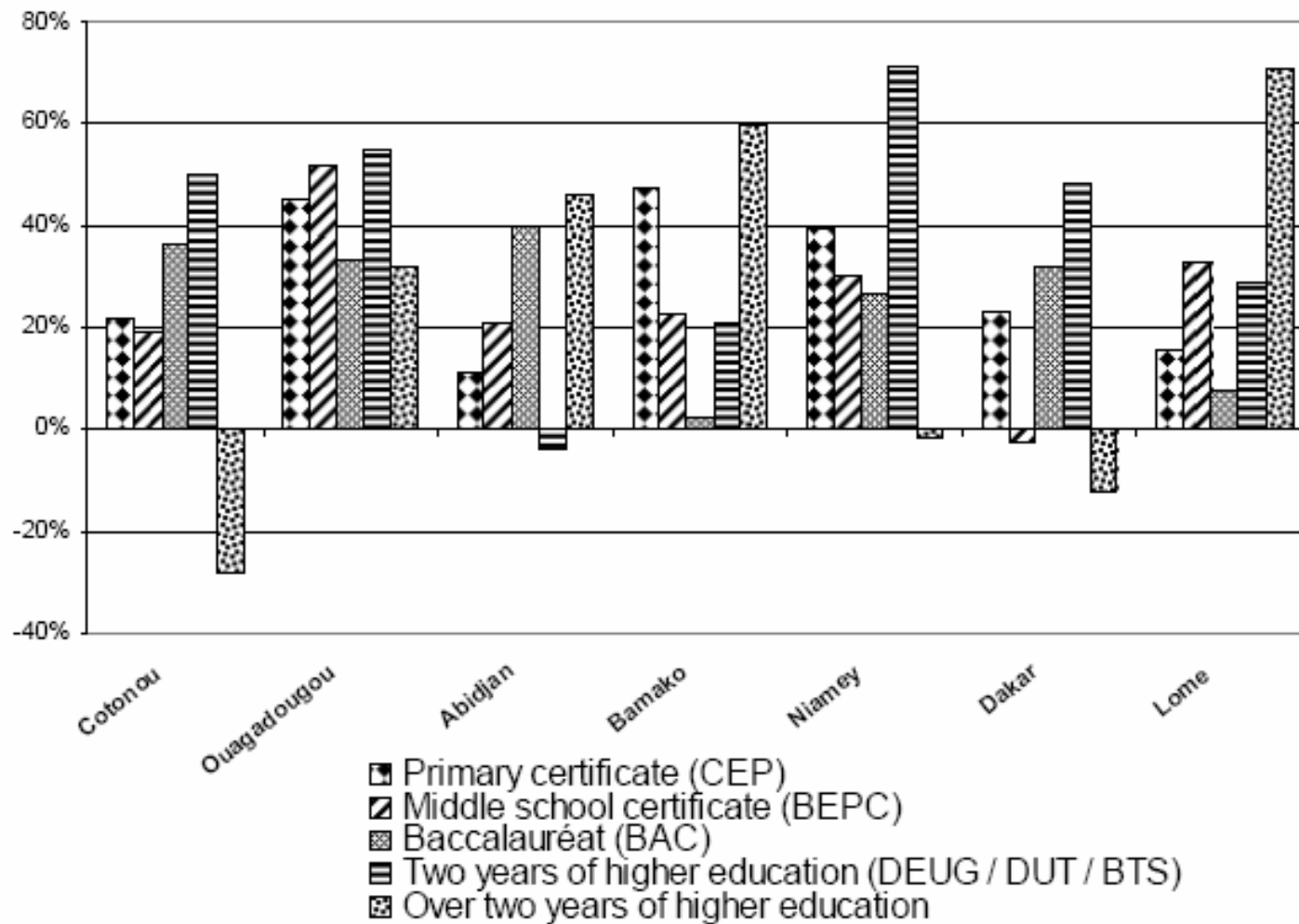
- ❑ Education works! even in the Informal Sector (See Kuepie, Nordman, Roubaud Education and Labour Market Outcomes in Sub-Saharan West Africa, DIAL DT/2006/16)
 - ❑ But debatable in agriculture, see Gurgand on Côte d'Ivoire)
 - ❑ Education is an insurance against poverty
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Figure 7: Returns to the Vocational Certificate (BEP*) Across Sectors



*BEP: Brevet d'Études Professionnelles

Figure 6: Marginal Returns to Qualifications in the Informal Private Sector



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Flexibility vs Norms

- Does it make sense to promote “flexibilisation” like WB, IMF, OECD (high costs of firing = reluctance to hire)
 - Does it make sense to protect workers by international norms (ILO’s “decent work”, prohibition of child labour)?
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Labour markets and pro-poor growth (operationalizing pro-poor growth report)

- *Designing labor market regulations to create attractive formal employment for poor workers helps expand their earnings, particularly in countries with fast growth.*
 - Labor market regulations, often designed to protect the interests of poor workers, can restrict formal labor markets and the access of poor workers. In India states with “proworker” legislation recorded lower growth rates and less efficiency in reducing poverty (the same applies in Bolivia and Romania)
 - By contrast, Indonesia’s high degree of labor market flexibility during the Suharto years promoted formal employment and labor-intensive growth. But since the 1997 Asian crisis, minimum wage increases prompted by union activity have left almost all employment growth to the informal sector, at wages below those in the formal sector.
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Labour markets and pro-poor growth (cont'd)

- Three caveats:
 - First, labor market regulations are only one of a set of factors that affect the investment climate and the willingness of a firm to formalize. Other critical constraints include policy uncertainty, fiscal burdens, cost of finance, corruption and the quality of courts.
 - Second, loosening labor market regulations in some regions, particularly Africa, may have little impact on labor markets, especially if employment is mainly in agriculture.
 - Third, labor market regulations, though imperfect, constitute a form of social protection. The extent of labor market regulation needs to reflect a balance between workers' needs and employers' needs, a balance that hangs on a country's labor market conditions and level of development.
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