Chapter 5

THE IMPACT OF GOVERNMENT POLICIES ON URBAN EMPLOYMENT IN SMALL ECONOMIES

Gary S. Fields
Chairman, Department of Labour Economics
Cornell University

Comments by
Pang Eng Fong and Friedrich Kahnert

For our purposes, a small economy is essentially a price-taker in world markets. Large developing countries (India, China, Indonesia and Brazil) are therefore excluded.

Before turning our attention to various policies, a number of issues need to be clarified. First, should we consider just direct employment policies, such as public sector employment and fiscal incentives for private sector employment, or should we also address other policies which have an important bearing on employment, such as trade and industrialisation strategies and wage policy? In my view, the latter policies are more important.

Second, to what extent can we talk about specifically urban employment policies? Most policies, including those mentioned, have both urban and rural components. Furthermore, even policies which are explicitly rural or urban have effects on the other sector because of rural-urban migration and other such interconnections. It is therefore better to consider the effects of government policies on labour market outcomes more generally than to restrict our attention to urban employment *per se*.

Third, in considering employment, do we wish to talk only about the fact of employment (that is, the number of persons who are working, using some standard definition of employment) or also about the returns from employment? It is well known that many of those counted as employed earn unsatisfactory amounts, while many of those counted as unemployed are without work because they have forgone employment in poorly paying activities, whether in the urban traditional sector or elsewhere, and instead have gone on searching for better jobs. The fact of employment is interesting, but so too are the composition of employment and the wages paid.

Most of the policies intended to affect urban employment are not specifically employment policies nor are they specifically urban. Rather, the amount of urban employment, the composition of that employment, and the returns from it are determined

by a whole host of policies. To review them all in a short paper is an impossible undertaking. The criterion by which I decided which policies to consider is policy-relevance, asking which set of policies is apt to have the largest impact on employment.

Given the available policy options in today's world economy, what should the government of a small developing country do to improve urban employment opportunities (by which I mean more and better jobs)? No completely general policy prescriptions can be given, because the right set of decisions for a particular country depends upon that country's typology, its circumstances, the political constraints it faces, etc. Nonetheless, by understanding what has worked elsewhere in what circumstances (and also what has not), policy-makers may gain insights into possible actions they might undertake. Accordingly, the central questions addressed in this paper are: What lessons from abroad might an economic planner in a small country find informative and potentially helpful in choosing policies to help improve employment conditions? What should small developing countries do?

My conclusions can be summed up as follows. Those government policies which have the most important impact on urban employment operate on the demand for labour, not labour supply. Labour demand is strongly influenced by economic growth, which in turn reflects countries' trade and industrialisation strategies. The efficacy of export-oriented growth for employment creation depends, among other things, on the type of product produced and the country's wage and other labour market policies. Labour-intensive, export-led growth remains a viable option. Trade strategies and labour market policies must be chosen accordingly.

I. LESSONS

At the risk of overstating certain conclusions which hold true in many but by no means all developing economies. The major patterns I see emerging from empirical studies are:

1. *Typically, employment of unskilled workers in modern sector jobs is constrained by the demand for labour, not the supply. Policies to increase urban employment must address the demand side of the labour market*

It is by now commonplace to observe that the rate of growth of the labour force in developing countries far exceeds the rate of growth of modern sector employment[1]. Given that wages usually are higher and working conditions better in modern sector urban jobs than elsewhere, it follows that in general, the supply of unskilled labour to the modern sector in developing countries is abundant. (Whether these workers have satisfactory training and employment characteristics is, however, another question.)

If employers seek to hire more workers for unskilled modern sector jobs in urban areas, the supply of labour will not in general pose a constraint. Not only will the labour supply within that labour market prove adequate, in all likelihood, more workers will try to get those jobs. Some will come from the urban informal sector, others from rural

areas. But in either case, workers will be willing to move to the urban modern sector, because they improve their economic positions by doing so.

What constrains employment in most places is thus not the supply of labour but the demand for labour. A wide variety of development models, including those of Lewis (1954), Jorgenson (1961), Fei and Ranis (1964), and Harris and Todaro (1970), assume this. These models demonstrate the empirical fact that in many developing economies, employment in urban areas is as low as it is because employers do not wish to hire any more workers. Their wishes to hire workers are not, in general, frustrated by inadequate labour supply; the quantity of labour demanded is restricted by the non-availability of complementary inputs.

If inadequate demand for unskilled labour is the principal problem, policies to increase the demand for that labour are the principal remedy. Demand-side policies are the focus of attention in the current literature on the employment problems of Africa, Latin America, and South Asia, as indeed they should be. These policies are treated at length below. Nor is this policy focus new: precisely that conclusion was reached by Turnham and by Little, Scitovsky and Scott in their work for the OECD Development Centre at the beginning of the 1970s.

It should be noted, however, that the Newly Industrialised Countries (NICs) of East Asia have a different employment problem. In Hong Kong, Korea, Singapore, and Taiwan, essentially full employment was attained in the 1960s. Among scholars working on those economies, there is some debate about the precise timing of the turning points from labour abundance to labour scarcity. Nonetheless, all agree that the turning points have long since occurred. Now that labour is scarce in those economies, the primary economic development problem is how to enhance the productivity of that labour to sustain economic growth. The policies being pursued carry such ambitious labels as "structural transformation", "productivity enhancement", "economic restructuring", and even a "Second Industrial Revolution". In those four economies — notable for their success but atypical of developing countries as a whole — the problems are different and consequently so too are the policies to deal with them[2]. But for the rest of this paper, given its importance in most of the developing world, the problem of how to increase labour demand will be the primary focus.

2. *In many countries, economic growth has increased urban employment. Recession has halted or reversed the growth in employment. Therefore, seek economic growth*

One of the clear stylised facts to emerge from the patterns of growth literature of Kuznets, Chenery, and others is the tendency for economic growth to change the structure of labour utilisation in an economy. As an economy grows, larger proportions of the economically active population are engaged as wage and salary employees and fewer as self-employed or unpaid family labourers. The percentages of the labour force employed in industry and services tend to increase and the percentages employed in agriculture and other "primary" activities tend to decrease as the economy grows. Accompanying these changes is a tendency toward urbanisation of employment, with the locus of economic activity shifting from rural to urban areas. These patterns led to the expectation that economic growth would result in increased employment, much of which is located in urban areas[3].

However, the literature on choice of production techniques — another line of study contemporaneous with the patterns of growth work — casts doubt on the conclusion that growth would enhance employment. Economies might be in the position of having to choose between products and techniques which generate high levels of output but relatively little employment and others which are relatively labour-intensive but entail lower output. They might, for instance, have to decide between allocating their scarce capital between mineral exploitation (high in output, employing little labour) and agricultural development (labour-intensive, possibly lower output). Output-employment conflicts are therefore possible. Whether this conflict arises in practice, however, hinges on two key questions: *i)* whether factor prices in an economy are market-determined or whether "factor price distortions" render capital artificially cheap and labour artifically expensive, and *ii)* whether technologies are of the neoclassical type, characterised by smooth substitution possibilities between capital and labour or whether technological choice is limited to one or a few fixed proportions between capital and labour[4].

Of course, both suggestions from these lines of work may be right. That is, while it may generally be true that the structure of employment in an economy reflects that country's level of development, it may also be true that on the margin, firms may confront a real output-employment tradeoff.

In any event, the evidence from the preceding literature on how employment is affected by economic growth is somewhat indirect: much of the patterns of growth literature is cross-sectional, comparing employment patterns of different countries at different stages of development rather than over time, and the output-employment literature is typically more micro than macro oriented. More direct evidence on intertemporal aspects of the growth-employment relationship is obtained by looking at changes over time in different countries.

The results from the intertemporal studies are clear: in those economies that have grown rapidly, more and better jobs have been created. An early study (Morawetz, 1977: 32-38) examined open unemployment rates over time in nine developing countries. In two of those countries, unemployment declined markedly. Those were the two high-growth countries in the sample, Korea and Taiwan. Later work of mine showed that not only had the four East Asian NICs attained full employment, also, those countries' rapid economic growth had led to considerable improvements in the composition of employment, and as much as a fourfold increase in real wages (Fields, 1984; 1985). Contrariwise, slow or negative growth has resulted in stagnant or deteriorating employment conditions in many Latin American and African countries[5]. Out of seven Latin American countries that experienced economic recession in the 1980s, six had higher urban unemployment rates, five had lower real industrial wages, and none had both falling unemployment and rising wages (van der Hoeven, 1987: Table 4). This is a fairly uniform pattern of decline. But in seven African countries with slow or negative economic growth, although economic decline was accompanied by lower non-agricultural real wages in all seven cases, in six of those seven countries, non-agricultural employment in the modern sector was actually higher than before (van der Hoeven, 1987: Table 2).

The conclusion is thus that economic growth and improvements in employment conditions tend to go together, even if they are not inevitable companions. Policies aimed at achieving more rapid economic growth should therefore be sought.

3. *Outward-oriented countries generally have had better employment records than inward-looking ones. Export-led growth strategies may therefore have beneficial employment effects.*

Studies in the 1970s such as those of Little, Scitovsky and Scott (1970), Bhagwati and Srinivasan (1978), and Krueger (1978) showed that countries that adopted more export-oriented trade strategies had grown more rapidly. Another conclusion reached was that successful growth had been achieved in a variety of ways, ranging from active allocation of resources to "export promotion", to more neutral "export substitution", or even *laisser faire* kinds of policies (the terminology is from Ranis, 1981). Subsequent studies showed that the export-oriented countries had also registered much better employment records than did import-substituting countries; see Krueger (1981), Little (1981), and Balassa (1982).

These findings suggested that developing countries look outward and ask: What can we produce that other countries want to buy? It is possible that not only the national product but also employment may increase as a result. These possibilities are explored at length below.

But here, a word of caution is warranted. When countries seek to expand exports, significant resources may need to be expended. Such export-promotion measures as providing infrastructure, establishing overseas commercial offices, and granting fiscal incentives to export firms are costly. Care needs to be taken to be sure that the costs are warranted by the potential benefits. It is worse to export at a social loss than not to export at all.

4. *Export-led growth strategies have had different employment effects depending on the type of products exported. Therefore, when choosing which products to export, be careful about the type of products.*

Three types of export products may be distinguished: manufactured goods, agricultural products, and minerals. These three types of products contribute very differently to employment.

Manufactured products may be heavily labour-intensive. From the vast literature on "appropriate technology" comes the conclusion that labour-intensive production methods can be efficient both technologically and economically. Garment and assembly operations around the world are examples. When manufacturing operations in developing countries have been capital-intensive, it has often been because labour has been made artificially expensive and capital artificially cheap. But when factor prices have been determined by market forces, labour-intensive production has been the norm. A country's trade policy must be chosen with its labour market policy in mind, and vice versa.

Agricultural products are also produced with labour-intensive methods. The reason why these sectors are able to flourish is that labourers are not demanded in those countries' urban modern sectors. In Sri Lanka, for instance, workers on the tea estates and agricultural day labourers would willingly take up urban jobs if they were available, which they are not. The same is presumed to be true of banana plantation workers in Central America, sugar workers in the Caribbean, coffee pluckers in Kenya and the Ivory Coast, and paddy farmers throughout Asia. In Costa Rica, the severe economic

crisis of 1980-1982 caused a decline in urban employment opportunities, which in turn led to a movement of urban labour from the cities and back to the land.

Mineral products have typically generated the least employment. For many such products — oil, copper, tin, and bauxite among them — the most efficient technology for mining or refining the product entails a great deal of capital and relatively little labour, given any possible set of factor prices. A country which goes in for these products faces an uncertain return: the prices of mineral products fluctuate notoriously. Furthermore, the country will have to incur at least some cost, often a very large cost, in order to exploit and export these resources. Frequently overlooked in the drive for export expansion is the fact that the resources so used have substantial opportunity costs. These opportunity costs are smallest when a multinational corporation supplies its own capital for the mining and refining operation and when those resources would not otherwise have been available to the developing country in question. The opportunity costs are much larger when the country sets up its own mining operations, or when the multinational corporations come in demanding very large expenditures on infrastructure or other inputs. When a developing country uses its resources in this way, it does not have those funds available for providing social services, contributing to urban employment expansion, or developing its agricultural sector. To the extent that the required costs of resource exploitation are large, that the prices received may be low, and that the employment effects are limited, it may be better to leave the minerals in the ground.

I have distinguished here between different classes of export products because of an unfortunate tendency among less careful observers to lump exports together rather than categorising them on the basis of their growth and employment effects. If the exportation of copper had unfortunate consequences for the economic development of Chile, it does not follow that the exportation of wine or leather goods would have the same effect. Similarly, although bauxite mining had small benefits and large costs for Jamaica, it does not follow that the exportation of coffee or textiles would do likewise. These alternative products make heavy use of labour. The social benefits of producing them may be substantial.

It is downright illogical to argue, as many do, that because exporting one kind of product is socially unprofitable, that all exports are socially unprofitable. Especially in Latin America, the unfortunate tendency is to look at one's neighbours, observe that export-led growth has had a small social benefit in a number of circumstances, and to conclude that export-led growth must necessarily do more harm than good. Latin Americans would do well to look instead to the Far East, where export-led growth has had enormous employment and distribution benefits.

5. *Labour-intensive export-led growth continues to be a viable option for developing countries. Generally, foreign markets are open to their products. Policy makers in developing countries would do well to seek to penetrate these markets.*

The export-optimism which I have just articulated places me at odds with quite a number of developing country policy makers. As I read the evidence, their export-pessimism is unwarranted. Furthermore, were the smaller of the developing countries to act on their export-pessimism and pursue inward-oriented policies, they would condemn themselves to economic stagnation.

Some critics of export-oriented growth say that trade makes the developing countries vulnerable to economic conditions in the rest of the world. I would respond by saying that even the economic giants like the OECD countries view themselves as vulnerable to world economic conditions, and the small developing countries are even more vulnerable. However, a country's vulnerability to world economic conditions can be reduced if it produces profitably those goods which are in high demand in the world market. The East Asian NICs have succeeded by seeking to identify what those goods are and then producing them.

Other critics of export-oriented growth are not worried about the principle of involving developing countries in the world market. They worry about trying to get developing countries involved in *today's* world market. The principal contention is that in the stagnating world economy of the late 1980s, it would be futile to try to export, because new markets are only being created at a slow pace. Fears of protectionism are often evoked as an additional argument in support of this position.

I respond this way: the argument that it is futile to try to export when world markets are growing slowly relies on the assumption, nearly always made implicitly, that importers will maintain their traditional supply sources no matter what. This, I contend, is empirically false. As a general rule, consumers and firms have been willing to buy elsewhere if it pays them to do so. Fickleness, not loyalty, is the predominant characteristic of world product markets. It is the ability of the developing countries to supply high quality goods at lower prices, rather than an increase in world demand for these products, which has enabled those countries to grow rapidly.

Two empirical facts support this contention. The first is that the export-oriented economies of East Asia experienced much milder recessions in the early 1980s and recovered much more rapidly than did the more inward-oriented economies of Latin America[6].

The second is that developing countries have continued to succeed by penetrating export markets, even in the 1980s. Several specific examples may prove instructive.

In a few short years, a Korean automobile, Hyundai, became the number one import in Canada and quickly achieved large sales in the United States. The reason for Hyundai's success is that it saw the US and Canadian markets as potentially profitable and sought to penetrate them. Hyundai believed that the North American markets would be open to them in the 1980s even though world economic conditions were difficult. They were confident that consumers in Canada and the United States would choose their product over Toyotas or Chevrolets if Hyundais were better in quality and/or price. Those beliefs proved completely warranted. True, the time will probably come when Hyundai will be asked to impose some "voluntary" export restrictions; but when they do, their sales will have stabilized at the level of several hundred thousand units for export to each country, with all the employment this level of activity implies. Just as Hyundai did not fear to compete in autos, neither did other East Asian exporters: Samsung in consumer electronics, Wilson in sporting goods, Toshiba in computers.

One other example of successful labour-intensive outward-looking growth is that of Costa Rica. That country suffered a severe economic depression, termed "the crisis", between 1980 and 1982. Unemployment doubled and real wages fell by 40 per cent in just three years. But in late 1982 and early 1983, a macroeconomic stabilization programme was enacted. Trade policies have since been liberalised and the licensing

regulations and other economic controls established during the crisis dismantled. Incentives for export have been offered under the United States Government's Caribbean Basin Initiative. The result of these efforts is that two major non-traditional export industries - manufacturing assembly and cut flowers - have expanded rapidly. More than 15 000 new jobs have been created in these activities, adding more than 10 per cent to Costa Rica's manufacturing employment (Inter-American Development Bank, 1985).

What these examples illustrate is that world markets have in fact proved to be open to developing countries' exports in the 1980s. Employment in the developing countries is higher as a result.

What characterised these countries' successes? The shared pattern is that they produced what people in other countries were already buying. They succeeded by producing goods of comparable or superior quality at equal or lower prices. They believed that export markets would be open to them if they could do better. They looked not for sources of new demand but rather for places where they could become new suppliers.

These successes invite imitation. I do not mean by this that other countries should seek to produce the same products that the NICs are now producing. What I mean is that other countries should ask the same questions that the NICs ask themselves over and over. Here are some examples from an American perspective: Is it possible to grow cashews in The Gambia, can them, and market them in the United States for less than the going price of $7 a pound? Can lightbulbs be manufactured in the Dominican Republic and sold in the United States for less than $2.99 for a package of four? And where can footballs be made and sold to the National Football League and to collegiate and high school teams for less than they are now paying? These kinds of questions are endless. Of course, most of the time, the answers will be discouraging. Perhaps ninety-nine times out of a hundred, there will be a good reason for existing supply sources to be maintained: coffee will be produced in the tropics, aircraft in the United States and Europe, and fine wines in France. But it is that hundredth time that makes the difference.

6. *Labour demand policies will have labour supply effects. Policies to increase urban employment may result in fuller employment and higher earnings or in increased urban unemployment. Which it is depends on the economy's wage structure and job-search institutions. Urban employment policies must be chosen accordingly.*

Policies to increase the demand for urban labour and hence urban employment will assuredly affect the supply of urban labour. Workers make realistic, informed choices. The way in which they choose among various labour market options can be predicted from the structures of employment and earning opportunities in different parts of the economy (see, for example, Todaro, 1976). The notion of the irrational, tradition-bound peasant has been laid to rest (for instance, in Schultz, 1980).

We have learned that if more good jobs are created, more workers will come to try to get those jobs. How the supply is affected — whether a new job is given to someone who previously was unemployed or underemployed, or whether it alternatively induces additional unemployment — depends upon the structure of the labour market and, in particular, the economy's wage structure.

Consider first an economy with a single unified wage structure such that urban and rural wages are effectively identical. This may arise in either of two circumstances: in those countries which are so small that spatial wage differentials could not persist in so small a geographic area; and in those countries which lack the usual institutional forces pushing urban wages up above rural wages. The small Caribbean islands fall into the first category, the NICs of East Asia into the second, and Hong Kong and Singapore into both. In such cases, a shift of the demand curve for labour in the modern sector will have effects like those shown in Figure 5.1: movement up the labour supply curve in the modern sector, and hence higher wages there; a leftward shift of the labour supply curve in other sectors, and hence higher wages among those who remain in those sectors; and thus a general and widespread increase in wages with no corresponding increase in unemployment. This is in essence what has happened in Hong Kong, Korea, Singapore and Taiwan for roughly the last twenty years (Fields, 1984).

Suppose instead that we have a labour market which offers higher real wages in the modern sector than in the traditional sector. The first case to consider is one in which modern sector employers hire as many workers as they want, while those not hired there take up employment in the traditional sector. The labour markets in the works of Lewis (1954) and Fei and Ranis (1964) are of this type. What characterises this type of labour market specification is the existence of wage dualism without unemployment. In such an economy, the effects of policies to expand modern sector employment are indicated in Figure 5.2: an increase in earnings for those additional persons who are able to gain employment in the modern sector, an increase in earnings for those who are left in the traditional sector, but no change in earnings for those who already were in the modern sector and no unemployment, either before or after.

If we continue to assume that we have a labour market which offers higher real wages in the modern sector than in the traditional sector, we may consider a different job search mechanism: in order to be hired in the modern sector, an individual must migrate from the rural to the urban area where, it is assumed, hiring takes place probabilistically. (In the models of Lewis and Fei and Ranis, migration is unnecessary to get a job: people just remain in the traditional sector and wait to be called for modern sector jobs.) The assumption that migration is necessary (but not sufficient) for an individual to be hired in the modern sector is the core notion of the labour market model of Harris and Todaro (1970). In these circumstances, it would not be optimal for all the workers not hired by the modern sector to wait in the traditional sector. Except under extreme risk-aversion, job aspirants would be willing to accept at least a short period of unemployment if, in so doing, they have a good chance of obtaining a very much higher wage in the modern sector than they might have earned had they remained in the traditional sector. But potential workers also know that if they were all to flock to the modern sector to try to get jobs there, they would be in such heavy competition with one another that they would lose out; their expected wages in the urban area would be less than in the traditional economy. Hence, they weigh the higher wages if successful in obtaining a modern sector urban job against the risk of seeking such employment and choose among the various sectors of the economy in order to try to maximise the expected returns from alternative labour market strategies.

If more modern sector jobs are created in a Harris-Todaro economy, more workers will show up to try to get those jobs. This is because with the larger number of jobs,

relatively risky search strategies are rendered more attractive, and the riskiest search strategy is that of migrating to the urban area and searching full-time. We may predict, therefore, that in those economies where the modern sector pays substantially higher wages than elsewhere, more urban employment will create more urban unemployment. This is shown in Figure 5.3.

It is precisely this that happened in Kenya at the time of the Tripartite Agreement of 1964. Kenya faced serious urban unemployment. To try to remedy this problem, government, employers and labour organisations agreed to increase hiring by 15 per cent, provided wages were not increased. But after the Tripartite Agreement was implemented, the urban unemployment problem was not resolved — if anything, unemployment was worse (Harbison, 1967).

Kenya's Tripartite Agreement was based on a logical and well-respected theoretical foundation: the Lewis-Fei-Ranis model. According to that theory, urban employment creation would have improved the employment situation. But the increase in urban unemployment following an increase in urban employment posed a problem: theory and fact contradicted one another. The facts could not be disputed: more people were unemployed in the cities after the Tripartite Agreement than before. Instead, a theory needed to be devised to fit the facts. The result was the Harris-Todaro model.

The Harris-Todaro model was devised in Kenya to fit the Kenyan circumstances. The model reasoned that urban unemployment was caused by the higher wages in urban than in rural areas and the consequent rural-to-urban migration by job-searchers. Thus, it reached a conclusion which, at the time, was quite paradoxical: the solution to urban unemployment is rural development.

The Kenyan economy did not fit the Lewis-Fei-Ranis model, and thus a policy warranted by that model did not work. It was only when theory and empirical observation interacted that more appropriate policies could be designed. This did not prevent the Kenyan authorities from concluding a second Tripartite Agreement in 1970. But when unemployment did not fall then either, they turned to the Harris-Todaro policy prescription. Rural development has worked much better in Kenya than has urban job creation.

This example points out that a given employment policy may have very favourable labour market consequences in one institutional circumstance and very unfavourable consequences in another. Whether a policy is warranted or not may well depend on which labour market model most closely fits a given country's situation.

7. *Market wage determination has served well those countries that have tried it. However, most developing countries have wages which, at least in some sectors of their economies, are higher than market-clearing levels. Both prematurely high wages and wage repression should be avoided. Trade policies should be planned accordingly.*

Different wage policies tend to be found in different developing regions. In most of the countries of Latin America, the Caribbean, Africa, and South Asia, wages in key sectors are not determined by supply and demand but by any or all of a number of non-market forces; minimum wage laws, labour unions, public sector pay policy, and labour

codes and protective legislation. These institutional influences, discussed in more detail below, often result in wages that are very much higher in certain sectors of these economies than in others. Both labour demand and labour supply are affected.

The East Asian NICs are different. Wages and other labour costs have not been artificially inflated there. Rather, the norm has been for wages to be set at but not above market levels. This wage policy was chosen in conjunction with those countries' trade policies: policy makers realised that if they were to succeed in exporting to the rest of the world, they could not afford for wages to be higher than they needed to be. Consequently, wages were left to be determined by supply and demand (with certain notable exceptions; for example, Singapore).

The empirical record shows that market wage determination served Hong Kong, Korea and Taiwan very well. [See Fields (1984, 1985) for details.] The favourable outcomes included:

- The rapid attainment of full employment and the subsequent maintenance of unemployment rates on the order of 1 to 4 per cent;
- Improved employment composition, with larger shares of the labour force employed in the higher-paying industries and occupations and fewer engaged as own-account workers and unpaid family labourers;
- An approximate doubling of real wages for the entire labour force;
- Low to moderate levels of inequality, with Taiwan recording the lowest level of inequality of any economy in the world; and,
- Sharp declines in absolute poverty with comparably large increases in material standards of living of the masses.

These data disprove the conjecture that market wage determination kept workers in those economies down and left them poor. Rather, these data show that the workers in those economies did indeed benefit greatly from labour-intensive export-led growth under market wage determination.

One problematic area in the Far East, though, is Singapore. In that country, wages were repressed through the government's direct involvement in the tripartite National Wages Council, de-registration of disruptive unions and arrests of their leaders, the restriction of fringe benefits, and the outlawing of strikes (Lim and Pang, 1982). By the end of the 1970s, labour shortages had become so severe in Singapore that the wage repression policy was abandoned and replaced by a "wage correction policy", the aims of which were to raise real wages, encourage capital-labour substitution and technological upgrading, and reduce the need for reliance on foreign labour. Still, this "high wage policy", as it was called, went too far, "contribut[ing] to declining international competitiveness, and thus to the decline in manufactured exports and employment and in economic growth...by 1985, when the external economic environment weakened, resulting in large-scale layoffs" (Lim, 1986: 11). In 1985, a wage freeze was imposed. Prime Minister Lee stated that "only after we have made up the ground lost in the years of negative growth in 1985 and, I fear, also in 1986 ... can we afford to loosen our policy of wage restraint, and then we must peg future increases in wages to increases in productivity" (*Asian Wall Street Journal*, 24th June 1986). This chronicle of events in Singapore illustrates how government involvement in the wage-setting process can result

in labour market distortions which impede not only employment but also exports and output.

A different pattern of non-market wage determination occurred in Jamaica. Tidrick (1975, pp. 308-309) describes the labour market there as characterised by "... a distorted wage structure, that is, a wage structure in which workers of the same skill level receive different wages in different industries ... Disparities among major sectors are dramatic. Unskilled bauxite mining workers earn about twice as much per week as unskilled workers in transportation or construction, the next most highly paid industries ... Unskilled construction workers, in turn, earn almost two and one-half times as much as agricultural workers." One major institution responsible for the wage gap in Jamaica is trade unions. Each of Jamaica's two major political parties maintains close links with a major trade union federation. These parties have endeavoured to strengthen the unions' hand in collective bargaining and through legislative action in exchange for their political support. Another important wage institution in Jamaica is the granting of relatively high wages to workers in the bauxite industry; this is facilitated by the fact that bauxite mining is very intensive in capital and energy but requires very little labour, so that labour cost is a very minor part of total cost. However, the Jamaican economy is not advanced enough to provide employment at such high wages in the manufacturing or mining sectors for all who seek such jobs. Potential workers are attracted to the high-wage sectors, with many of those not able to find work ending up unemployed. Chernick (1978, p. 86) concludes for Jamaica (and the Caribbean Community countries more generally): "Although distortions in the wage structure help to produce open unemployment, governments are unlikely to limit the unions' freedom to bargain with the enclave industries and expose themselves to the considerable consequent political risks". Those countries' development policies must be chosen in accordance with this constraint.

The important lesson here is that the efficacy of an export-oriented trade strategy may well depend on a country's choice of wage policy. If a country like Jamaica which aspires to export to the rest of the world adopts a lenient wage policy which permits premature wage increases to be granted, the country's exports may be rendered unprofitable in world markets. At best, units of product which might have been produced when wages were lower are not produced when wages are inflated; at worst, whole industries never get started. Employment suffers. And should this take place in an export-promoting country in which substantial government resources are used to support the export sector through publicly-provided infrastructure or costly fiscal incentives, the revenues earned by private exporting companies may fail to equal the social costs of exporting. In this event, the country loses money by exporting. Yet, exporting might have been socially beneficial in both output and employment terms had wages in the export-sector been set at market levels.

My point here should not be mistaken. It is not to argue that wages should be kept low. Indeed, workers in developing countries are paid too little, and the whole purpose of economic development is to enable them to earn more. The point, rather, is that if wages are artificially pushed too high too fast, the goal of improved earning opportunities may suffer. Jamaica is a country which has done this. With wages several times as high in the unionised manufacturing sectors as in the rest of the economy, and with no other obvious production advantages, it is not surprising that Jamaica's attempts at export-led growth have failed. Real wages among the Jamaican labour force have become lower

and unemployment higher. Only Jamaicans themselves can decide which is preferable: high wages for a select few or lower-wage employment for many[7].

8. *"Protective labour legislation" may not offer much protection. A better way to protect workers is to stimulate the demand for their labour.*

Some international agencies, most notably the ILO and some governments have promulgated protective labour legislation. Employers should not be free to exploit workers by engaging them in indentured servitude or other types of bondage, subjecting them to unhealthy or unsafe labour conditions, requiring excessively long working hours, or exploiting the economic vulnerability of children. Other laws aim to set minimum wages and regulate other conditions of employment (dismissals, fringe benefits, etc.). The aims of such wage and employment regulations — to raise earnings and enhance job security — are laudable. In the context of developing countries, however, an unfortunate fact is that such actions may not in reality afford workers much protection. To illustrate this point, I take the case of Panama.

In 1972, a populist government instituted a comprehensive labour code with the following key elements: policies directly influencing pay levels (legal minimum wages, contract minimum wages and collectively-bargained wage increases); measures directed toward job rights (employment security, anti-discrimination legislation); actions aimed at job environment (work rules, job/occupational training); social legislation (maternity leave, paid sick leave, unemployment compensation); policies affecting the economic environment (collective bargaining framework, bureaucratic and legal regulations). Because these regulations are enforced vigorously in Panama, they greatly influence the functioning of labour markets there.

The effects of the labour code on the labour market are many. Because of severance pay provisions, Panamanian workers essentially have job security after two years. This limits employers' flexibility to hire or dismiss labour as needed. The law specifies that no collective bargaining agreement can worsen already existing conditions. This restricts the ability of wages to respond to adverse product market conditions. These rigidities are particularly problematical in Panama, because that country has no control over its exchange rate. (The Panamanian Balboa is pegged to always equal US $1.) The labour code's social security provisions raised total labour costs an estimated 45 per cent beyond the wage paid to labour (Butelmann and Videla, 1985). Overall, Spinanger (1985) has estimated that labour costs are 90 per cent higher than they would be in the absence of the labour code, from which he concludes that "Panama is suffering, to a large extent, from classical unemployment.These policies have increasingly come into conflict with the need — or rather the necessity — for flexibility in the labour market. It would be quite correct to state that many of the unemployed were just priced out of the market."

At present, Panama faces economic malaise, high and rising unemployment and, not unrelatedly, political turbulence. It is widely believed that the labour code has hurt employment and exports. After much debate, in 1986 the government weakened the labour code somewhat, making labour contracts more flexible and establishing new criteria for fixing wages. But those modifications are expected to have little effect.

II. WHITHER RESEARCH

The major lessons emerging from my review of employment policies in small countries have been highlighted in the text for easy reference. I shall not repeat them here. In this conclusion, I limit myself to a few points about directions for future research:

The first point concerns my call for continued search for successful new exports. Researchers need to conduct detailed analyses of various export endeavors to understand better what exactly led to successes or failures. Only by in-depth micro-level analyses can we hope to learn why America's new cars are made in the Far East and "Why the Emperor's New clothes are not Made in Colombia"[8].

Second, we need to refine labour market models for developing countries and use these models to deduce the effects of various policy actions in various circumstances. As the example of Kenya's Tripartite Agreement indicated, a labour market policy which is warranted in one context may well have deleterious consequences in another. Policy effects depend on such factors as wage structure, job search conditions, the presence or absence of preferential hiring, capital markets, and so on. The robustness of policy conclusions to alternative labour market specifications must be carefully explored, and if (as is likely) policy conclusions are found not to be robust, care must be taken to assure that the policy decisions taken in a particular economy match up with that economy's labour market typology.

Third, while we must give due consideration to particular countries' initial conditions and historical circumstances, recognising that these determine the time path of employment, we must also be careful not to devote too much attention to the unchangeable. For instance, although it is valid to point out that major land reforms preceded rapid, labour-intensive, export-led growth in Korea and Taiwan, it would be injudicious to conclude that land reforms must be undertaken in other countries before they pursue outward-oriented development programmes. If land reform were to be insisted upon as a necessary precondition, most of us would probably not see much progress on the employment problems in most countries in our lifetimes. We ought not to let the search for first-best policies dominate the search for the best feasible policies. Although ivory tower academicians may wish to engage in the former, the efforts of international agencies like the OECD Development Centre are best directed towards the latter.

Fourth, we need to be especially careful about how we think about the urban informal sector. Nobody writing today can fail to heed the conclusions emerging from the ILO (for instance, Sethuraman, 1981) and PREALC (as in Tokman, 1978) about the value of this sector in generating earnings opportunities and contributing to economic activity. Clearly, this sector needs to be incorporated into development planning and into our analytical models. In so doing, though, we must avoid a couple of logical mistakes, which now are frequently made. One is the tendency to confuse the operationalisation of the informal sector with the definition of it. Small firms are not by definition informal, even though firm size is often the criterion used to distinguish formal from informal in empirical work. Large employers who hire workers on a casual basis might reasonably be classified as informal, whereas individual proprietorships operating in a fixed location year after year are more properly viewed as formal. The distinguishing characteristic between formal and informal should be the nature of work relations, not

the number of workers. The other mistake is the tendency to lump together under the heading "informal sector" two very different kinds of labour markets: *i)* a free-entry sector, with flexible and very low wages, in which workers earn a cash income while seeking to escape into higher-paying employment elsewhere, and *ii)* a relatively high-paying sector, often characterised by self-employment, which can be entered only after substantial accumulation of financial and/or human capital and which may be an end in and of itself. To my thinking, the first kind of labour market is informal and the second is not. In any event, regardless of the labels we assign to them, these labour markets are very different and should be treated as such.

Finally, in those circumstances (the majority, I think) in which the most appropriate specification is a multi-sector labour market model with intersectoral linkages, we must be particularly careful about policy prescriptions. Consider statements of the type "workers in sector X have a problem, therefore such-and-such should be done to remedy that problem." Although such statements are often appropriate in single sector situations, they should be avoided in multi-sector contexts. This is for two reasons: First, a basic feature of multi-sector models is that resources applied to one sector create incentives for people to enter that sector. Such movement, to the extent that it is allowed, may or may not be desirable. Another reason is that although resources may indeed yield benefits if applied to sector X, they may be deployed even more effectively in sector Y. Cost-benefit calculations must take account of induced reallocations and opportunity costs.

Theoretical labour market modelling, based on empirical observation and oriented toward policy assessment, deserves the highest priority in the years ahead.

NOTES AND REFERENCES

1. See, for instance, David Turnham with Inglesies Jaeger, *The Employment Problem in Less Developed Countries,* Paris, OECD, Development Centre, 1971;

   Lyn Squire, *Employment Policies in Developing Countries,* New York, Oxford University Press, 1981; and,

   ILO *World Labour Report* Vol. 1, Geneva, 1985.

2. Persons interested in learning more about labour market issues in those countries are referred to the works of:

   Lawrence B. Krause and Gary S. Fields in Walter Galenson, ed., *Foreign Trade and Investment,* Madison, University of Wisconsin Press, 1985;

   Linda Lim, "Export-Oriented Industrialisation and Asian Labour: Myths and Confusions", paper for the *Conference on Origins and Consequences of National Development Strategies: Latin America and East Asia Compared,* Duke University, 1986;

   Tony Addison and Lionel Demery, eds., *Wages and Labour Conditions in the Newly-Industrialising Countries of Asia,* London, Overseas Development Institute, 1987; and

   the four papers on those economies in Colin I. Bradford, Jr. and William H. Branson, eds., *Trade and Structural Change in Pacific Asia,* Chicago, University of Chicago Press, 1987

   among other sources.

3. For details and documentation, see:

   David Turnham, *op. cit.,* 1971;

   Hollis B. Chenery and Moises Syrquin, *Patterns of Development 1950-1970,* New York, Oxford University Press, 1975;

   Lyn Squire, *op. cit.,* 1981.

   World Labour Report, op. cit., 1985.

4. One well-known analysis of this issue is that of Frances Stewart and Paul Streeten, "Conflicts between Output and Employment Objectives in Developing Countries", *Oxford Economic Papers,* July, 1971.

5. See, for instance:

   Inter-American Development Bank, *Economic and Social Progress in Latin America* (various years)

   The World Bank, *Poverty in Latin America: The Impact of Depression,* Washington, D.C., World Bank, 1986;

   PREALC, *Beyond the Crisis,* Santiago, 1985;

   ECLAC, "The Economic Crisis: Policies for Adjustment, Stabilization and Growth", *Cuadernos de la CEPAL* No. 54, Santiago, 1986;

   on Latin America, Victor E. Tokman and J. Wurgaft, "The Recession and the Workers of Latin America", in ILO, *World Recession and Global Independence: Effects on Employment, Poverty, and Policy Formation in Developing Countries,* Geneva, ILO, 1987; and

   on Africa, A. Aboagye and K. Gozo, "Subsaharan Africa", in ILO, *op. cit.,* 1987;

   and Ralph van der Hoeven, "External Shocks and Stabilization Policies: Spreading the Load", *International Labour Review,* March-April, 1987.

6. For comparisons of the growth and adjustment experiences of various regions, see:

   Bela Balassa, *Development Strategies in Semi-Industrial Economies,* Baltimore, Johns Hopkins University Press, 1982;

   Parvez Hasan, "Adjustment to External Shocks", *Finance and Development,* December 1984; and

   Jeffrey D. Sachs, "External Debt and Macroeconomic Performance in Latin America and East Asia", *Brookings Papers on Economic Activity,* 2, 1985.

7. For more details on wage-setting institutions in different parts of the Third World, see Gary S. Fields and Henry Wan, Jr., "Wage Setting Institutions and Economic Growth", paper presented at the *Conference on the Role of Institutions in Economic Development,* Cornell University, December 1986, and the references cited therein.

8. To learn more about the latter, see David Morawetz, *Why the Emperor's New Clothes are not Made in Colombia,* Oxford, Oxford University Press, 1981.