eralization was accompanied by several large devaluations of the cedi and by an adjustment in macroeconomic policies so as to reduce inflation. The result was a real devaluation, which provided a major impetus for the growth of exports and cushioned the impact of reduced protection on the import-competiting sector.

A fifth dimension of policy design concerns the political economy of reform. Experience shows that the key to successful adjustment is a credible commitment to moving away from an old, bad development path to a new, growth-friendly equilibrium. Governments must gain this credibility, not simply by repeating the mantras of the International Monetary Fund and the World Bank, but by following a consistent approach to reform.

A credible and sustainable reform program requires that government, capital, and labor perceive a common interest. Winning the support of organized labor is critical, especially if, as is sometimes the case, unions represent only that part of the labor force that was relatively privileged before the transition and may have a vested interest in impeding reform. Making the long-term gains from reform explicit can help build support for change, as can mechanisms that precommit the government to follow through with the reforms and prevent it from reneging on its promises. In Israel and Mexico during the 1980s, all-encompassing social pacts helped gain broad support for reform. Such pacts may also play an important role in South Africa in the 1990s. Social pacts can provide a vehicle for labor, employers, and governments to reach some consensus on the reform package as a whole and on the tradeoffs involved. They can also help break nominal price-wage inertia. But social pacts have important drawbacks. In particular, there is a conflict between the coordinated wage adjustments that social pacts bring and the strong need for relative wage flexibility and labor reallocation during restructuring. To resolve this conflict, countries that have centralized union bargaining may want to move quickly to a decentralized arrangement once they achieve stabilization. In early 1995 Mexico moved in that direction—perhaps belatedly—by terminating centralized wage agreements in favor of decentralized bargaining.

Over the past two decades many developing and former centrally planned countries have undertaken major shifts in their development strategies. Two features have dominated these shifts: a move toward export-oriented policies and open markets, and a reassessment of the role of the state. These long-term changes pose unique challenges to the functioning of labor markets. They require an acceleration of the redeployment of labor from unviable sectors to expanding ones. And they involve coping with sharp, transitory drops in the demand for labor nationwide. How labor fares during these periods of major change depends on how successfully countries manage these two tasks. Although initial conditions matter greatly in easing the adjustment process, so do policy choices about the timing, pace, and sequencing of reform.

CHAPTER 16

Winners and Losers

WORKERS SUFFER DURING THE wrenching transition from a failed development strategy, even if in the long run they benefit from the change. The poor may find it especially difficult to cope with the falls in wages and employment that tend to occur during the transition. Sometimes women are disproportionately affected. And the pain can be deeply felt if the transition is accompanied by recession or if the renewal of growth takes longer than expected.

Are the burdens that stabilization and reform programs place on workers an inevitable cost, or are they evidence of the programs’ flawed design? Many observers—from union spokespersons to some international and nongovernmental organizations—argue that, in developing market economies and former centrally planned economies alike, structural adjustment policies are too preoccupied with inflation and fiscal balance, and with deregulating and liberalizing markets, and too little concerned about the immediate impact on workers. A review of the evidence certainly suggests
that labor does suffer during adjustment, and maybe worse than other groups. But are there effective alternative policies that would better suit the interests of workers? This chapter examines the distribution of the burdens of transition and the claim that adjustment policies are not in labor's best interest.

**Adjustment, labor, and the poor**

Transformations involve profound structural reforms. They create new opportunities as well as new risks, which will necessarily generate winners and losers. But in moving labor to more productive uses, structural change eventually increases output and the returns to labor.

Labor does tend to suffer during the initial period of adjustment, and possibly more than capital. But most often it is not because the design of the adjustment policies is flawed, but because adjustment occurs simultaneously with—or is triggered by—a macroeconomic crisis, followed by a sharp drop in aggregate demand. Labor is less internationally mobile than capital and thus less able to leave when the domestic economy declines (see Chapter 9). So when an economy crashes, labor is likely to bear the brunt of the shock, while capital flees. But it is usually the aggregate demand shock, not the ensuing adjustment, that hurts labor.

Adjustment can pay off for labor, despite temporary declines in employment and real wages, as the experience of adjusting African countries during the 1980s demonstrates. Of twenty-nine Sub-Saharan African countries examined in a recent World Bank study, the six that went furthest in undertaking and sustaining major policy reforms enjoyed the strongest resurgence in economic growth. Between 1981-86 and 1987-91 these six countries experienced a median increase in annual growth of GDP per capita of 2 percentage points. The countries that did not undertake adjustment saw their median growth rate fall to −2 percent a year. Although data on wage and employment trends in Africa are scarce, evidence from two adjusting countries—Ghana and Tanzania—reveals that both employment and wage performance improved following structural reform. During 1985-92, employment in Tanzania grew at an average annual rate of 6.1 percent, up from −1.5 percent during the first half of the decade. In Ghana real earnings in the private sector almost tripled between 1983 and 1988, following the reforms.

In Latin America the poor certainly suffered during the macroeconomic crisis, but largely because of past policy mistakes, not because of the adjustment policies themselves. Rising poverty in Brazil and Peru in the 1980s was due to lack of adjustment and economic decline. In some Latin American countries there is evidence that inequality rose in recessions and fell in recoveries (Figure 16.1), but this appears to be an inherent feature of the business cycle—as it is in some industrial countries—and not of reform. In Chile there is some evidence of rising wage differentials among workers of different educational attainments until 1992, but rapid growth in wages and employment clearly brought substantial benefits for all Chilean workers.

The transition has been associated with rising inequality in the former centrally planned economies. Inequality under socialism was very low, but market economies require some inequality to function efficiently: wages must differ if investments in skills and experience are to be rewarded. An increase in inequality was thus an unavoidable—and indeed a desirable—consequence of the move from central planning toward a market system. In the Czech Republic, Poland, Slovenia, and eastern Germany increased inequality has largely resulted from rising relative returns to the highly educated. There has been little or no change in the ratio between the wages of the lowest-paid 10 percent of workers and those of the median worker.

The transition to the market has meant an increase in the ranks of the poor in all the former centrally planned economies. Increases in poverty have been large in Belarus, Lithuania, Moldova, and Russia. The incidence of poverty is likely to fall with economic growth, which has already resumed in several transitional economies. The poverty that occurs during the transition should thus not become permanent for most of those who fell into it. Only those with poor educational qualifications that prevent them from adapting to the new system are likely to remain poor.

The worst scenario for poor workers is a reform that starts and then falters. In countries that abandon reform midway or get stuck between paths, living standards often fall dramatically and stay low. In Côte d'Ivoire in 1984-86, sustained economic growth resulting from an attempt at structural reform and from buoyant cocoa and coffee prices led to substantial reductions in poverty. But when the country's terms of trade collapsed in 1986 and the government abandoned reform, GDP growth plummeted and poverty soared, erasing the earlier gains. Between 1985 and 1988 the share of the population living below the poverty line increased from 30 percent to 46 percent. Another example is the Philippines in the early 1980s, where inflation and a misaligned exchange rate caused the poor to suffer and prevented them from achieving any gains. And in Ukraine in the early 1990s, hyperinflation, continued restrictions on foreign trade, and a sluggish response in the private sector pummeled the poor without delivering on the promise of quick improvement.

Recession, unemployment, and falling wages all hit the poor very hard in the early phase of transition, but the structural reforms that constitute the real transformation are good for poor workers, even in the short run. Trade liberalization and real depreciation of the currency together promote exports, which tend in developing countries to be
intensive in less skilled labor. And private sector development often means the growth of new businesses in labor-intensive sectors. Because tradable goods account for a smaller part of the consumption baskets of most poor people than of the well-off, the rising relative prices of imports affect them less.

In former centrally planned economies, however, these short-run effects can work against the poor. Housing, utilities, and public transport were almost free under the previous system, and food was subsidized, whereas most imported goods were unavailable or available only at very high prices in the black market. With trade liberalization, exchange rate adjustment, and cuts in subsidies, imported goods become less expensive or available for the first time, while prices of utilities, food, and housing increase.

Who bears the burden of major changes?
Most households depend largely on their incomes from work. Therefore household living standards during periods of major change are closely—although not exclusively—tied to what happens in the labor market. But looking at wages alone can be deceptive, because a number of other factors influence current standards of living, such as labor force participation rates, rates of personal saving, the variety and quality of products consumed, and formal and informal income transfers (Box 16.1).

The demand for labor has fallen in almost all episodes of transition and adjustment (except perhaps in those of China and Viet Nam) as a result of some combination of macroeconomic decline and labor redeployment. The reduction is most pronounced in sectors that are no longer economically viable. Almost no adjusting economy entirely escapes a temporary decline in real wages and increase in unemployment, but the size and duration of both effects differ from country to country. What ultimately makes the difference is how many new jobs are created and how quickly—and that depends on the speed and credibility of reform.

How workers and households react to the shift in the pattern of labor demand depends on the age, sources of income, and employment status of the worker and on the size of the household. Where there is support for workers during spells out of work, whether in the form of income transfers from the state, from other household members, or from other households, the proportion of the working-age population that is out of work typically rises. The rise in the number of people out of work can take the form of increased unemployment, early retirement, or other withdrawal from the labor force (for example, the discouraged-worker effect).

In most countries in Central and Eastern Europe unemployment has reached levels well above 10 percent (it has risen above 15 percent in Bulgaria and Poland). At first inspection these levels do not appear much higher than those in many Western European economies, none of which have suffered equivalent transitional shocks in recent years. But unemployment in Central and Eastern Europe would be much higher still but for the fact that large numbers of workers have dropped out of the formal labor force. Even in those countries that cut subsidies to public enterprises, forcing them to shed workers, there was little movement.
Box 16.1 Do we know how much household welfare declines in periods of major change?

Households in reforming economies can face crippling losses in welfare as both real wages and employment decline. But households do not absorb these shocks passively; they try to adapt. Households switch from wage to nonwage sources of income, particularly through increased participation in the informal sector. More women join the labor force, and other household members work extra hours to bring in supplementary income. In some countries additional income earners join the household to pool incomes and risks. And because households affected by the shocks accompanying transformation alter their consumption patterns as well, measurement problems arise in estimating wage declines. As a result, aggregate estimates of the decline in wages and employment may be inaccurate barometers of how households are faring. Studies from Ecuador, Mexico, Poland, and Zambia illustrate why this is so.

A simple way to see the discrepancy between changes in wages and changes in welfare is to look at how consumption is modified during periods of major change. In Mexico real wages dropped by 8.6 percent a year between 1983 and 1988, but private consumption fell by a more moderate 1.9 percent a year. The 32 percent drop in real wages in Poland during 1990 should be evaluated alongside the smaller 14 percent decline in consumption, according to official estimates, or the 5 percent fall derived from consumer expenditure data. In both Ecuador and Zambia, participation in the informal sector increased—from 3 percent of employment in 1988 to 21 percent in 1992 for Ecuador, and from 19 percent in 1978 to 52 percent in 1992 for Zambia. And in Ecuador, Mexico, and Zambia more women entered the labor force: in Guayaquil, Ecuador, for example, the proportion of wives working outside the household jumped from 45 percent to 90 percent during the transition years. Mean household size also increased from 4.3 to 5.3 percent in Zambia, while in Ecuador the proportion of extended households rose from 33 percent to 38 percent.

Welfare is notoriously difficult to measure. The Polish data do not account for the improvement in product variety and quality during the transition or for the relief from long waiting lines. On the other hand, the data for Ecuador and Zambia cannot capture the increased crime and violence, even within households, that accompanied the fall in living standards. None of the data reveal the extent to which household members, especially women, have to work longer hours (in and outside the home) to make ends meet. Certainly, formal wage and employment data reveal only a small part of the picture.

Among workers who remain employed, the effects of reforms can vary greatly. Table 16.1 looks at who wins and who loses in transitions. Workers are grouped by their participation in the formal or the informal labor market, place of residence (urban or rural), sex, and skill level. The effects of transition on each group are compared with the effects on the average worker across the four broad categories of countries identified in Chapter 15.

Formal and informal sectors

Shifts from formal into informal employment are as important a feature of labor market adjustment as the increase in unemployment rates, especially in countries with no safety net or unemployment insurance. Informal employment tends to swell during adjustment, as workers laid off in the formal sector seek new jobs, and women and other household members find outside employment to help offset declines in household income. This informalization of employment has characterized both former centrally planned economies, where the informal sector was underdeveloped, and Sub-Saharan African and Latin American market economies, where the informal sector was already highly developed but the formal sector suffered steep declines. Surveys in September 1994 showed that more than a third of
the Polish labor force worked full- or part-time in the informal sector and that 46 percent of the unemployed were in fact employed full- or part-time in informal sector activities. Conservative estimates for Mexico place informal sector employment at 25 to 40 percent of total employment, and growing 9.5 percent a year between 1983 and 1988. Similarly, in Brazil employment in the informal sector swelled by nearly 30 percent during the recession of 1981–83, while private formal sector employment declined.

Workers in the informal sector have generally fared better than those in formal employment during major transformations. Evidence from former centrally planned economies suggests that informal sector workers did better during the initial stages of transition. In Poland, for example, informal sector wages were initially several times higher than formal sector wages—in part because workers and employers operating in the informal sector were earning high profits outside the taxed economy, and in part because these workers were moving into new, profitable sectors where demand was extremely high. This differential has since shrunk, and informal sector wages are now heading below those in the formal sector. In parts of Sub-Saharan Africa, too—for example, in Côte d’Ivoire—adjustment hit workers in the formal public sector harder than those in agriculture and informal urban employment. But in much of Latin America self-employed urban workers—particularly those in the informal sector—saw their position erode relative to that of formal wage workers. During the 1981–83 recession in Brazil, for example, the ratio of formal to informal sector incomes increased by 7 percent. In the Asian agrarian countries the picture is more diverse. At one extreme is China, which has protected workers in the formal sector and postponed reform of state-owned enterprises. At the other extreme, Viet Nam has gone through a dramatic state enterprise reform since 1989, shifting about one-third of the 2.4 million employees in that sector to the private sector. Overall, even though formal sector workers in the Asian countries may have lost ground relative to informal sector workers, the welfare of both groups has risen in absolute terms.

**Rural and urban areas**

In almost all countries the poor are most numerous—and poorest—in rural areas. But poor rural households have often benefited from adjustment. Although workers in agriculture are affected by macroeconomic decline, they are typically better shielded from the effects of a shrinking public sector than workers in urban areas. And in many countries they have benefited greatly from the removal of the pro-urban biases that pervaded the old, protected, import-substituting regimes. Where price changes improved the terms of trade for rural workers, rural households gained even before the overall economy started to grow. In Ghana agricultural real wages rose by 27 percent, whereas wages in nontradable-goods sectors (mainly commerce) declined by about 22 percent following adjustment. In Latin America and Asia the rural population also benefited in relative terms during the adjustment period, even though poverty remains concentrated in rural areas. Only in the former centrally planned economies of Europe do rural households appear to have suffered more in relative terms during the transition, as policies of agricultural protection were discontinued.

**Women**

The position of women in periods of major change deserves special attention because of the increased demands they face in periods of crisis. On top of their usual household responsibilities, women are typically called upon to help sustain household incomes when the wages of male heads of household fall. When employed, women are often more vulnerable than men, disproportionately concentrated in low-wage sectors or occupations and often segregated into the informal sector. Not surprisingly, their relative position has often deteriorated during structural adjustment.

In Latin American adjustment episodes the hourly earnings of women declined even more dramatically than those of men, partly because women were concentrated in the informal sector and in hard-hit low-paying sectors such as apparel. But women in poor households also exhibited strong increases in labor force participation—what is often called the “added worker” effect. In Ghana women working in the informal sector also saw their wages decline, as excess labor released from formal employment moved into informal activities. Women were further affected by a shift in resources away from food crop agriculture—where women predominately work.
nate—toward cash crops. In Côte d’Ivoire women’s relative lack of education placed them at a disadvantage, and in Egypt women were hurt by lengthening waiting lists for government employment and by their more limited private sector alternatives. Women played a distinct role during the transition in Asian countries as well. Although Vietnamese women faced particular challenges resulting from the collapse of childcare services provided by cooperatives, their overall position improved in line with economic growth, and female-headed households are now no poorer than those headed by men.

The evidence on the effect of adjustment on women in the former centrally planned economies is mixed, but their situation is clearly not as gloomy as is usually portrayed. On the one hand, women have shifted out of the labor force at a higher rate than men, starting from very high participation levels compared with other countries. They also exhibit slower transition rates out of unemployment. On the other hand, studies in the Czech Republic and Slovenia indicate that, when individual characteristics are controlled for, women have actually gained relative to men in both wages and employment, either because women are better educated (and returns to education have risen) or because they disproportionately occupy jobs in sectors that have been hurt less by labor demand shocks, especially services and labor-intensive industries.

Skilled and unskilled workers
The burden of adjustment falls most heavily on the unskilled and uneducated in both former centrally planned and market economies in transition. These workers are more vulnerable to structural change because they are less able to adjust to a changing environment and to take advantage of new job opportunities. In former centrally planned economies there is a strong inverse correlation between skill levels and the probability of sliding into poverty. The relative position of manual workers and low-skilled clerical staff, often with only a vocational education or less, has deteriorated more than any other group during the transition, whereas returns to education increased sharply in Slovenia and Poland. In some market economies such as Chile and Mexico the relative wage structure has also shifted in favor of the more highly skilled, possibly as a consequence of trade liberalization. In Viet Nam and Mongolia the largest wage gains have taken place in the booming services sector, which employs increasing numbers of skilled workers who have moved out of the shrinking industrial sector.

Severe shocks to the economy can create opportunities for some workers and have wrenching effects on others. Transformation follows diverse patterns in different countries, but it always involves a marked acceleration in the destruction of unviable jobs and the creation of new ones. That process is almost always accompanied by macroeconomic decline, requiring a reduction in the demand for labor and a fall in real wages. The net effects are often large drops in labor incomes, rising unemployment, and a shift from the formal to the informal sector. Even the best-designed reform produces gainers and losers in the short term, with losers particularly concentrated among the unskilled and formal sector workers in urban areas. Moving the economy as quickly as possible to the new growth path is key to limiting welfare losses, whereas giving up halfway hits poor workers hardest.