

EMPLOYMENT CREATION, LABOR MARKETS AND GROWTH IN ASIA IN A GLOBAL ECONOMY

Reforms for what?

Jesus Felipe
Senior Economist
Economics and Research Department
Asian Development Bank

jfelipe@adb.org
http://www.geocities.com/je_felipe

MAKING MARKETS WORK BETTER FOR THE POOR
ASIAN DEVELOPMENT BANK
February 15, 2005

The views expressed are the author's and do not necessarily reflect the views or policies of the ADB

LABOR MARKET ISSUES AND GLOBALIZATION

We have observed that some Asian countries are achieving respectable **rates of growth**. But **unemployment** is on the rise. Not exactly 'jobless growth'

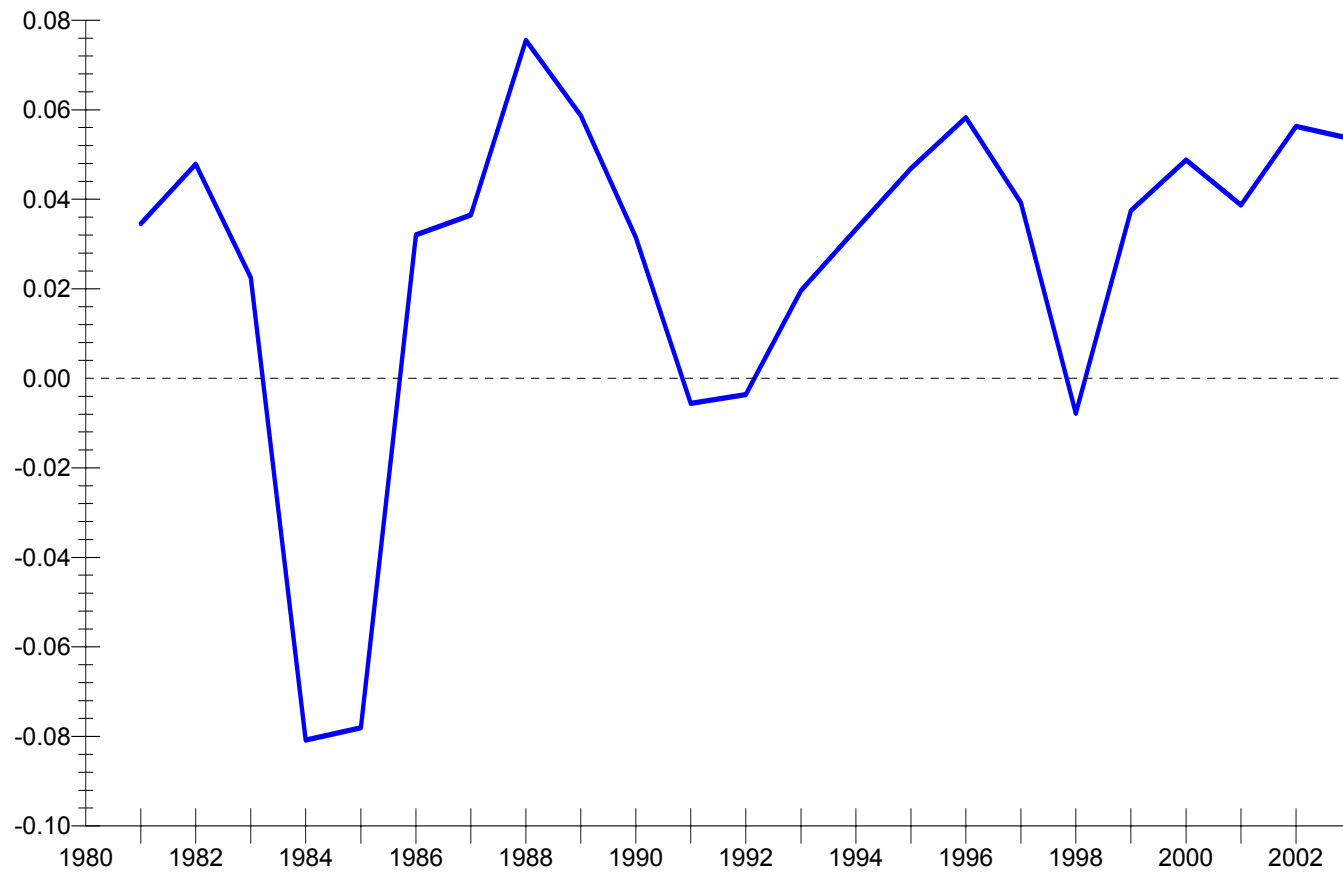
Millennium Development Goals

What sort of policies and institutional reforms (in particular in the labor market) should be implemented to achieve high and sustained growth and simultaneously generate enough employment?

This paper asks: (i) whether **wage-led employment strategies** are feasible; (ii) whether labor market policies **hinder** the creation of employment; and (iii) argues that the objective of labor market, or any other, reforms in Asia should be the achievement of **full employment**.

This objective will be achieved through the development of a labor market that is not only **well-functioning**, in the sense of efficient and fair, but also that is **inclusive** in the sense that it provides employment opportunities.

FIGURE 1. GROWTH RATE OF OUTPUT



NUMBER OF LABOR ENTRANTS & JOBS CREATED

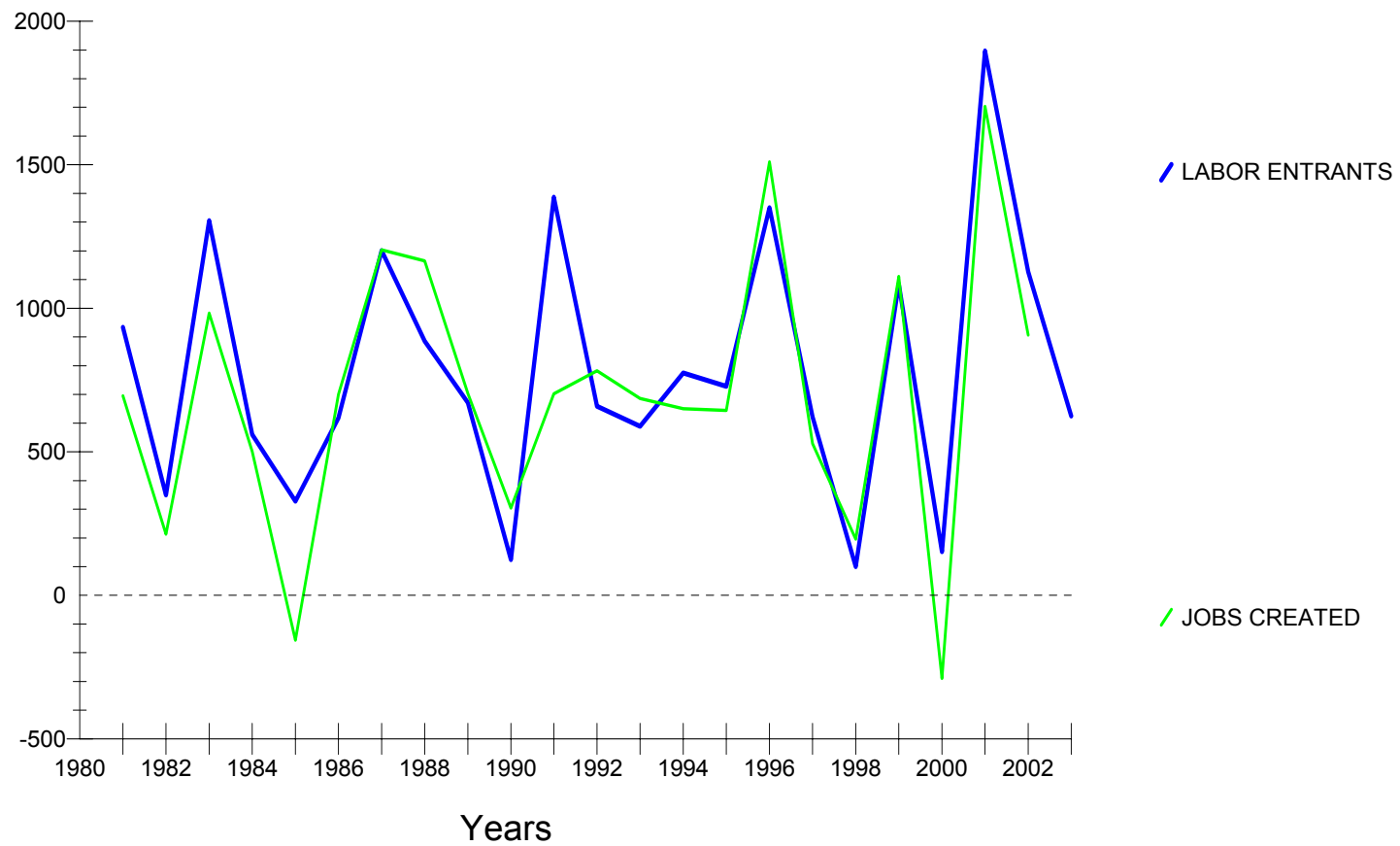


FIGURE 23. UNDEREMPLOYMENT & UNEMPLOYMENT RATES

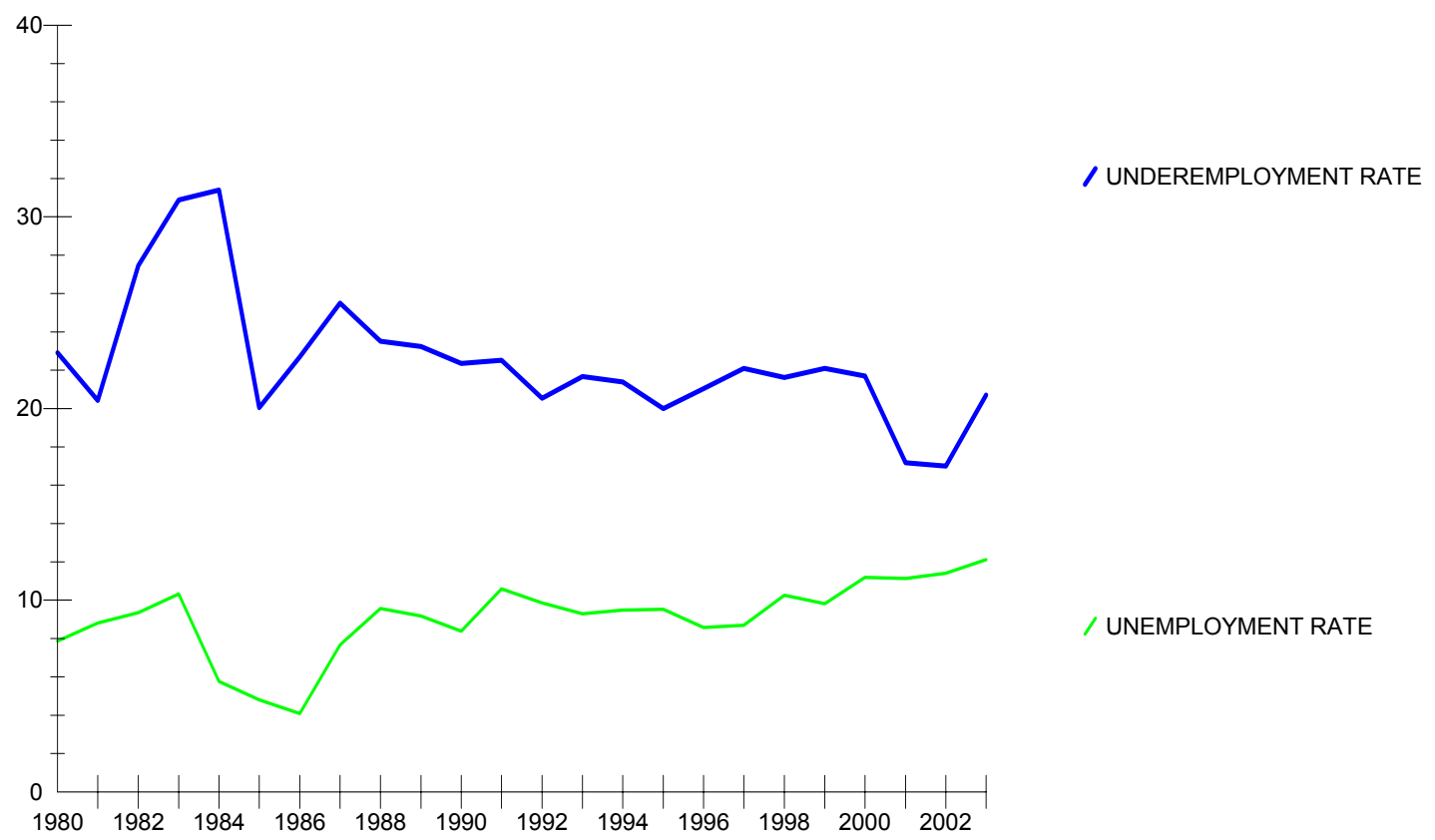
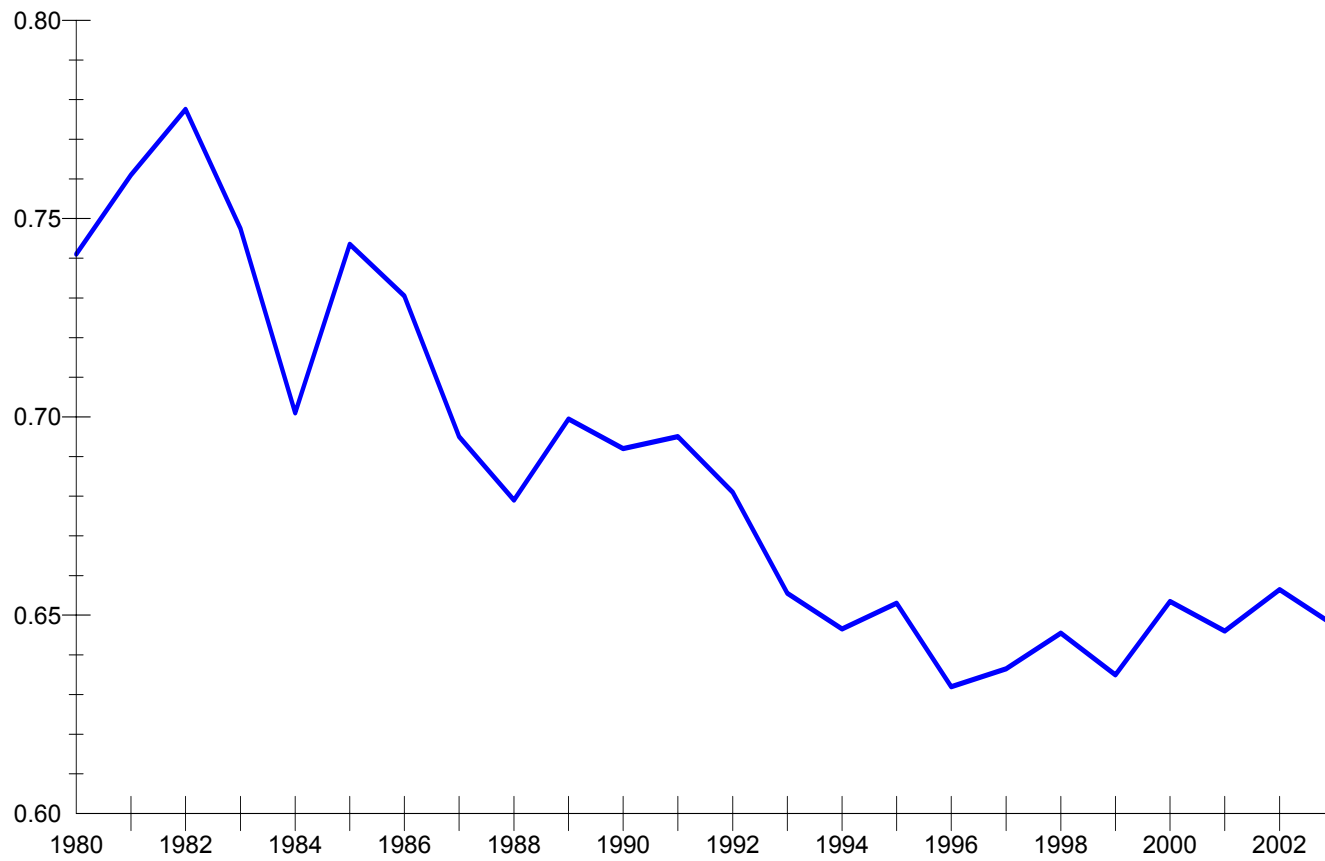


FIGURE 3. ADJUSTED LABOR SHARE



WHAT IS NEW IN RECENT DECADES?

- **END OF THE *GOLDEN AGE OF EGALITARIAN POLICY AND FULL EMPLOYMENT***
- **GLOBALIZATION, TECHNICAL CHANGE AND COMPETITION (Competitiveness)**
- **HUGE GLOBAL OVERSUPPLY OF LABOR:**
 - (i) End of the Cold War;**
 - (ii) Demographic Transition in many Asian countries;**
 - (iii) Globalization has turned a segmented worldwide labor market into an integrated market.**

Problem: This magnificent increase in the labor force has not been accompanied by a concomitant increase in capital for investment.

Consequence: Jitters are being felt all over world because the combination of these changes has led to the so-called "race to the bottom" argument.

Result: Shake in the belief that government redistributive policies and wage increases can promote full employment and economic growth

And today ...

the emphasis is on **COMPETITIVENESS**, that is, on **COSTS** and **PRODUCTIVITY**

IMPLICATION: WAGE RESTRAINTS and **LIMITATIONS OF SOCIAL EXPENDITURES** are seen as necessary conditions for adequate economic performance

UNEMPLOYMENT AND THE PRODUCTIVITY PARADOX

PROBLEM: GROWTH RATE OF OUTPUT IS NOT ENOUGH TO ABSORB THE GROWTH RATE OF THE LABOR FORCE (Not a new phenomenon –ILO 1970s)

WHAT IS HAPPENING IN MANY DEVELOPING COUNTRIES TODAY?

EMPLOYMENT-PRODUCTIVITY:

$$\hat{L} = \hat{Y} - \hat{y}$$

- (i) Detractors of Globalization
- (ii) Defenders of Globalization

EVIDENCE: Indicates that **increasing returns to scale** and **technological progress** have produced an adverse combination. Indeed, a faster rate of technical change, *if it does not lead to a fast growth of output*, may actually lead to increasing unemployment.

LUDDITE MOVEMENT AND DAVID RICARDO

WAGE-LED ECONOMY: IF FOLLOWING AN EXOGENOUS INCREASE IN THE REAL WAGE OR IN THE LABOR SHARE, CONSUMER DEMAND INCREASES AND SO DOES OVERALL DEMAND

A **WAGE-LED EMPLOYMENT REGIME** IS AN INSTITUTIONAL STRUCTURE WITHIN WHICH AN EXOGENOUS WAGE INCREASE INDUCES AN INCREASE IN EMPLOYMENT

ADAM SMITH AND KARL MARX THOUGHT THAT **EGALITARIAN** ECONOMIC POLICIES DESERVED CREDIT AND THAT **INCREASES IN REAL WAGES** PROMOTE EMPLOYMENT AND STIMULATE ECONOMIC GROWTH

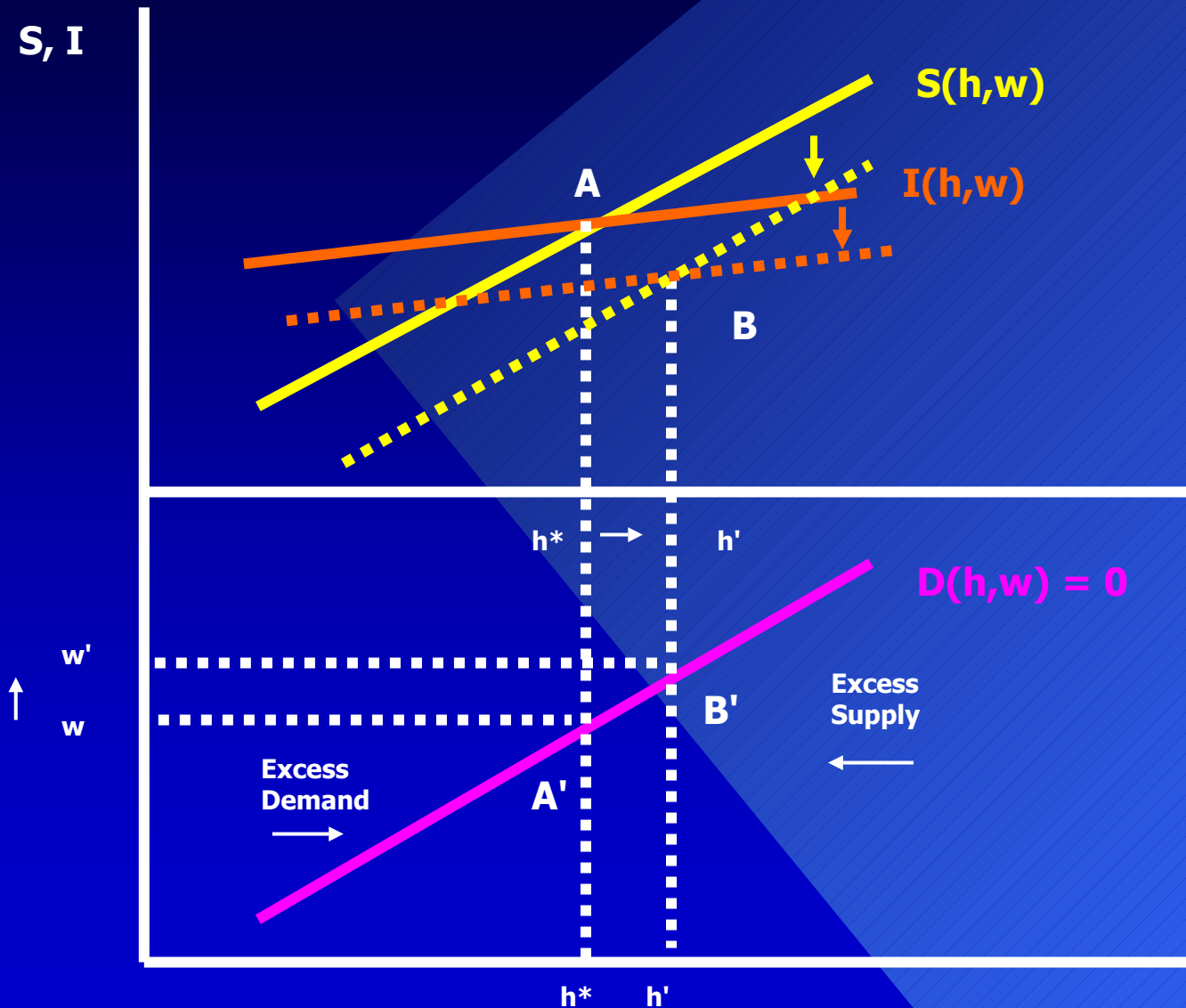
HOW CAN IT BE DETERMINED IF AN ECONOMY IS WAGE-LED?

$$D(w, h) = I(w, h) - S(w, h) = 0$$

$$\frac{dh}{dw} = - \frac{D_w}{D_h} = \frac{S_w - I_w}{I_h - S_h} > 0$$

$$(s_r - s_w) > i_r$$

AGGREGATE DEMAND FOR LABOR FUNCTION: THE WAGE-LED CASE



HOW DO WAGE-LED ECONOMIES REACT TO PRODUCTIVITY IMPROVEMENTS?

SHORT-RUN:

Productivity Improvement

Does not lead to Real Wage Improvements

Some Jobs are Eliminated

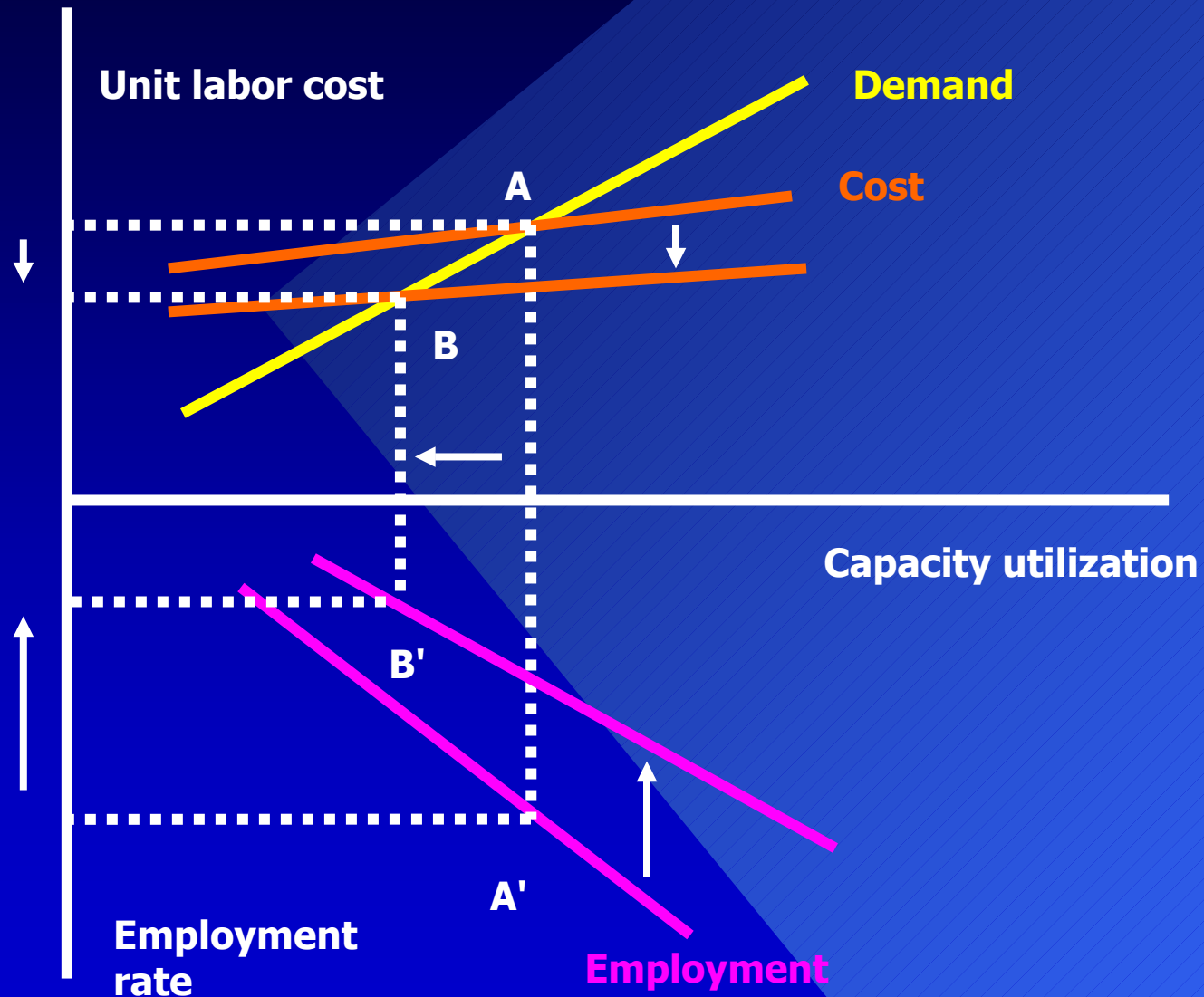
The Wage Bill Declines

This will lead to a decline in consumer demand

Eventually, new capacity formation and investment will fall

Question: Is the unemployment that potentially results from increases in productivity a reason to prevent the diffusion of labor-saving techniques?

EFFECTS OF FASTER PRODUCTIVITY GROWTH WHEN EFFECTIVE DEMAND IS WAGE-LED



CONCLUSION: A WAGE-LED ECONOMY IS NOT WELL PREPARED TO ABSORB TECHNICAL CHANGE

PARADOX: Growth in real wages and income per capita are impossible without productivity gains, themselves the result of technical change. The question, therefore, is **not** how to impede productivity gains, but how to shift them to higher real wages and aggregate demand.

LABOR MARKET POLICIES AND REGULATIONS: ARE THEY EVIL?

Critics of labor market regulations claim that the collective bargaining institutions, employment regulations and income security measures reduce employment growth.

However, and contrary to common perception, a protective labor market policy, measured in terms of greater labor market regulations and standards, has not resulted in poor economic and employment conditions (**Freeman 1993**).

Labor market reforms tend to be a **thorny issue**. In fact, they are more difficult to implement than reforms in any other economic areas.

It is possible that the reason why this happens is that **trade unions** oppose them.

However, there is another reason worth considering. This is the **public perception** about their effects, for they are associated with deregulation and a tendency towards “free markets” and a laissez-faire view of the economy.

Do Labor Market Policies Constrain Employment?

	Labor Code Article no./Labor Laws	Main features
Employment laws:		
Dismissal of Workers	Article 278/Rule I of Book VI of Rules implementing Labor Code	In cases of regular employment, the employer shall not terminate the services of the employee except for just and authorized causes and subject to requirements of due process.
Workers' retrenchment and retrenchment compensation	Article 283	The employer may terminate the employment of any worker due to the installation of labor-saving devices, redundancy, retrenchment to prevent losses, or the closing or cessation of operation of the establishment, after serving notice to the workers and the Department of Labor and Employment (DOLE). Workers affected are entitled to a separation pay equivalent to at least one month pay or to at least one month pay for every year of service.
Subcontractor	Article 106	While subcontracting is allowed, the DOLE may restrict, prohibit the contracting out of labor. Distinctions are made between labor-only contracting and job contracting as well as differentiations within these types.
Holiday Pay	Article 94	Every worker shall be paid his regular daily wage during regular holidays, except in retail and service establishments regularly employing less than workers.
Regularization	Articles 279 and 281	After six months of probationary employment, the worker qualifies as a regular employee in accordance with the reasonable standards made known by the contract between the employer and employee
Wage Supplements	R.A. no. 6971	The state encourages the provision of appropriate incentives to both labor and capital for undertaking a sharing of profits. The productivity bonuses shall not be less than half the percentage increases in the productivity of the firm.
Minimum Wages	Article 127	No wage order issued by the Regional Tripartite Wages and Productivity Boards shall provide for wage rates lower than the minimum prescribed by the Congress.
13 th Month Pay	P.D. 851	All employers are required to pay a 13 th month salary

Do Labor Market Policies Constrain Employment?

TABLE 2. SCORES FOR ASIAN COUNTRIES

Variable	PRC	India	Indonesia	Malaysia
Employment laws				
Part-time workers are not exempt from mandatory benefits of full-time workers	1	1	1	1
It is not easier or less costly to terminate part-time workers than full-time workers	1	1	0	1
Fixed-term contracts are only allowed for fixed-term tasks	0	0	0	0
Maximum duration of fixed-term contracts.	0	1	0	1
Days of annual leave with pay in manufacturing	6.00	15.00	10.00	16.00
Paid mandatory holidays	7.00	5.00	12.00	10.00
Premium for overtime	1.50	2.00	1.50	1.50
Premium for work on the primary rest day	2.00	n.a.	2.00	n.a.
Maximum number of hours per week.	40.00	48.00	40.00	48.00
Maximum days of work per week.	5.00	6.00	6.00	6.00
Maximum hours of work in a day.	11.00	24.00	24.00	12.00

Do Labor Market Policies Constrain Employment?

TABLE 3. REGIONAL SCORES

Variable ^{1/}	Asia ^{2/}	Developed ^{3/}	Latin America ^{4/}	Africa ^{5/}
Employment laws				
Part-time workers are not exempt from mandatory benefits of full-time workers	1	1	1	1
It is not easier or less costly to terminate part-time workers than full-time workers	1	1	1	1
Fixed-term contracts are only allowed for fixed-term tasks	0	0	0	0
Maximum duration of fixed-term contracts.	0	0	0	0
Days of annual leave with pay in manufacturing	14.19	19.10	21.46	19.13
Paid mandatory holidays	10.00	7.43	10.23	8.87
Premium for overtime	1.51	1.34	1.51	1.32
Premium for work on the primary rest day	1.90	1.76	2.06	1.80
Maximum number of hours per week.	45.25	40.81	46.15	44.47
Maximum days of work per week.	5.75	6.10	6.15	5.93
Maximum hours of work in a day.	18.56	19.57	16.08	20.93
Weeks worked in a year	47.75	47.77	46.82	47.27

We believe that labor market policies and regulations **are not the evil** cause of unemployment.

Conclusion: while *some aspects* (excessive regulation) of the labor market are in need of deep reform in a number of countries, perhaps inefficiencies in this market are not the binding constraint for faster growth and more employment.

FULL EMPLOYMENT AS THE OBJECTIVE OF LABOR MARKET REFORMS IN DEVELOPING ASIA

WHAT DOES FULL EMPLOYMENT MEAN? ECONOMISTS LIKE PASINETTI REJECT THE NOTION OF "NAIRU". FOR HIM, FULL EMPLOYMENT REFERS TO ZERO INVOLUNTARY UNEMPLOYMENT.

For **Pasinetti (1993)**, achieving full employment must be *the* paramount objective of economic policy (not an objective of central banks, governments and international organizations today)

What are the arguments for full employment?:

- (i)** The economic and social costs of unemployment and underemployment are staggering;
- (ii)** The right to employment is part of the “Universal Declaration of Human Rights”;
- (iii)** Countries like the US require, by law, the promotion and achievement of full employment, and New EU Constitution;
- (iv)** It is an ethical imperative

How should the notion of **“full employment”** be understood in developing countries? It must refer to the maximization of the absorption of labor. This is not just about maximizing employment but about **creating the conditions** under which the high-wage segments of the economy generate more jobs.

The key is how to **expand the demand for labor** in the wage sectors outside agriculture so that these sectors can draw labor from agriculture. If labor surplus exists, this will lead to an increase in productivity in the economy without a fall in agricultural output.

STRATEGY TOWARDS FULL EMPLOYMENT IN DEVELOPING COUNTRIES should contemplate the implementation of an effective policy that aims at:

- (i)** increasing income in the non-wage sector (self-employed workers, unpaid family workers, informal sector);
- (ii)** reducing the gap between the formal and informal sectors; and
- (iii)** increasing the proportion of workers in the wage (formal) sector.

FIGURE 6. SHARE OF EMPLOYMENT BY CLASS

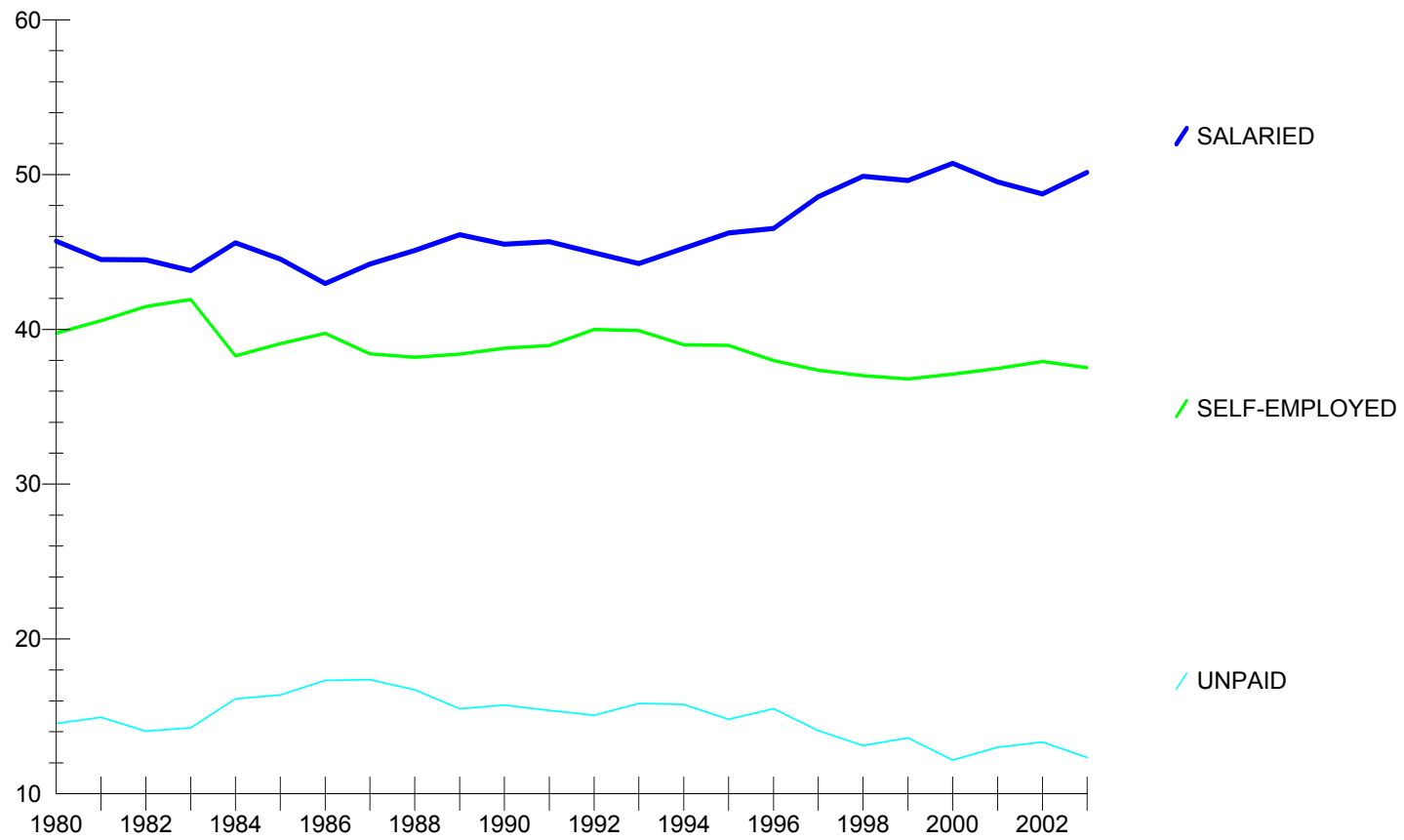


FIGURE 9. AVERAGE REAL WAGE RATE OF THE ECONOMY

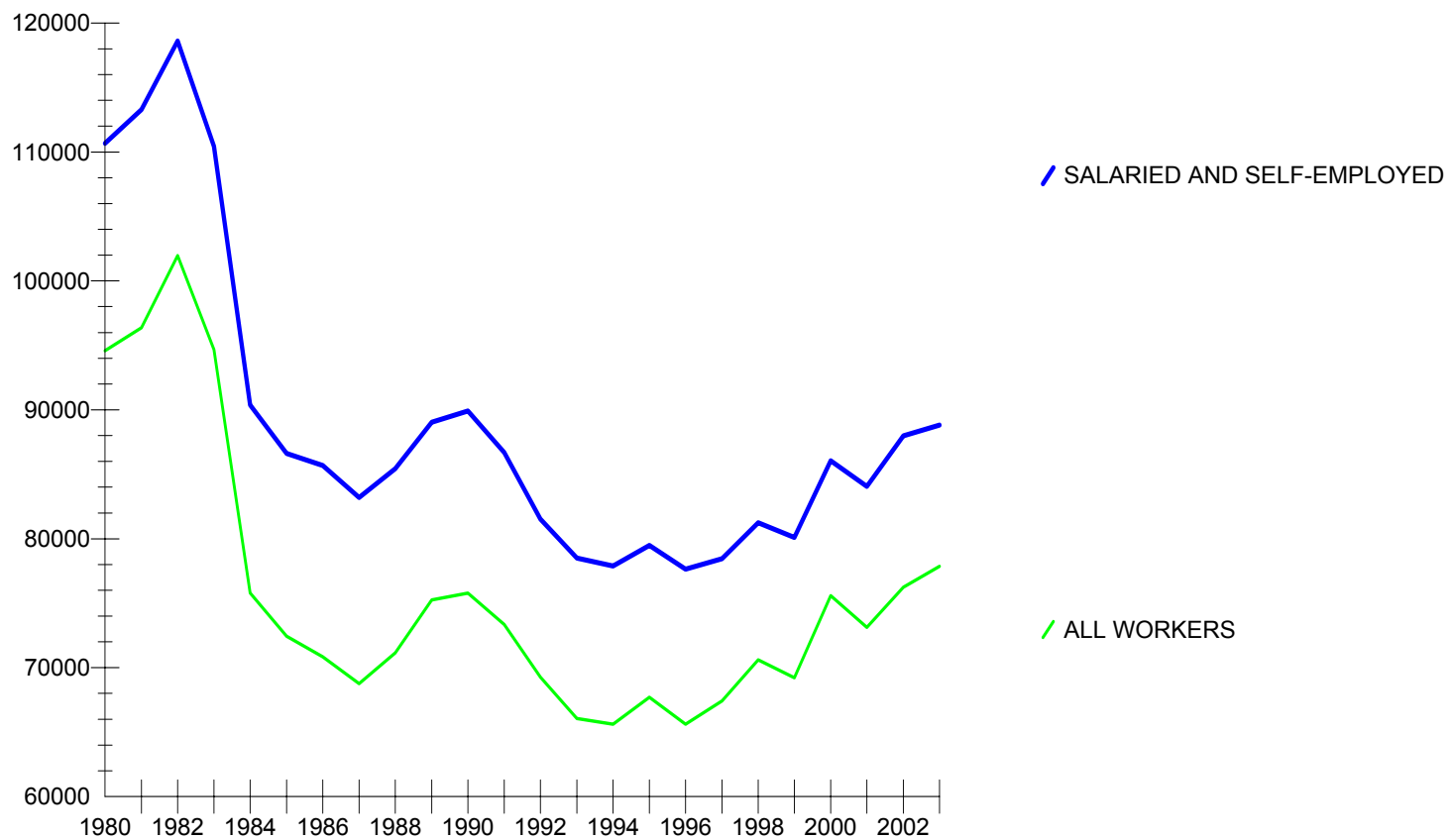
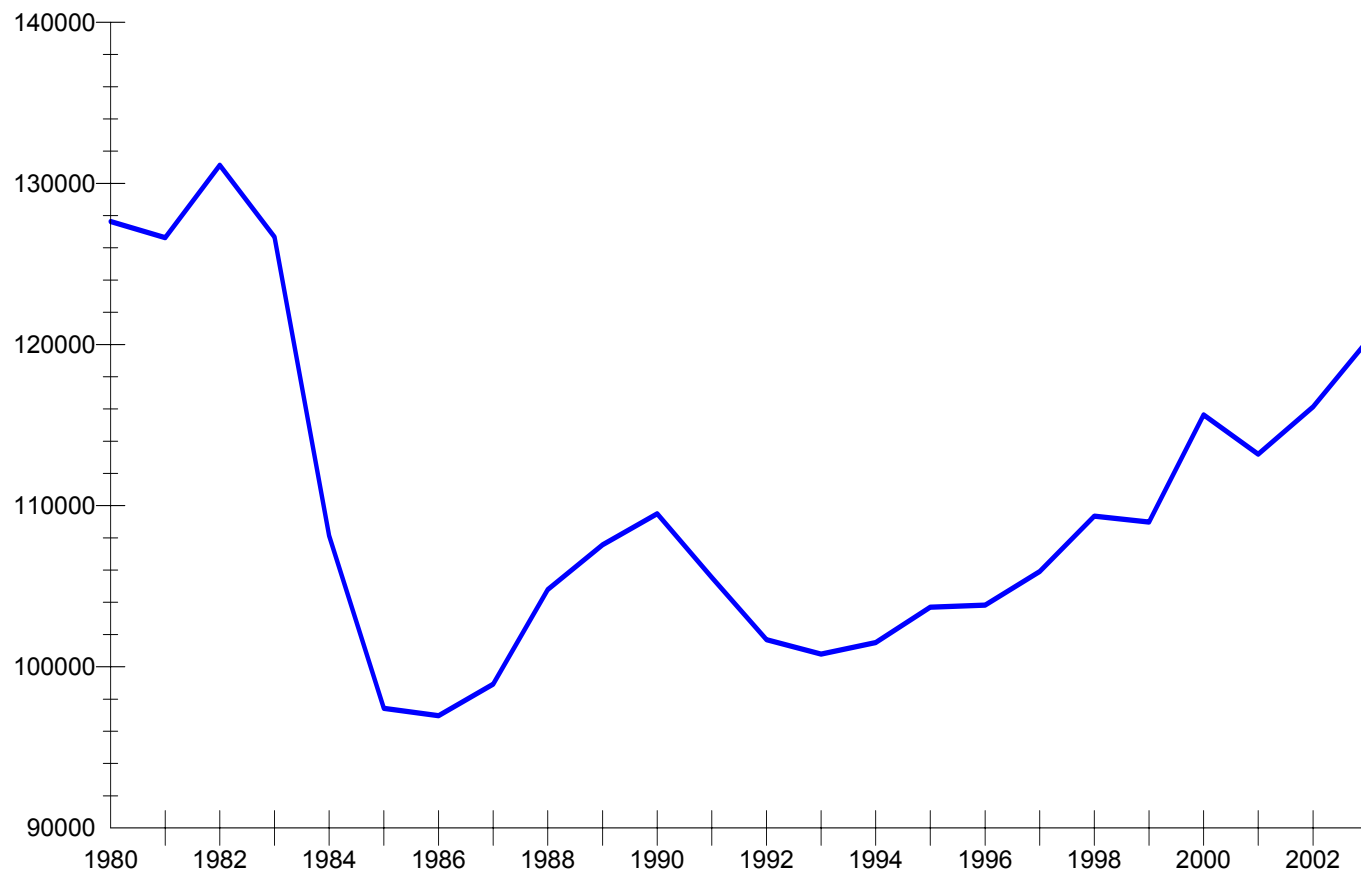


FIGURE 15. LABOR PRODUCTIVITY



POLICIES TO PROMOTE FULL EMPLOYMENT IN DEVELOPING COUNTRIES

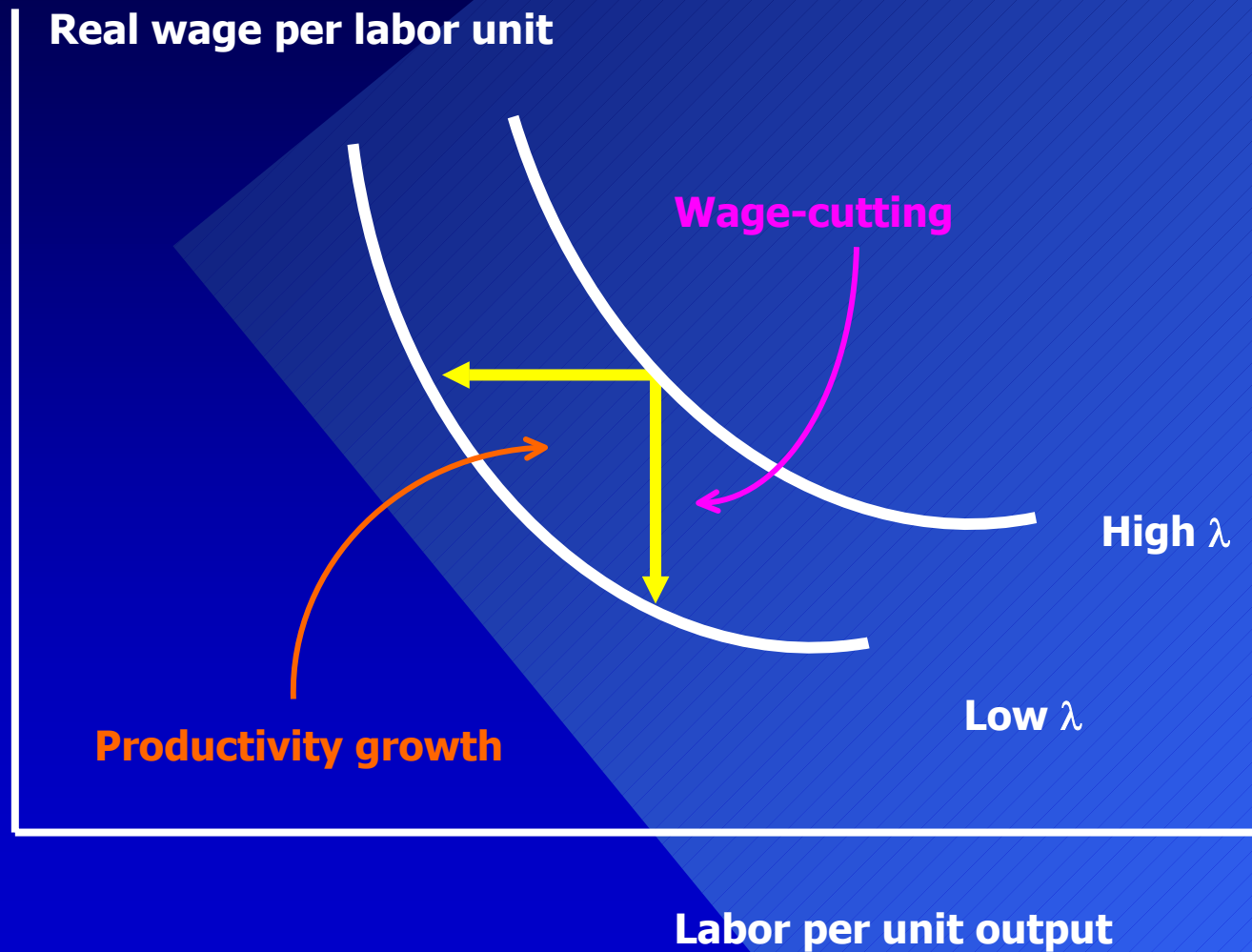
IS IT POSSIBLE TO ACHIEVE FULL EMPLOYMENT IN THE CONTEXT OF A GROWING ECONOMY WITH SECTORS EXPANDING AT DIFFERENT RATES?

IN GENERAL, THIS WILL BE VERY DIFFICULT

PROBLEM OF DEVELOPING COUNTRIES IS HOW TO TRANSLATE PRODUCTIVITY INCREASES, THE KEY TO PROSPERITY, INTO HIGHER REAL WAGES, AGGREGATE DEMAND AND EMPLOYMENT:

- (i) INCREASE PUBLIC INVESTMENTS IN INFRASTRUCTURE**
- (ii) INVESTMENTS IN TRAINING**
- (iii) EXPORT PUSH INDUCED BY LOWER UNIT LABOR COSTS**
 - LOWER WAGES**
 - HIGHER PRODUCTIVITY (East Asia)**

WAGE-CUTTING VS. PRODUCTIVITY GROWTH IN REDUCING UNIT LABOR COSTS

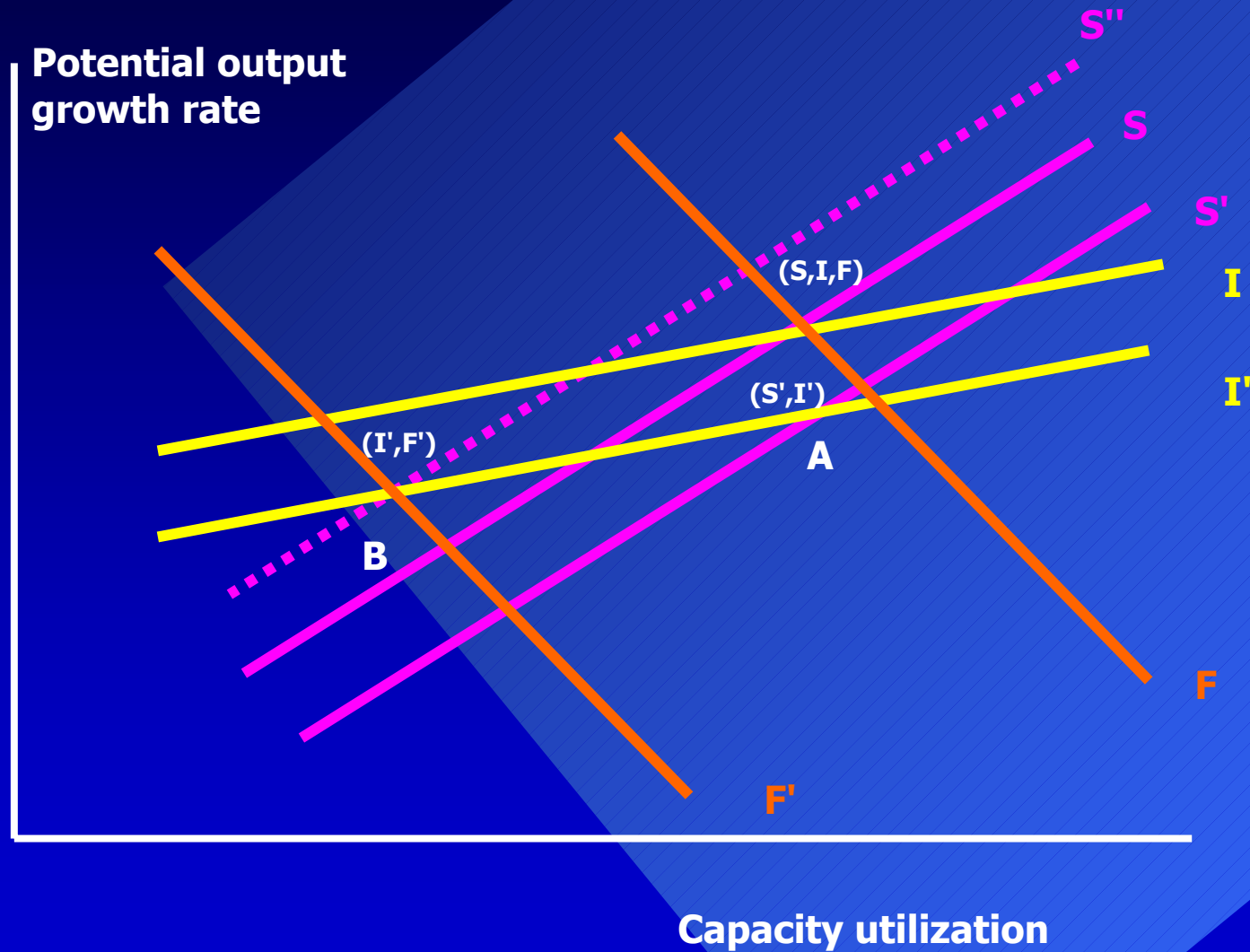


How does productivity increase?

- (i) Increase the capital-labor ratio
- (ii) More training
- (iii) Reorganization of the shop floor
- (iv) Competition Policy

However, **not all countries in Asia** have been as successful as the East Asian. Most other countries are severely constrained, in the sense that there exists a gap between the available and desirable level of resources. Moreover, they have few options to implement successfully output and employment policies, in particular because they are often hit by shocks.

AN ADVERSE EXTERNAL SHOCK IN A THREE-GAP MODEL



Policy package (no guarantee that employment will increase):

Fiscal restraint (S left)

Public Investment (I left)

Exports (F right)

EMPLOYMENT CREATION, LABOR MARKETS AND GROWTH IN ASIA IN A GLOBAL ECONOMY

Reforms for what?

Jesus Felipe
Senior Economist
Economics and Research Department
Asian Development Bank

jfelipe@adb.org
http://www.geocities.com/je_felipe

The views expressed are the author's and do not necessarily reflect the views or policies of the ADB