

ning. These interventions can be justified in terms of their contribution to individual and family health and welfare.

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Economic growth delivers higher wages and encourages workers to move to higher paid, high-productivity jobs in the formal sector, as Malaysia's experience demonstrates. Investment in physical capital and in people is key to economic growth and higher productivity—without investment, wages stagnate and living standards fall, as they did

in Ghana before its reforms. But simply increasing the stock of physical capital and years of schooling will not automatically translate into sustained growth, as Poland discovered. A market-based development strategy that encourages enterprises and households to invest for the future in a productive and profitable manner can sustain rising labor demand. Such a strategy will enable low- and middle-income countries to expand employment opportunities and raise the wages of their often rapidly growing labor forces.

CHAPTER 3

Households, Growth, and Employment

MOST PEOPLE, WHATEVER THEIR race, nationality, or the stage of development of their country, spend most of their lives working for a living. Economic growth and rising income per capita have a dramatic effect on the type of work households do, the incomes they receive, the way they manage their time, the sectors in which they work, and whether to migrate. Rising labor productivity and higher real wages affect decisions about who in the household should work, who should receive education and how much, and how households deal with risk and income security. For employers, higher productivity affects labor demand, the organization of production, and the nature of employment contracts. The interaction of households' supply of labor and employers' demand for it yields the employment outcomes we observe.

This chapter maps out the changes in household labor decisions and the organization of employment relationships that development brings. It then looks at what determines unemployment in rich and poor countries.

Household decisions and labor supply

Households everywhere have limited resources with which to meet their objectives. For most, especially in low- and

middle-income countries, labor time is their primary resource.

Labor force participation

Households must decide how to allocate their collective labor time between home-based and market activity. Household income and the wages each member commands will influence their decisions. Low wages will not always mean long hours of work. In Ghana and Malaysia, evidence from household surveys suggests that workers from families in the bottom 40 percent of the income distribution worked 15 to 20 percent fewer hours on average than did individuals from the top 20 percent. This finding is probably due to a lack of opportunities, especially in rural areas. But at some point rising labor productivity and higher real wages raise household incomes enough so that individuals can choose to work fewer hours. One of the benefits of the sustained economic growth of today's high-income industrial countries has been an almost 40 percent decline in hours worked per person per year, from an average of 2,690 in 1900 to 1,630 in 1986.

Households must also decide who will work and in what activities. As work is conventionally measured, men work more than women. In a wide range of countries almost all men between twenty-five and fifty-four are

directly engaged in income-generating activities, whether in the home, on the family farm or enterprise, or in the labor market (Figure 3.1). Differences between countries are confined to the young and the old. For example, a much larger fraction of male teenagers and elderly men work in Uganda than in Brazil, in part because of different income levels and hence different schooling and retirement patterns.

Among those who participate in market activities, wage employment is most common among the young; the incidence of self-employment and entrepreneurship increases with age; and unemployment is highest among young workers (who are more likely to change jobs). This suggests that, for a number of individuals, wage employment is a way to start out, earn some income and learn skills, save,

Male patterns of labor force participation are similar across countries, whereas those of females differ.

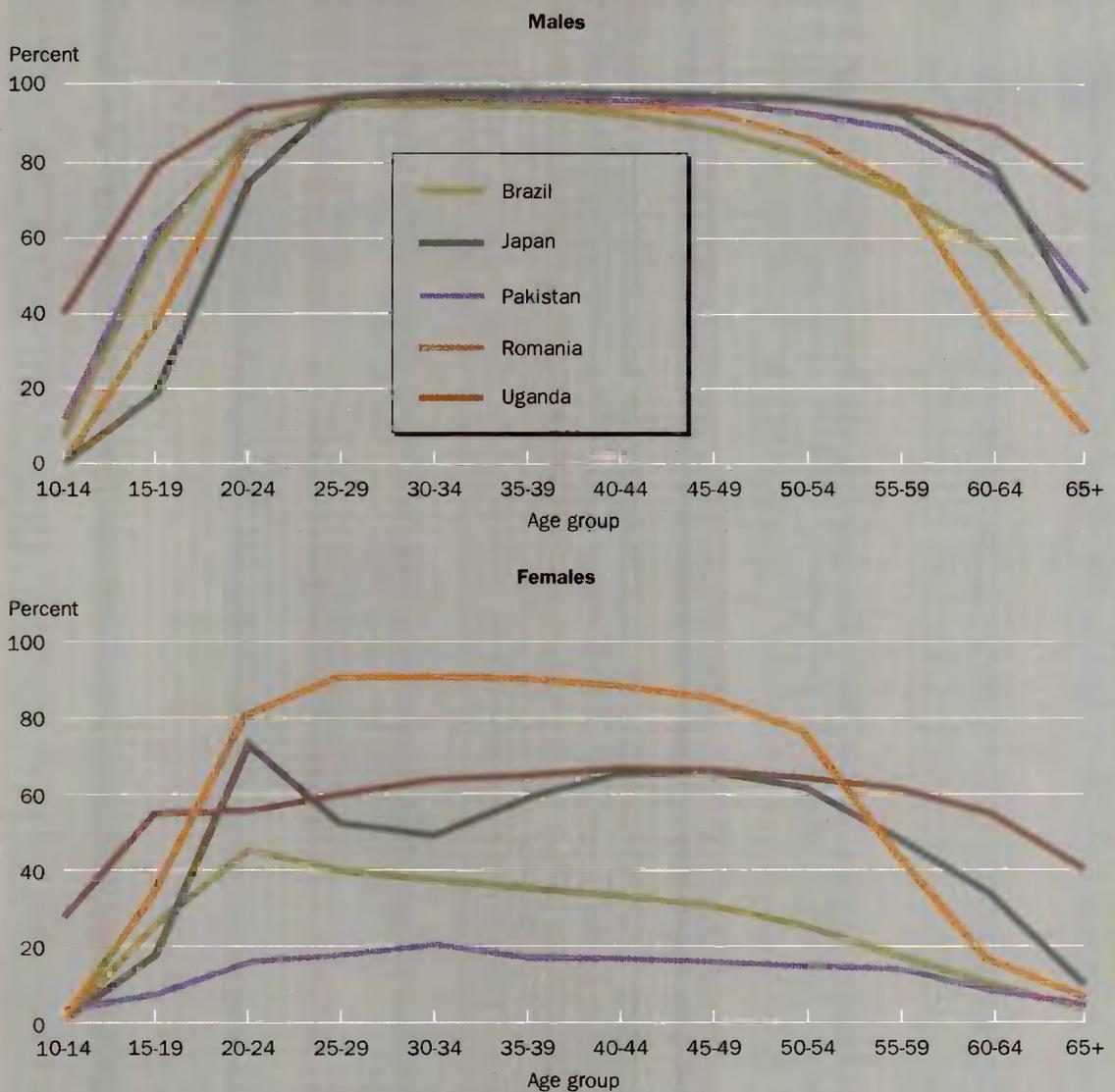


Figure 3.1 Labor force participation rates by sex and age. Data are 1995 estimates. Source: ILO 1986 with ILO data updates.

and ultimately set up an independent business. Figure 3.2 provides a snapshot of the working-age population in one country, Malaysia, showing how time allocation varies by age and sex.

But the conventional definition of “work” mischaracterizes relative effort, because time allocated to household activities other than agriculture is rarely counted. In almost all societies most households assign to women the bulk of child-rearing and home management. Microeconomic studies often find women working longer hours than men—especially when they are also working in the market economy.

The labor force participation of women often changes in significant ways as development proceeds. Female participation rates tend to be higher when an economy is organized around family-based production in agriculture. With economic growth and increased urbanization, participation often declines, as women stay at home while men go out to work. At still higher levels of income per capita, female participation increases again as labor market options for women increase. Patterns of labor force participation also reflect cultural and ideological differences. A combination of economic and noneconomic factors is required to explain why Japan, Romania, and Uganda have higher female participation rates than Brazil and Pakistan (Figure 3.1).

Migration

Households also must decide where to work. Migration—be it permanent or temporary, domestic or international—is largely a labor market decision: household members move to where the jobs are. Where incomes are low, working for wages often requires members of rural households to move away, either temporarily or permanently. Migration also reflects a desire to diversify income sources—households may send one person to work in the city while others stay on the family farm or in the local wage economy. Temporary migration is generally associated with seasonal jobs and may involve crossing international borders: examples include Indonesian farm laborers traveling to Malaysia, Mexican workers to the United States, and Mozambicans to South Africa.

Economic development tends over time to increase urban employment opportunities and encourage workers to resettle to the cities. This process, however, can be distorted by policies biased against agriculture and toward urban areas in the creation of jobs, the supply of public services, or both (Chapter 4). Whatever the case, migration behavior needs to be understood as a household response to opportunities elsewhere, which means that attempts to control migration can be futile or costly to enforce.

Fertility and schooling

How many children a couple has largely reflects preferences about family size. Children of poor rural households are an

Labor force participation, wage employment, and unemployment all vary by age and gender.

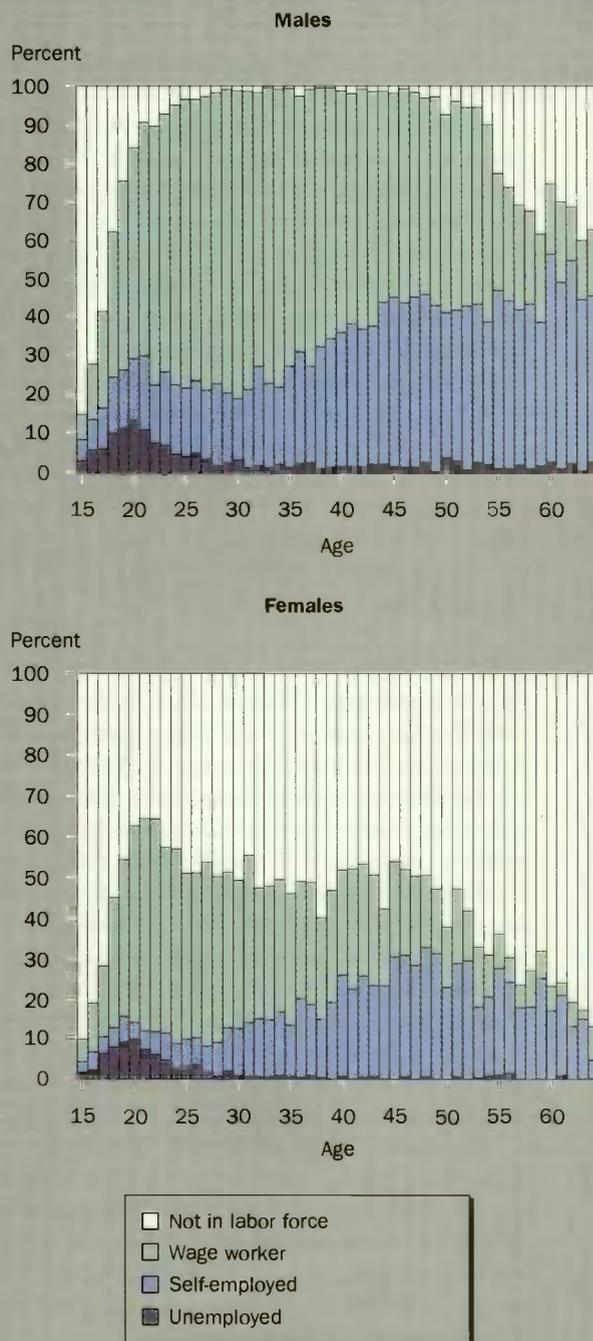


Figure 3.2 Employment status of the working-age population by sex and age in Malaysia. Data are for 1989. Source: Malaysia Labor Force Survey data.

important source of farm labor and of security in old age. With development, most families desire fewer children, as employment opportunities and the market value of a woman's time increase and women opt to have fewer children. At the same time, rising incomes decrease the economic value of children as family workers and as a substitute for either public or more formal private systems of income security, including old age support.

As wealthier parents choose to have fewer children, they also invest more heavily in them, especially in the form of more education. In most countries girls get less education than boys—substantially so in South Asia and the Middle East—but in some regions, notably in Latin America, girls actually get more education. Less schooling for girls reflects fewer economic opportunities for women, as well as direct cultural influences. A feature of East Asian development was a rapid expansion of the education of girls as well as boys, bringing benefits to the next generation. More-educated mothers generally devote more household resources to the nutrition and upbringing of their children and give higher priority to their education. The cumulative effect of these household decisions is a slower growing and increasingly skilled work force—after a lag of some fifteen to twenty years.

Dealing with risk

A pervasive concern of households is how to manage the risks they face, whether of crop failure, unemployment, ill health, or incapacity in old age. Part of a household's strategy for allocating its labor time involves dealing with the risks of temporary or permanent falls in income. Even poor working households find ways of dealing with economic uncertainty and succeed in having much less variation in consumption than in income. This is achieved by a variety of mechanisms—the reallocation of labor time, fertility and marriage decisions, financial savings, transfers within the family or from the community, or borrowing. Fertility decisions, for example, are partly a function of the perceived risk that some children will die before reaching adulthood, jeopardizing parents' primary source of old age support.

The extent to which the allocation of labor responds to a strategy of risk management varies with the alternatives available. In Botswana and elsewhere it has been found that households decide how to allocate their members' time working at home and in other towns (or abroad) on the basis of reducing risks. With economic development, households tend to allocate more time to market-based activities. Labor market-related risks, particularly that of unemployment, become relatively more important.

Employment relationships

Half the world's workers are self-employed or work in family enterprises. But as economies grow, more workers work

for wages, and employment relationships become increasingly formal, varied, and complex. Many forces typically come into play in eliciting and monitoring effort, sharing risks, and ensuring fairness. Arrangements that work well at one stage of development may not function later as the economy evolves.

The predominant form of labor organization in traditional economies is the family enterprise, typically a farm. Its main advantage is that the household reaps all the gains from its activity, so that all members have a direct interest in working productively; the disadvantages are small size and limited resources. Economies of scale are not important when most of production is agricultural; even where new techniques involving mechanization initially confer advantages on farms of larger size, rental markets usually develop that allow small farms to make use of them. Larger farms usually do have better access to credit, but this is generally outweighed by the advantages family farms have in eliciting effort. Family farms and other small-scale enterprises remain efficient forms of labor organization for much production in poorer societies.

Even where family farms and household enterprises predominate, other types of employment relationships coexist. The simplest form of labor contract is for purely casual work, for example by fruit pickers, taxi drivers, and temporary workers. In this part of the labor market productivity is easily measured, and piece rates are acceptable to workers and employers as a fair system of rewards. Demand for this labor is a function of the value of a worker's contribution to output, while supply depends on how much individuals value their time (or what they can earn elsewhere). As employment opportunities expand, this type of labor service becomes more specialized, and often a prearranged payment for services is required to secure labor supply at the appropriate time. Labor contractors emerge as important actors in this context, as they did in the fruit industry boom of the 1980s in the north of Chile. These entrepreneurs have been essential to a labor-intensive industry located in a sparsely populated area. They contract with farmers, act as employment agencies, and contribute to the flow of information across labor markets of neighboring regions.

Implicit contracts

Studies of rural labor markets in developing countries find that subtle social and economic forces often influence wages. In poor villages wages may be set at a level that ensures that workers have enough to eat to work effectively. More commonly, wages will be set for a given task for a season, and considerations of what is fair may apply. Studies in India find that daily wage rates in particular rural areas are strikingly uniform for workers of the same sex, despite differences in individual productivity. Wages do vary for different tasks, which are season-specific, but they do not

directly reflect productivity. Instead more-productive workers tend to get more employment, while less productive ones have less employment in slack seasons. Such contracts contain incentives to reward effort and often have an element of risk sharing. Sharecropping contracts are popular for the same reasons, but they are more likely to be used where monitoring costs are high or where the relationship between effort and productivity is tenuous.

Formal contracts

With rising income per capita and industrialization, informal arrangements and small-scale production become less useful. Most manufacturing and many service activities exhibit greater economies of scale, in either production, marketing, or finance, than agriculture. In addition, workers are hired not just to accomplish a strictly contained task but to become part of a coordinated effort. They must be trained and given responsibilities, challenges, and incentives. Considerations of eliciting effort, concerns over risk, and social norms continue to interact with technology to produce the outcomes observed in the labor market, but this is increasingly resolved through formal contracts between employers and employees.

Formal labor contracts typically provide a framework for joint investments by employers and workers. Firms value a trusted and well-trained work force that knows the specific characteristics of its production process. They therefore devote resources to recruiting and training a work force tailored to their needs and offer incentives to those who remain loyal. Workers in turn value the security of a regular wage. Some firms offer “efficiency wages”—wages set deliberately above the market wage—to raise the cost of job loss to the worker and in return obtain, keep, and motivate good workers. The specifics of formal labor contracts must conform with a larger system of statutory workers’ rights that typically governs labor relations in modern economies, covering minimum standards, union membership, and job security. We return to these issues in Part Three of the Report.

Unemployment

For almost half his fifty-two years Maciek was employed at the Star Truck Factory in Starachowice, Poland. Under new management the factory is being restructured, and he was among a thousand workers who lost their jobs. At his age and with his limited skills, Maciek will have great difficulty in finding a new job.

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N’golo, a landless peasant living near Korhogo in northern Côte d’Ivoire, works fifteen hours a week on average. He would like to work more hours to improve his family’s standard of living and pay for his children’s education. But except in harvest season there is not enough work.

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Zeba graduated three years ago from Dhaka University in Bangladesh. Nearly all of her male classmates have found work, but despite searching hard for a job in Dhaka, Chittagong, and her home town of Khulna, Zeba has had no offers. Employers prefer to hire men, believing they will be more committed to their careers.

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Households supply labor, employers demand it, and this interaction along with self-employment and household production yields the employment and wage outcomes we observe. But many who want work cannot find it. Unemployment takes many forms, as illustrated by the contrasting stories of Maciek, N’golo, and Zeba. All involve human cost. The causes of unemployment are complex and often unrelated to the level of development. The difference between French and Japanese unemployment rates (11.6 and 2.5 percent, respectively, in 1993) clearly is not the result of differing incomes. But development does have an important impact on how unemployment manifests itself and is reported in official statistics (Box 3.1).

In low-income countries, informal and formal employment together usually absorb the entire labor force, especially in rural areas. Many of these workers are not fully employed. Some may work only part of the time, putting in long hours in peak agricultural seasons but otherwise mostly idle. But the nature of production in agricultural economies is such that open unemployment—defined as those without employment who are seeking work—is relatively rare. Individuals from poor households cannot afford to be without a job, and the sharing of low-productivity work in agriculture is widespread. But while open unemployment is low, underutilization of labor is pervasive. In Ghana rural laborers work on average only twenty-eight hours a week, whereas in Viet Nam nearly 10 percent of the labor force works less than fifteen hours per week, even though many of them would choose to work more. In Bangladesh the Bureau of Statistics estimated that nearly 43 percent of the country’s labor force was underutilized in 1989.

In almost all countries there is underutilization of human resources—people who want to work cannot find as much work as they would like. In poorer, rural areas this mainly takes the form of seasonal underemployment. In urban areas one manifestation is that of the discouraged worker, who has given up searching for work. (In South Africa total unemployment of blacks is close to 40 percent, almost three-quarters of whom have given up even looking for a job.)

Over the course of development, and reflecting the structural transformation of the economy, the concentration of unemployment shifts from underemployment to some form of more open unemployment. This transition is

Box 3.1 What is unemployment?

Who are the unemployed? They include rural workers in Côte d'Ivoire and landless laborers in India who can find no work in the slack season; Polish steelworkers and Dutch longshoremen who have lost their jobs to sectoral shifts in the demand for their skills; members of the underclass in the United States and a generation of young workers in South Africa who have been unable to secure jobs or have been denied access to them; Egyptian university graduates and former civil servants in Nicaragua whose expectations for good jobs have failed to materialize and who are being supported by their extended families until suitable openings arise.

How many are unemployed? Most reported unemployment rates refer to the standard recommended by the International Labour Office (ILO): persons above a specified age who during the reference period (for example, the past week) are without work, currently available for work, and seeking work. By this definition the unemployed usually account for a relatively small percentage of the working-age population, although during acute episodes of adjustment—the United

States in the 1930s, Chile in the early 1980s, Bulgaria in the 1990s—recorded unemployment can involve 15 to 25 percent of the labor force.

More comprehensive measures of labor underutilization come closer to capturing the true extent of idle labor time. Such measures include discouraged workers—those who are not working and would like to, but have given up looking because of a lack of opportunities. Another group not counted as unemployed consists of those who work less than full-time, not because they choose to but because more work is unavailable. This group includes those who remain formally fully employed but who no longer report to work (China's "off-post" employees) or who have been placed on indefinite unpaid leave (a common practice in Ukraine). Because the "availability" of work is partly subjective, precise estimates of the size of these groups are especially difficult. Nevertheless, when estimates of discouraged and underemployed workers are added to those counted as unemployed, the measured underutilization of labor rises significantly (see table).

Unemployment and underemployment in selected countries

(percentage of the labor force)

Country	Year	Unemployed	Discouraged workers	Underemployed ^a
Ghana	1988–89	1.6	1.5	24.1
Viet Nam	1992–93	1.3	3.5	10.0
Ukraine	1994	0.4	..	14.5
South Africa ^b	1993	11.9	25.5	5.5
Spain	1985	17.3	2.6	4.5
United States	1991	6.8	0.9	..

.. Not available.

Note: Countries are listed in ascending order of per capita income. Except for Ukraine, discouraged workers are counted in the labor force.

a. Those working fifteen hours or fewer per week.

b. Africans only.

Source: For Ghana and Viet Nam, Living Standards Measurement Study Survey data; for South Africa, Project for Statistics on Living Standards and Development data; for Spain, *La Encuesta de Condiciones de Vida y Trabajo*, 1985; for United States, Ehrenberg and Smith 1994; for Ukraine, *Labor Market Dynamics in Ukrainian Industry in 1992–94: Results from the Ukraine Labor Force Survey ILO-CEET*, Budapest 1994, and *Statisticheski Bulletin: Rynole Truda v stranakh SNE*, Moscow 1994.

partly due to rising incomes and urbanization. As countries grow and household incomes rise, individuals can begin to afford periods without work while waiting for a job. Also, more-modern economies organize work in ways that do not lend themselves as easily to work sharing or adjustment of hours as agricultural arrangements do. However, even among countries at the same level of income there are huge differences in open unemployment. Algeria, Brazil, and Poland have very similar incomes per capita, but in the early 1990s their rates of open unemployment, respectively, were 21.0, 3.9, and 16.0 percent (Figure 3.3). To under-

stand this variation it is important to recognize the various economic forces that generate unemployment.

Open unemployment can be driven by labor supply or labor demand: it can reflect a worker's decision to reject the jobs on offer and wait for a better one; it can be a sign of mistaken expectations; or it can result from policy failures or rigidities that reduce labor demand relative to supply. Unemployment is often subdivided by type or cause. Frictional unemployment results from the normal operation of markets, is typically of short duration, and is part of the process of workers looking for the right jobs, and employers

for the right workers. Cyclical unemployment results from fluctuations in aggregate demand, and although sometimes widespread and severe it is usually temporary. Such unemployment can result in an increase in long-term unemployment if the unemployed find it difficult to reenter the work

force once growth resumes. Structural unemployment is associated with economic stagnation, malfunctioning labor markets, or policy failures. It typically is of longer duration. Its elimination requires not only a recovery of aggregate demand, but also tackling problems of skill or geographic

Even among countries at the same level of income there are huge differences in unemployment rates.

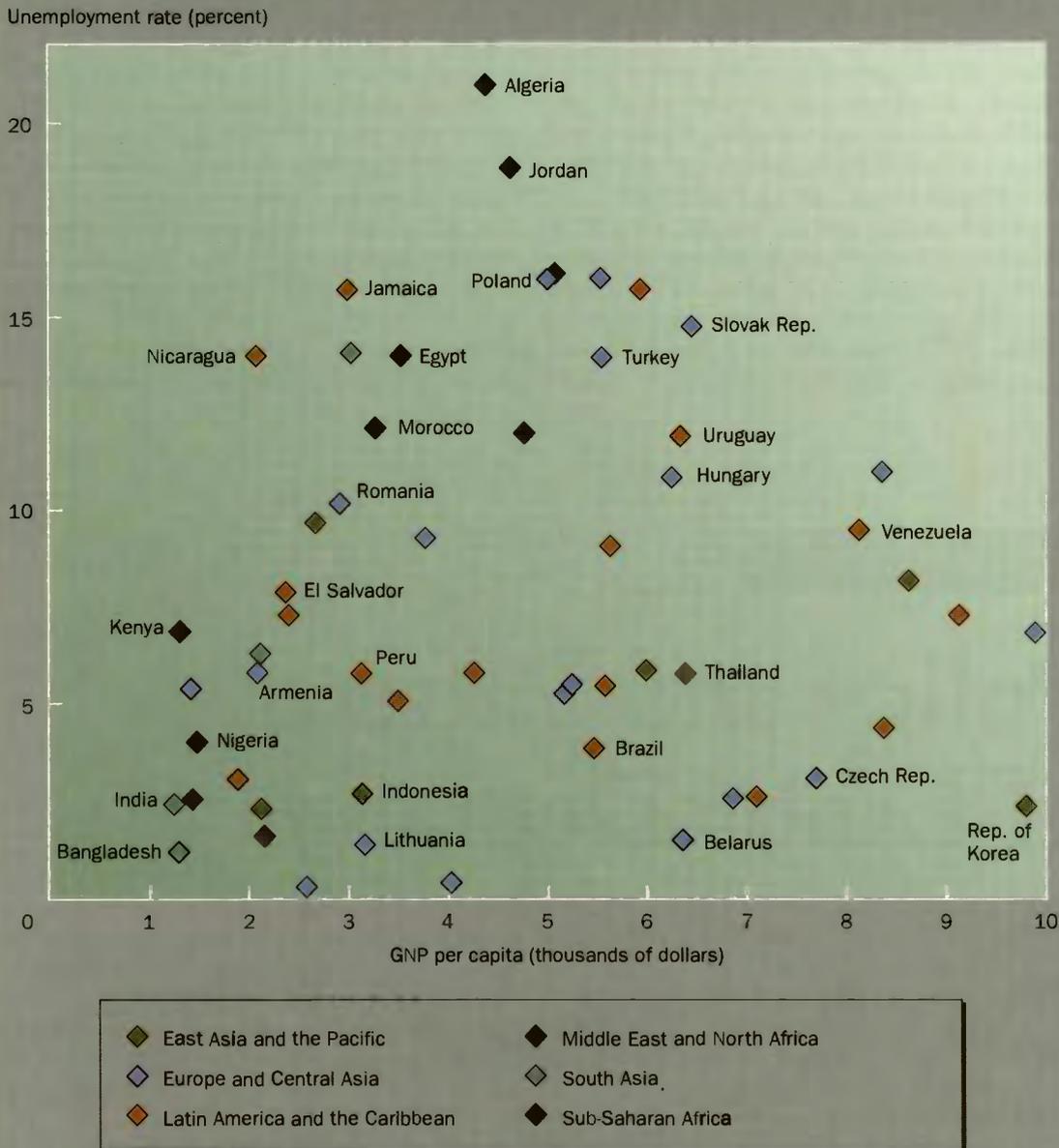


Figure 3.3 GNP per capita and unemployment. The sample consists of fifty-seven low- and middle-income economies. GNP per capita is in 1993 international prices. Unemployment data are for various years in the late 1980s and early 1990s. Source: EBRD 1994; ILO 1994; World Bank data.

mismatch between jobs and workers, eliminating rigid wage and employment practices, and upgrading the skills of workers.

Recent trends in unemployment are especially troubling. Despite a steady recovery in the world economy, open unemployment has grown in many countries. In Europe the persistence of high unemployment rates during the 1980s is believed to have been caused by a combination of weak growth in labor demand, real wage rigidities in the face of declining demand for unskilled workers, a welfare system that gives its beneficiaries disincentives to accept jobs, and restrictions in some service sectors that have held back employment growth.

Unemployment is particularly severe in many of the former centrally planned economies, where many enterprises, exposed for the first time to the discipline of markets, have been forced to cut back production or to shut down altogether. In Bulgaria, Hungary, and the Slovak Republic, officially recorded unemployment was negligible as recently as 1989. But by 1993 all three confronted open unemployment rates of between 12 and 16 percent. However, not all economies facing transition have had the same experience. In Belarus, the Czech Republic, and Russia open unemployment remains in single digits, although many workers

in Belarus and Russia are effectively laid off or working part-time.

During the 1980s growth in modern sector employment stagnated in many poor countries in response to reductions in aggregate demand and public enterprise restructuring. In urban centers open unemployment grew as new entrants to the labor force and displaced workers failed to find work. Once viewed as a luxury, available only to better-off young people waiting for a modern sector job, unemployment now affects all social classes.

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Economic development brings new and rapidly changing opportunities to participants in the labor market. Progress depends on the willingness and capacity of households to save and build up their productive assets, the willingness of entrepreneurs to organize productive factors so that gains from specialization can be achieved, and the willingness of governments to enhance rather than discourage these endeavors. Economic growth makes labor services increasingly expensive, inducing households to choose alternative ways of managing their time, and employers to discover better ways of organizing production. But these interactions are not perfect, and often many workers find that their labor is underutilized and their incomes are low.

CHAPTER 4

Policy and Patterns of Labor Demand

ECONOMIC DEVELOPMENT MEANS DRAMATIC changes in the structure of employment and enormous increases in productivity. The pattern of work in traditional industries changes as the rising cost of labor, together with technological advances, encourages new methods. Meanwhile job opportunities expand in services and industry, as employment in agriculture declines and workers move to urban areas and from the informal to the formal sector. Workers have prospered more when the process of productivity upgrading and labor transfer has been based on market realities. Attempts by governments to force the pace of change by protecting industry and formal

employment have proved unsustainable and often counterproductive, slowing economic growth, depressing labor demand, and encouraging informalization.

This chapter seeks to explain why productivity growth changes the pattern of employment. It then asks how policy choices can help or hinder a process of labor-demanding growth and structural transformation.

The transformation from low- to high-productivity activities

Productivity growth and rising real wages change the way economies work. As skills and capital become more abundant, countries find it economical to use their labor to pro-