

Labour Market

CONCEPTS, ISSUES AND EVIDENCES

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1. Labour Market

- ❑ Deals with market of **labour services in exchange of wages** and covers mainly
 - ❑ Employment, wages, discrimination, job search, labour market institution etc.
- ❑ Basic model of neoclassical theory of labour supply deals with **trade-off between consumption & leisure**
 - ❑ Supply of individual is positive if $wage > reservation\ wage$; Relationship between labour supply and wage is determined by substitution and income effects; Household model of labour supply: unitary model and collective model; Two effect during crisis: added worker effect and discouraged worker effect
- ❑ Labour demand is derived demand
 - ❑ In short run $MPL = w/p$, in long run $MPL/MPK = w/r$
- ❑ Education and training are critical factor of labour markets
- ❑ Presently, it is recognized that there is **some imperfection in labour market**; sources of imperfection
 - ❑ Frictions –job search and matching, specific human capital
 - ❑ Market power and collusion
 - ❑ Labour market institutions: Employment protection legislation; Minimum wages, wage setting; Collective bargaining, trade unions; Unemployment benefits, income transfers.
 - ❑ Rationale for labour market institutions: Efficiency, equity, policy failures, stability, crisis mitigation.

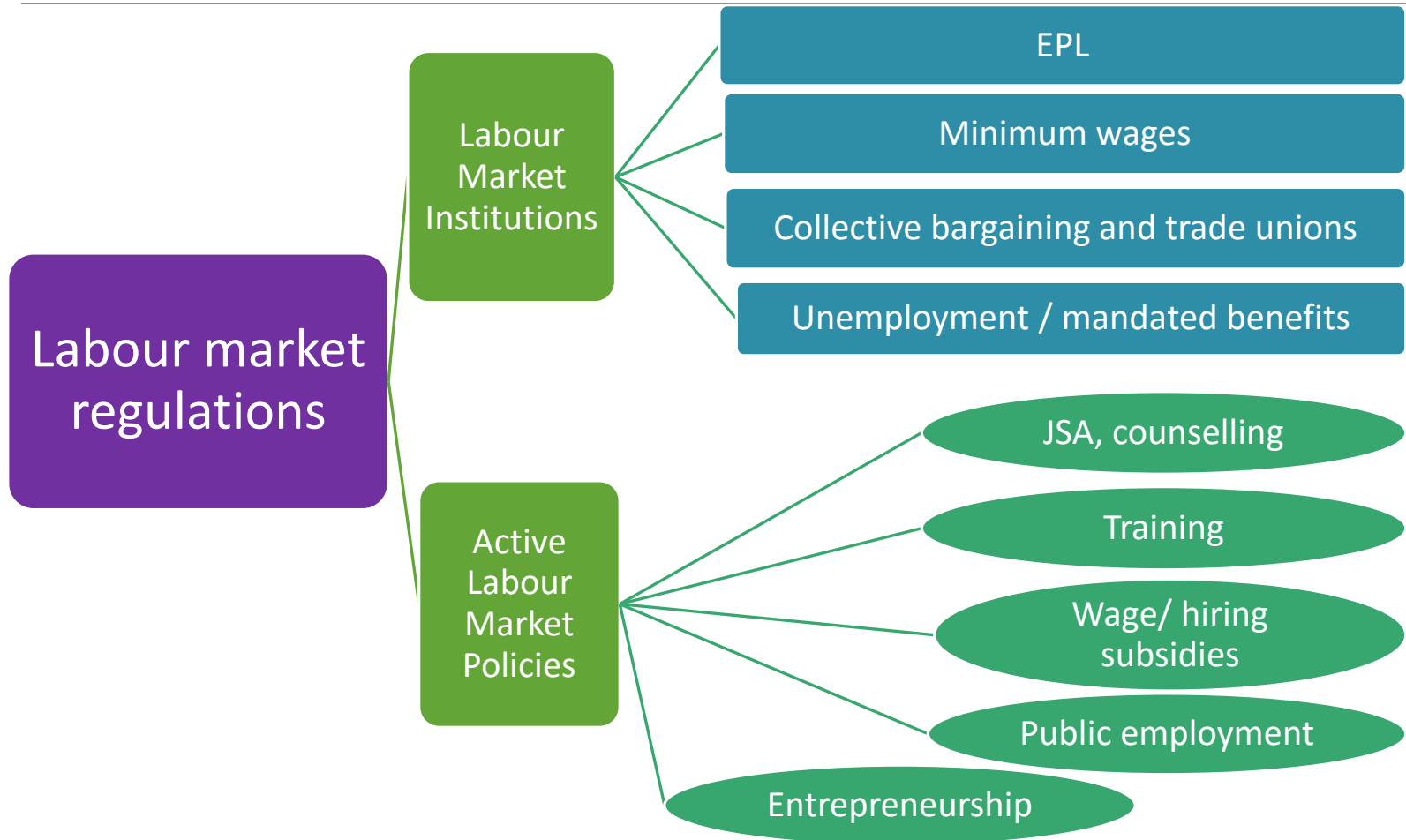
2. Labour Market in Developing Countries: A Positive view

- ❑ Labour markets **perform well** in developing countries, at least in aggregate, because of
 - ❑ approximate the competitive norm
- ❑ **Poor labour market performance** in terms of employment and wages is due to
 - ❑ the baleful influence of institutional factors
- ❑ Classic models of economic dualism (Lewis) also support an optimistic view of labour markets in developing countries as well as the importance of institutional factors in impairing labour market performance

2. Labour Market in Developing Countries: Less benign view

- ❑ **Segmented urban labour** market is reflected by open urban unemployment
 - ❑ Result of excessive rural-urban migration
 - ❑ Cannot be resolved by increasing the rate of urban job creation in the formal sector which will always lag behind urban-based labour supply
- ❑ Structural change is **growth reducing** when between sector component of productivity change is negative
- ❑ Jobless growth at the aggregate level is the **norm rather than the exception**
- ❑ Appropriate policy interventions that go **beyond institutional factors** are required
 - ❑ to respond to the challenge of excessive rural-urban migration, the 'wrong' kind of structural change and jobless growth at the economy-wide level
- ❑ Also focus on the challenge of '**skills mismatch**'
- ❑ The problem lies with a dysfunctional **education and training system**

3. Labour market institutions and policies: A conceptual framework



3. Labour market institutions: Empirical approaches

□ Impact of LMI

- Cost of dismissal, restrictions on contracts (strictness of legislation)
- Minimum wages
- Unemployment benefits – generosity and duration)

□ Outcomes of interest

- Unemployment (levels, flows)
- Employment (hiring, firing, levels)
- Composition of employment; Wages
- Impact for specific groups
- Productivity and output etc.

□ Macro-econometric approach (pooled regression using cross-country/time-series data)

□ Micro-econometric approach (over time within a country due to reforms/changes to LMIs)

□ Example of commonly used specification of the employment function:

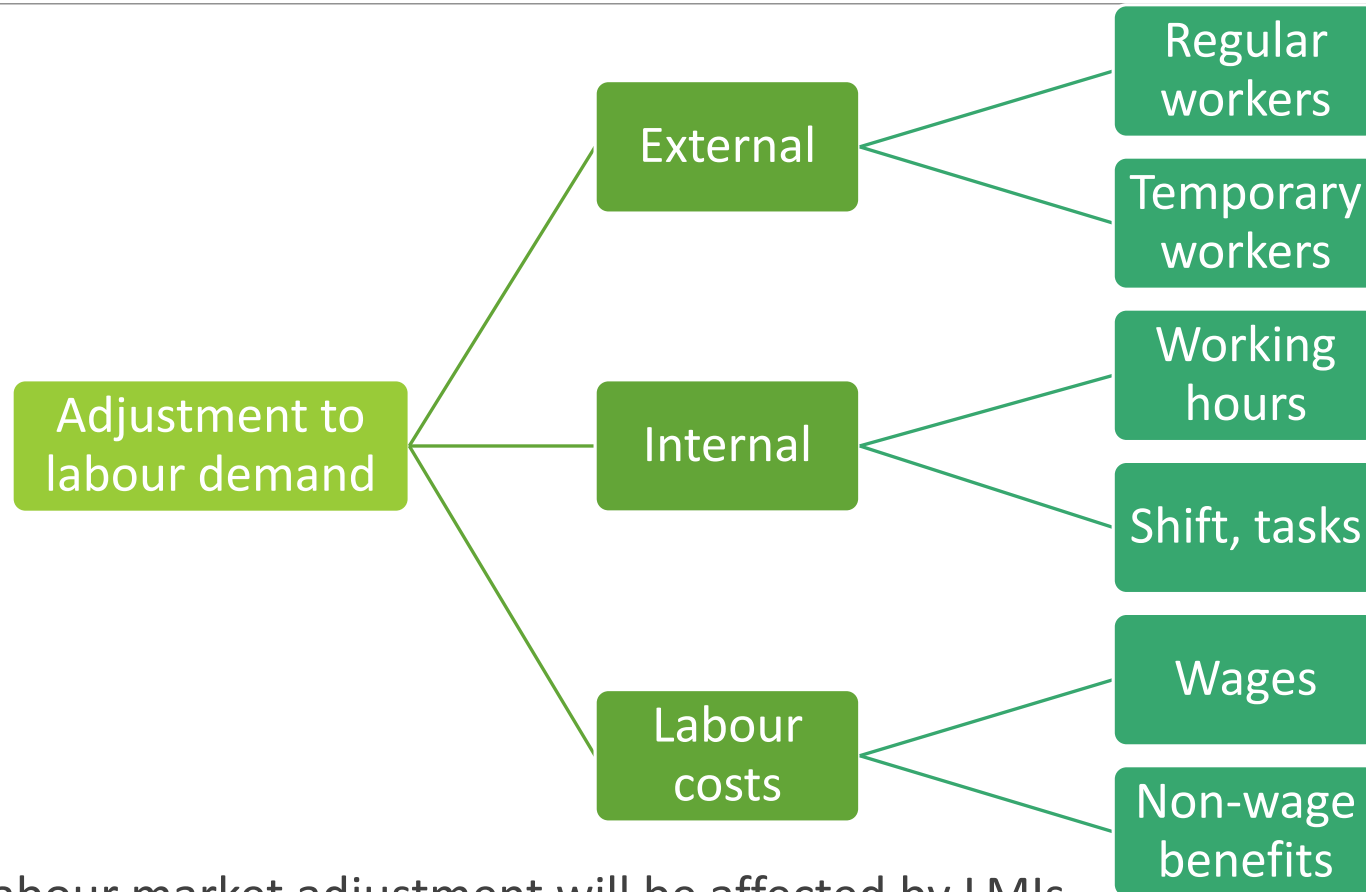
$$\ln L_t = \beta_0 + \beta_1 \ln w_t + \beta_2 \ln Y_t + \beta_3 \ln L_{t-1} + u_t$$

□ However, empirical evidence does not lead to a “smoking gun”

3. Labour market institutions in developing countries: New directions

- ❑ Capacity and commitment of developing countries has improved quite strongly in recent years
- ❑ Emphasis shifted from “job protection” to “worker protection” -> **flexicurity debate**
- ❑ Positive impact of minimum wages has galvanized new interest in their role
- ❑ **Mahatma Gandhi National Rural Employment Act (MGNREGA)** has also shown the impact of the world’s first wage floor for the rural (informal) economy
- ❑ **Social protection floor** covering the informal sector
- ❑ **Challenges remain** in developing countries
 - ❑ Coverage, enforcement and compliance
 - ❑ Capacity and resources
 - ❑ Political commitment
- ❑ **Need a shift in the debate**- from polarized positions (protection versus distortions) to one based on a concept and goal of effective labour market institutions (a balanced approach)

3. Labour market adjustment in response to a shock: at the firm-level



□ Labour market adjustment will be affected by LMIs

3. Active Labour Market Policies (ALMP): Do ALMPs work?

Intervention	Empirical evidence	Additional constraints for developing countries
Job search assistance	Generally positive impact; inexpensive and cost-effective	Lack of employment services (public and private); more relevant for formal transactions in the labour market; less relevant when structural and cyclical unemployment is high
Training	Stronger positive impact over longer term; on-the-job training more effective; training targeting youth have been generally less successful	Training facilities are inadequate and inappropriate
Wage/employment subsidies	Less effective (mixed evidence); can generate deadweight costs and substitution effects	Expensive and are only relevant to the formal sector
Public works/employment	Public works are an effective social protection scheme but are unlikely to improve employment outcomes; subsidized public sector employment tend to be ineffective	Working conditions tend to be poor in infrastructure-related programmes; poor link to training, entrepreneurship and other complementary interventions
Entrepreneurship incentives	Some positive impact for older/better educated	Low success rate

4. Growth, structural transformation and employment

- ❑ Commonly observed pattern of structural change: **agriculture → manufacturing → services**
- ❑ History of Developed Countries
 - ❑ Common sequence of change: agriculture to industry to services
 - ❑ Monotonous decrease in the share of agriculture and increase of services
 - ❑ Share of industry increased initially and declined later
 - ❑ Structure of employment changed with that of output _ shares roughly similar
- ❑ Alternative Paths to Structural Transformation: **diversification of agriculture**
 - ❑ Product diversification within agriculture can contribute to raising productivity and employment in rural areas
 - ❑ High value added crops like fruits and vegetables have high growth potential
- ❑ Macroeconomic policy to move away from **'single mandate'** and **adopt 'dual mandate'**
 - ❑ Guardians of stability and active agents of development

5. Earnings, inequality, and labour market segmentation

Technique to use to productivity measurement

- Translog TFP Index
- Multilateral TFP Index
- Malmquist Index
- Levinsohn-Petrin methodology (or other methodology of same type)
- Data envelopment analysis**
- Stochastic frontier production function

Different dimension of Inequality are

- Income/consumption
- Opportunity (access to education, employment, health etc)
- Assets (ownership of Land, house and other assets)
- Social Exclusion (gender and social groups/ethnicity)
- Regional /physical environment

Different dimensions of inequality are interlinked

5. Earnings, inequality, and labour market segmentation

- ❑ The most commonly used measures of inequality are
 - ❑ Gini-Coefficient (The coefficient varies between 0 (complete equality) and 1 (complete inequality))
 - ❑ Pseudo Gini (Pseudo Gini measures inequality in terms of the household welfare)
 - ❑ Quintile and Decile Dispersion Ratios (The dispersion ratios measure the “distance” between two groups in the distribution of expenditure/income)
 - ❑ Share of Income/Consumption of Poorest Group (the total income or consumption of the poorest group, as a share of total income or consumption in the population)
 - ❑ Palma Ratio (This ratio of richest 10% and poorest 40% population share of income)
 - ❑ Generalized Entropy Measures (The values of GE vary between 0 and infinity)
 - ❑ Decomposition of Inequality: Field (focusing the use of regression that helps us to get the contribution of different factors (explanatory variables) of income or earnings inequality)
 - ❑ Kernel Density Graph (This type of graph gives a visual idea and features of the distribution about the nature of inequality)
- ❑ Blinder-Oaxaca Decomposition Technique to measure discrimination in the labour market

Research to do

- Applicability of various model (e.g., Lewis and Harris-Todaro) in Bangladesh? (Rural-urban migration)
- Patterns of migration and factors influencing mobility of labour?
- Link between labour market performance and structural change and growth?
- Returns to schooling?/ effect of education and training?
- Connections among skill mismatches, wages, working conditions, employment and growth?
- Effects of labour Market interventions on employment?
- What is the impact of LMI on labour market outcome?
- How efficient the sector is? (DEA analysis)
- How is the scenario of inequality in labour market?
- How is the scenario of discrimination in the labour market? (e.g., gender)