

EE461

Lecture 7: Labor Market in Developing Economies

March 24th, 2012

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LABOR MARKET BASICS

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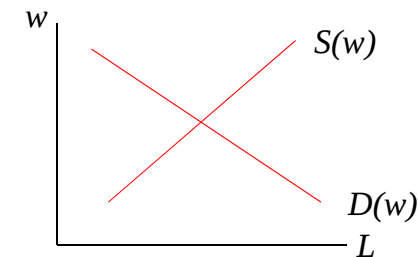
Why is labor market important?

- The market for *everyone* to sell their labor endowment.
- Where your intelligence should be rewarded
- The channel in which people can *work their way out of poverty*.
- The *direct* channel to distribute economic growth.

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Equilibrium Wages

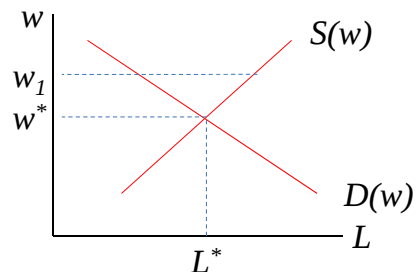
- Market clearing is when



- The equilibrium is **stable** when
 1. Economy *tends* there.
 2. Once the economy is there, it *stays* there.

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What are equilibrium forces?



- If we are at w_1 , to move to equilibrium, we need:
 1. Firms' ability to adjust $D(\cdot)$
 2. Individuals' ability to adjust $S(\cdot)$
 3. Ability for wages to rise & fall
- However, things are definitely *not* as in the model.

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Labor Market Institutions

1. Labor Unions
2. Minimum Wages:
3. Government Pay Policies
 - Gov't job is desirable with security.
4. Multinational Corporations
5. Labor Codes:
 - In Europe and Japan, it is extremely difficult to fire people.
 - In Thailand, it is *against* the labor law to deduct any paycheck of your employee without consent.

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Regulation vs. Flexibilization

- Regulations are set to protect labors especially low-skilled.
- Recent movement towards more flexible labor market



Flexibilization

Regulation

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Regulation vs. Flexibilization

- In India, states with “pro-worker” legislation recorded

(the same applies in Bolivia and Romania)
- By contrast, Indonesia's high degree of *labor market flexibility* during the Suharto years promoted
- Since the 1997 Asian crisis, minimum wage increases prompted by union activity have left almost all employment growth to the sector, at wages below those in the

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Urban Unemployment: Kenya

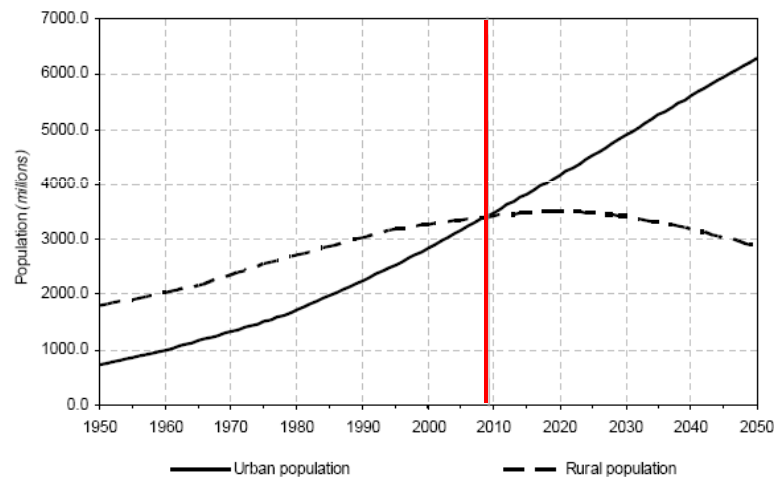
- In 1964, Kenyan government tries to fight urban unemployment. What to do?
- Enter a pact with capitalists and trade unions to increase employment by 15%
- Result?
 - Urban unemployment is higher than before!
- Why?

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URBANIZATION AND RURAL-URBAN MIGRATION: FACTS

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Urban & Rural Population of the World



Source: U.N. World Urbanization Prospects, Revision 2009

By the middle of 2009, the number of people living in urban areas (3.42 billion) had surpassed the number living in rural areas (3.41 billion) and since then the world has become more urban than rural.

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TABLE 8.2 The World's Fifteen Largest Cities, 1995 and 2015

City	1995 Population		Average Annual Growth Rate 1990–1995 (%)	2015 Population ^a	
	Rank	Millions of Inhabitants		Rank	Millions of Inhabitants
Tokyo, Japan	1	26.8	1.41	1	28.7
São Paulo, Brazil	2	16.4	2.01	6	20.8
New York, USA	3	16.3	0.34	11	17.6
Mexico City, Mexico	4	15.6	0.73	10	18.8
Bombay, India	5	15.1	4.22	2	27.4
Shanghai, China	6	15.1	2.29	4	23.4
Los Angeles, USA	7	12.4	1.60	—	—
Beijing, China	8	12.4	2.57	8	19.4
Calcutta, India	9	11.7	1.67	12	17.6
Seoul, South Korea	10	11.6	1.95	—	—
Jakarta, Indonesia	11	11.5	4.35	5	21.2
Buenos Aires, Argentina	12	11.0	0.68	—	—
Tianjin, China	13	10.7	2.88	14	17.0
Osaka, Japan	14	10.6	0.23	—	—
Lagos, Nigeria	15	10.3	5.68	3	24.4
Karachi, Pakistan	16	—	—	7	20.6
Dhaka, Bangladesh	17	—	—	9	19.0
Manila, Philippines	18	—	—	15	14.7
Delhi, India	19	—	—	13	17.1

Sources: World Resources Institute, *World Resources 1996–97: The Urban Environment* (New York: Oxford University Press, 1996), tab. 1.1; United Nations, *World Urbanization Prospects: 1994 Revision* (New York: United Nations, 1995), tab. 1.

^aProjections made in 1995.

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Urban & Rural Population in the World Regions

Development group	Population (billion)					Average annual rate of change (percentage)			
	1950	1975	2009	2025	2050	1950-1975	1975-2009	2009-2025	2025-2050
Total population									
World.....	2.53	4.06	6.83	8.01	9.15	1.89	1.53	1.00	0.53
More developed regions....	0.81	1.05	1.23	1.28	1.28	1.02	0.48	0.22	-0.01
Less developed regions.....	1.72	3.01	5.60	6.73	7.87	2.25	1.82	1.16	0.63
Urban population									
World.....	0.73	1.51	3.42	4.54	6.29	2.91	2.40	1.76	1.31
More developed regions....	0.43	0.70	0.92	1.01	1.10	1.97	0.82	0.58	0.33
Less developed regions.....	0.30	0.81	2.50	3.52	5.19	3.96	3.30	2.15	1.55
Rural population									
World.....	1.80	2.55	3.41	3.48	2.86	1.39	0.85	0.12	-0.77
More developed regions....	0.39	0.35	0.31	0.26	0.18	-0.30	-0.35	-1.01	-1.62
Less developed regions.....	1.41	2.20	3.10	3.21	2.69	1.77	1.01	0.22	-0.71

Source: U.N. World Urbanization Prospects, Revision 2009

The population growth rates in the world has been driven primarily by urban populations for two reasons:

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Reasons for City Growth

3 principal explanations of rapid city growth and urbanization

1. PUSH: unusually rapid rates of population growth pressing on
2. PULL: economic forces draw migrants into the cities
3. EXPAND:

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Rural-Urban Migration's Contribution to Urban Growth

Country	Annual Urban Growth(%)	Share of Growth Due to Migration (%)
Argentina	2.0	35
Brazil	4.5	36
Colombia	4.9	43
India	3.8	45
Indonesia	4.7	49
Nigeria	7.0	64
Philippines	4.8	42
Sri Lanka	4.3	61
Tanzania	7.5	64
Thailand	5.3	45

Source: K. Newland, *City Limits: Emerging Constraints on Urban Growth*, Worldwatch Paper No. 38 (Washington, D.C.: Worldwatch, 1980), p. 10. Reprinted with permission.

- Lower share of urban growth due to migration is a good sign that development is more even.
- Note that, richer countries tend to have faster urban growth, and lower share of growth due to migration.

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RURAL-URBAN MIGRATION: THEORY

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Migration and Development

- Development economists in the 1950s viewed rural-urban migration and city growth with **optimism**.
 - City immigration was seen as a favorable process whereby "surplus rural labor was withdrawn from traditional agriculture to provide cheap manpower to fuel a growing modern industrial complex" (Todaro, 1969)

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Example: China

- Surplus labor in rural areas is estimated between 52 and 150 million people.
- Final migration from the migrant to the urban sector is largely constrained by the *hukou* (residential registration system)
- Wages have been fairly stable, but began unexpectedly to increase in 2006 : +17 % in 2006 in the Shenzhen special economic zone
 - McDonald's (45000 employees) increased wages for the first time in 17 years in China in Sept. 2007, **between 12 to 56%**.

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Example: China

- If economic growth slows,

(Fu Jing, *China Daily*, 2008-08-14)
- "China's labor market is in the pincer grip of dwindling surplus labor on one hand and growing unemployment on the other as a result of mass closures of outdated factories" (shortage of skilled workers)" (Fu Jing, *China Daily*, 2008-08-14)

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But Lewis Didn't Have Everything

- Things began to change in the 1960s with evidence of high rates of **unemployment**:
 - view immigration to the city with alarm.
- Typical labor market model cannot capture unemployment.
- The current view is that this migration is *greater than* the urban areas' abilities to

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A Theory of Rural-Urban Migration

- Todaro (1969), Harris-Todaro (1970) model
- Suppose L workers, L_u and L_r is the numbers of employed in *urban* and *rural* sectors.
 - Urban wage: w & Rural wage: m where $w > m > 0$
- Assume L_u is fixed, so some might be unemployed, while L_r can always absorb labor (familiar?)
- Thus (*urban*) unemployment is:

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Todaro (1969), Harris-Todaro (1970)

- So far, there *cannot* be unemployment. Why?
- Assume, they don't know perfectly, and must base decision on *expected income*.
- Expected income of the rural is m .
- Expected income in the urban is w times the probability of finding a job $\frac{L_u}{L-L_r}$
- Migration continues if $w \frac{L_u}{L-L_r} > m$
- When & How equilibrium will be reached?

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Todaro (1969), Harris-Todaro (1970)

- Equilibrium is when
- Question what happens to unemployment as more jobs become available in the urban areas?
 - Rewrite as
 - Hence
- Try differentiate *unemployment* equation to convince yourself

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THE GOOD, THE BAD, THE URBANIZATION: ISSUES

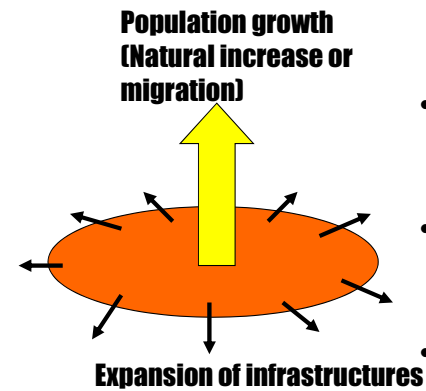
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What to Consider?

1. Context and Issues
2. Why People Move to Urban Areas?
3. Megacities and Urban Regions
4. Problems with Migration and Shantytowns

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1 Context and Issues: What is urbanization



- Urbanization is the agglomeration of population in cities
 - Growth of the proportion of the population living in cities
- Demographic process:
 - Urban population growth (natural increase or migration)
- Infrastructure process:
 - Expansion of urban infrastructures and land use
- Economic process:
 - Creation of secondary, tertiary and quaternary sectors
 - Creates a society where values and lifestyles are urban

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Context and Issues

- Causes of urbanization
 - Increased social interactions.
 - Institutions representing and supporting a society.
 - Linked with agricultural surpluses.
 - Increased economic efficiency.
 - Specialization, economies of scale and economies of agglomeration.
- Krugman is well-known for his analysis of agglomeration:

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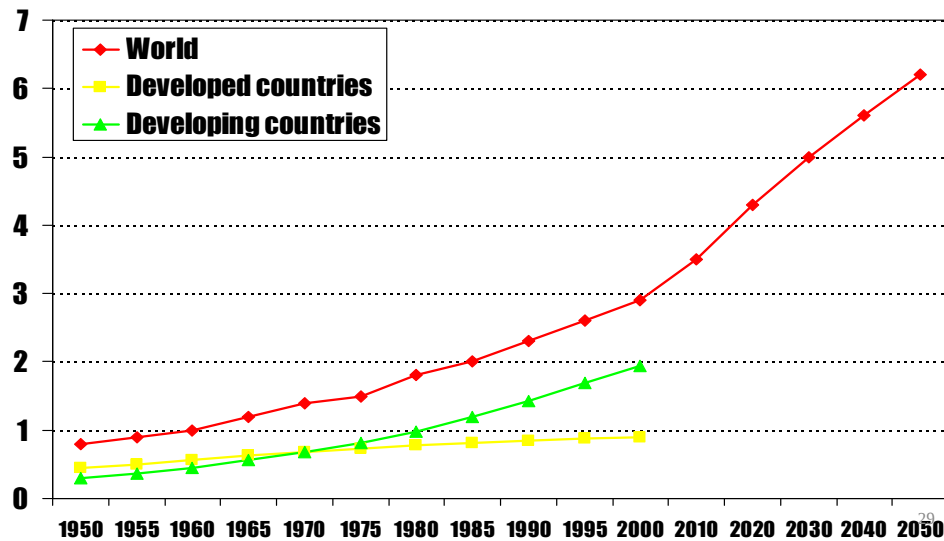
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Context and Issues

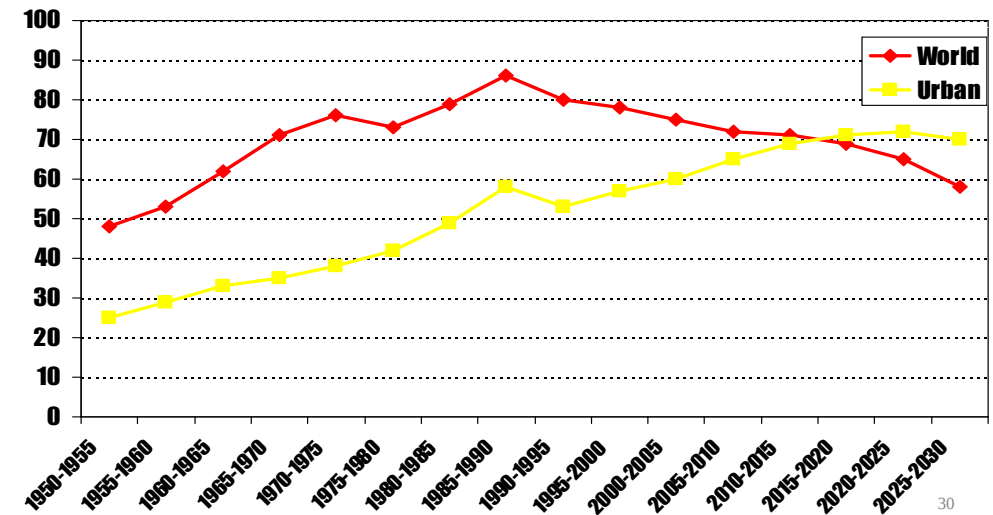
- The urban explosion
 - Urban population growth is the most important change in population geography.
 - About 50% of the global population, lives in cities.
 - Almost all the population growth between 2000 and 2030 will occur in cities.
 - By 2050, 6.2 billion people will live in cities, more than the current (2000) population.
 - Much of this growth will come in the world's poorest countries.

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World Urban Population, 1950-96 with Projections to 2050 (in billions)



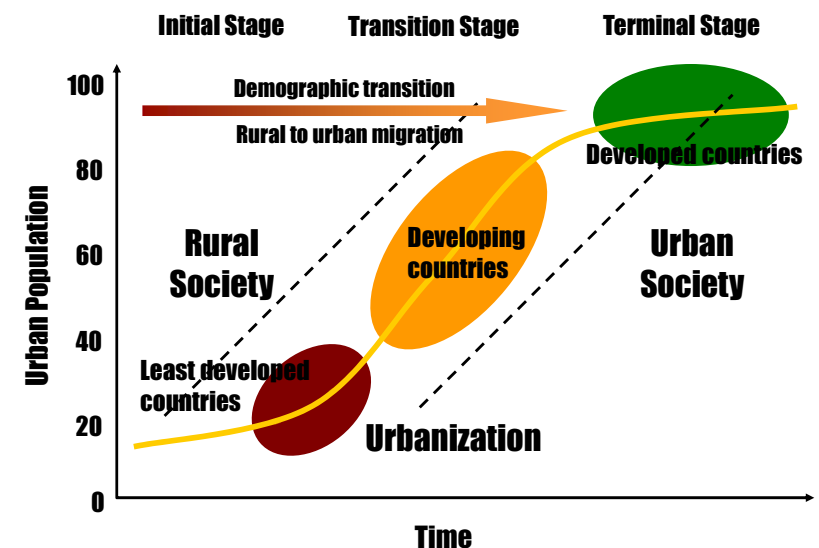
Annual Growth of World and Urban Populations, 1950-2030 (in millions)



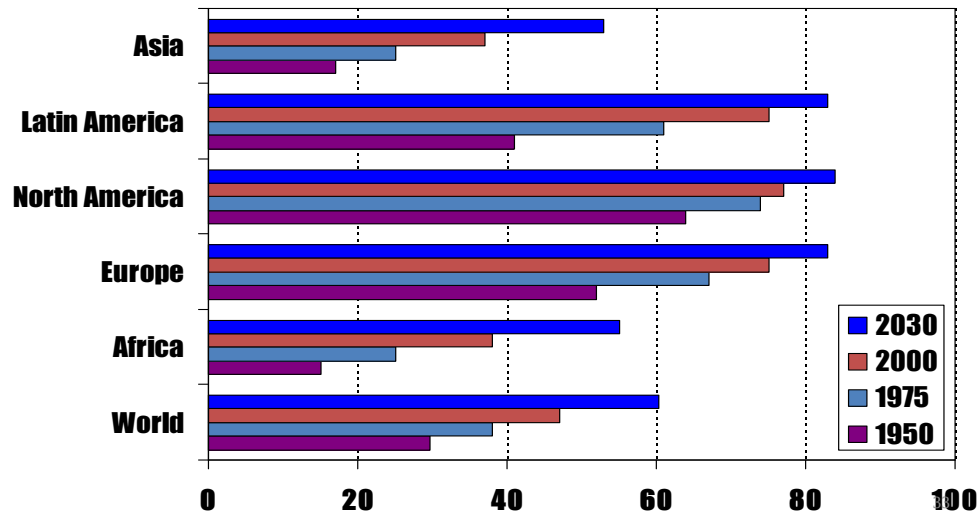
Context and Issues

- Developed countries
 - Developed countries are already urbanized.
 - Have been through the rural - urban migration process
 - Concurrent with demographic transition and industrialization.
- Developing countries
 - Going through a major phase of urbanization.
 - Will account for 93% of the 2 billion increase in the global urban population between 2000 and 2030.
 - Latin America and East Asia is farthest along.
 - The rest of Asia is a little further behind.
 - Africa is urbanizing more slowly than the other world regions.

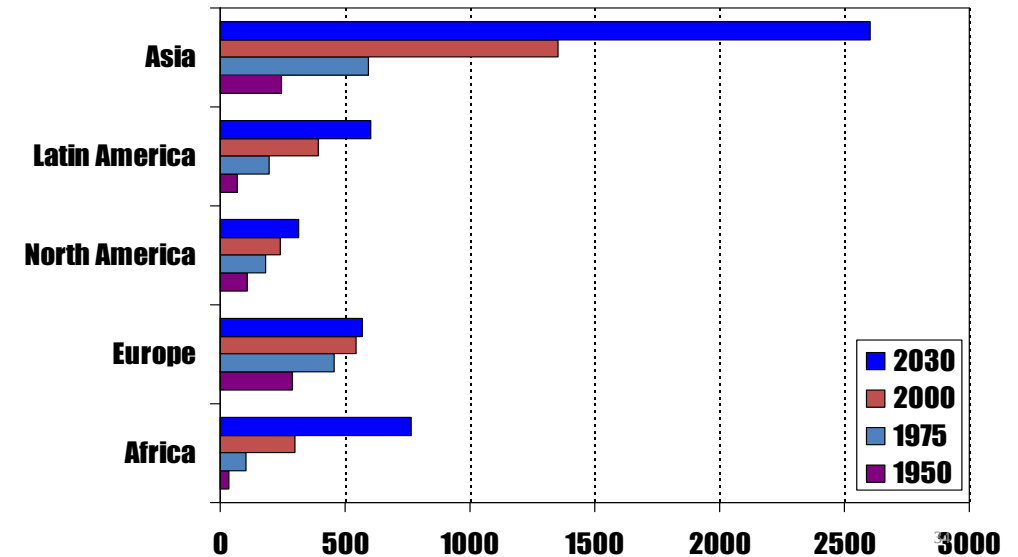
Stages of Urbanization



% of Urban Population, 1950-2030



Urban Population, 1950-2030 (in millions)



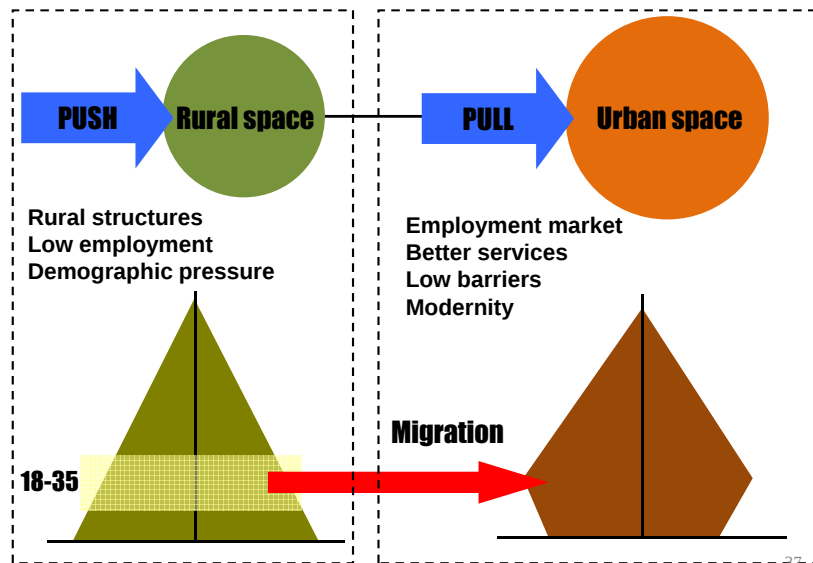
2 Why People Move to Urban Areas?

- Migration makes a significant contribution to the growth of urban areas.
 - 50 million new urbanites each year
 - 1 million new urbanites each week
 - About 155,000 new urbanites each day
 - About 75,000 rural poor migrate to cities each day
 - Major changes in the developing world.
- Migration accounts for between 40% and 60% of annual urban population growth in the developing world.
- Migration is expected to be a major factor in the coming years in regions with large rural populations.

Why People Move to Urban Areas?

- Push-Pull considerations
 - Both are affecting rural-urban migrations.
 - “Pull” of the cities may determine the destination.
 - Migrants are pulled toward cities:
 - Most early urbanization was the result of pull considerations.
 - “Pushed out” of rural areas:
 - “Push” factors predominate as the motivation to move.
 - Play more importance today than push considerations.

Push - Pull Factors for Urbanization in the Third World



Why People Move to Urban Areas?

- Political instability, natural disasters or wars
 - Major “push” factor.
 - Moving to cities from unsafe countryside.
- Hope or expectation of jobs
 - Higher wages or the greater expectation of employment
 - BUT the difference between urban and rural wages is minimal in some settings (for example in sub-Saharan Africa).
 - Informal sector of employment
 - Better and more variety of opportunities *for the better educated* are reflected in higher migration rates.

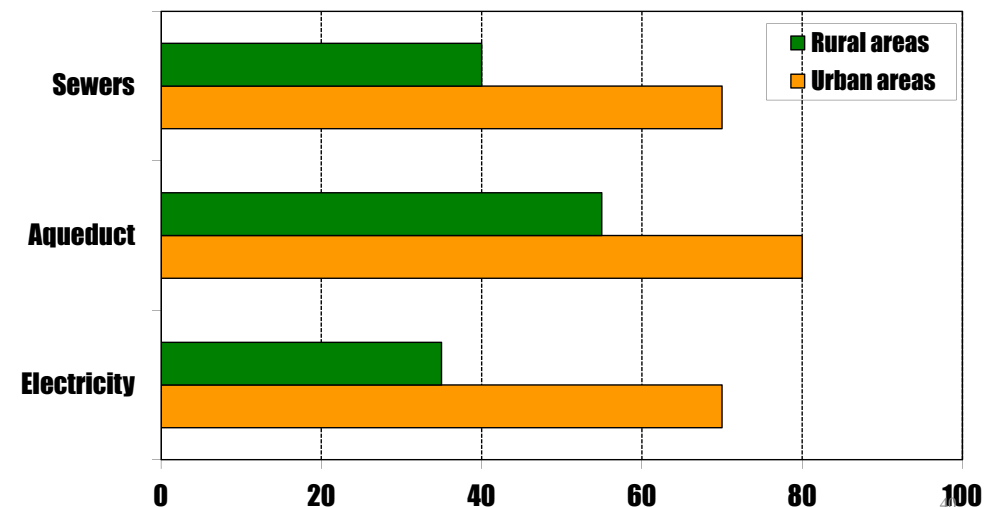
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Why People Move to Urban Areas?

- Deterioration of rural life
 - Rapid population growth among low-income groups in rural areas puts pressure on
 - Loosen social cohesion and the sense of community as they change economic relationships
- Better services and amenities
 - Educational opportunities and health services
 - Prospect of freedom in urban life
 - Life in the worst part of the city can be as arduous and services just as poor as in the village.
 - BUT quality of water and air and the risk of disease from inadequate sanitation and overcrowding may even be worse.

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% of the Population Having Access to Public Infrastructure in Developing Countries, 1990



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Why People Move to Urban Areas?

- Low barriers to migration
 - Better roads and transport reduce physical barriers such as distance and accessibility.
 - Networks of friends or relatives who provide a context of familiarity, encouragement and support
 - BUT Direct and indirect controls such as taxes, rationing, pass systems and policing slow migration.
 - Frequently evaded when motivation is strong
 - Freedom of movement can increase migration, although movement is more likely to be temporary if it is free.

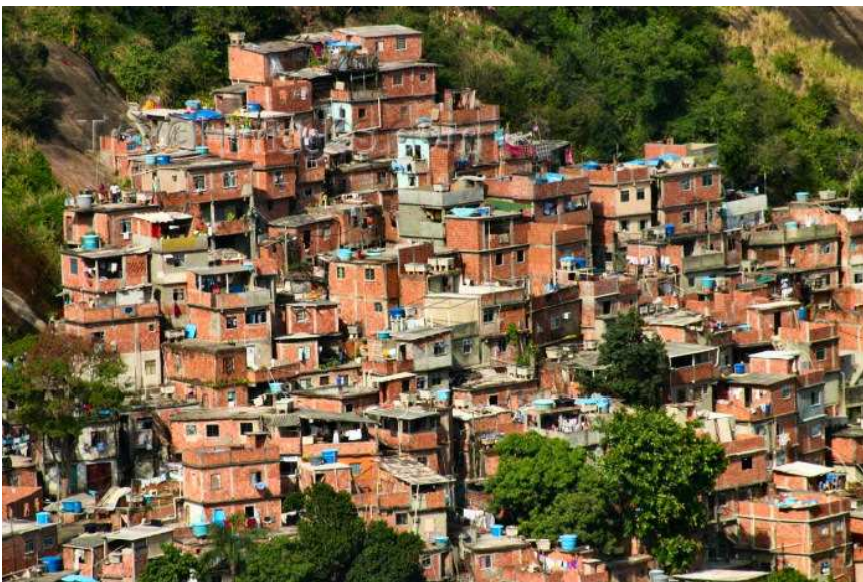
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Why People Move to Urban Areas?

- Urbanization and economic survival
 - Decision to move to an urban area part of a complex survival strategy
 - Families minimize risk by placing members in different labor markets
 - Largest labor market maximizing the chances of employment and survival
 - Cities are the largest labor markets

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Favela da Rocinha



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3 Megacities and Urban Regions

- Concentration
 - An increasing share of the global population lives in megacities.
 - Megacities (over one million)
 - Supercities (over 4 million)
 - Supergiants (over 10 million)
 - 1950:
 - 83 cities of more than 1 million
 - 34 cities in developing countries
 - 1995:
 - 280 cities of more than 1 million
 - All new megacities are in developing countries
 - 11 of the 15 largest cities are in developing countries

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Cities of more than 8 million, 1950-2000

1950	1970	1990	2000
Developed countries			
New York London	New York London Tokyo Los Angeles Paris	Tokyo New York Los Angeles London Moscow Osaka Paris	Tokyo New York Los Angeles London Moscow Osaka Paris
Developing countries			
None	Shanghai Mexico City Mexico City Buenos Aires Beijing Sao Paulo	Mexico City Sao Paulo Shanghai Calcutta Buenos Aires Bombay Beijing Seoul Jakarta Delhi Rio de Janeiro Tianjin Jakarta Cairo Delhi Manila	Mexico City Sao Paulo Shanghai Calcutta Bombay Beijing Jakarta Delhi Buenos Aires Lagos Tianjin Seoul Rio de Janeiro Dhaka Cairo Manila Karachi Bangkok Istanbul Teheran Bangalore Lima

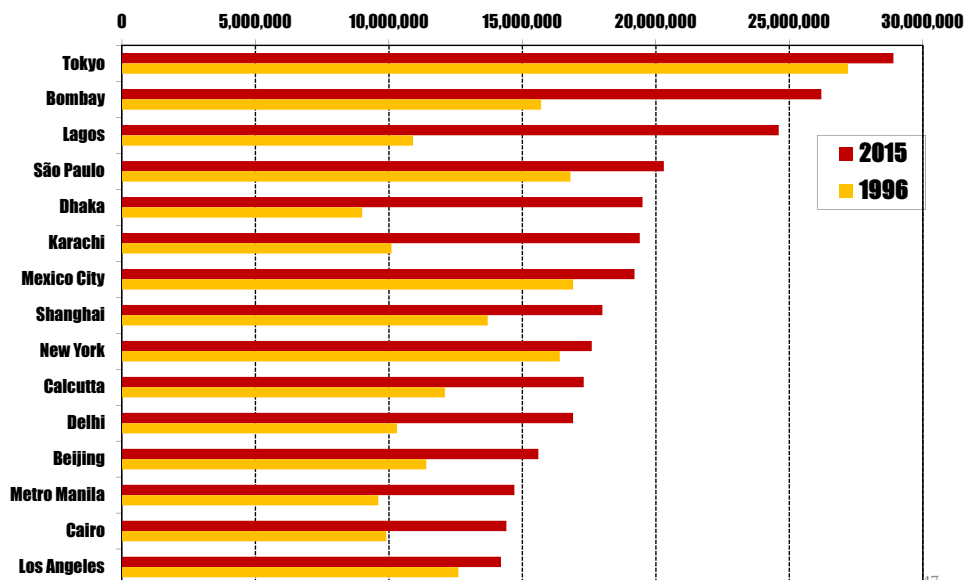
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Cities of more than 8 million inhabitants, 2000



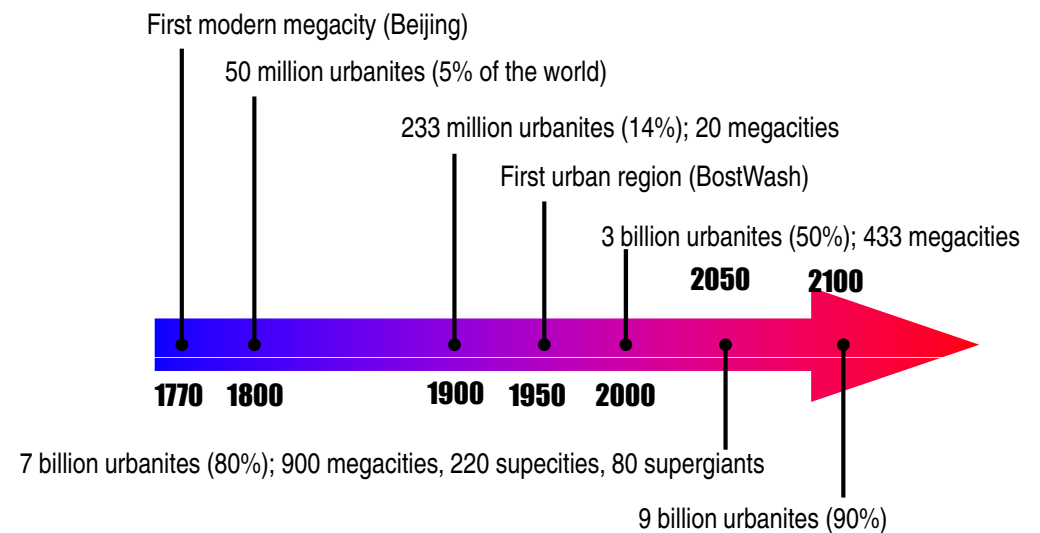
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The 15 Largest cities in the world, 1996, 2015



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Megacities



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4 Migration and Urbanization Problems

- The urban informal sector
 - Women in the informal sector
- High urban unemployment rate
- Slum and shantytowns

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Why are there so many cities?

- Difficult to block this self-sustaining process
 - Coordination failure and capital market failures make the creation of new urban centers a task that markets CANNOT complete.
- No adequate midsize cities to provide alternative locations for growth
 - Once a city is in a growth mode, it drains population from nearby cities
 - No incentive to move to lower cities (First City Bias)

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Result: Informal Sector

- Massive additions to the urban labor force mainly absorbed by the informal sector
- No legal registration, license or subject to government labor regulations
- **Long seen as parasitic activity with little social value so treated with** benign neglect at best and outright hostility at worst
- Labeled as “residuum”

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Not All Informal Activities Are Bad

More recognition of the beneficial role of the informal sector, especially as appears now a permanent rather than transitional phenomenon.

1. It is closely connected with the formal urban sector: informal activities can graduate to the formal sector
2. Creation of employment and income opportunities especially allows huge numbers to escape from extreme rural poverty and underemployment: especially for **women**
3. Creation of a surplus that could provide an impetus to growth in the urban economy.
4. Important role in the formation of human capital.
5. Absorbs semiskilled and unskilled labor not demanded elsewhere.
6. Adopts appropriate technologies and make use of local resources.
7. Recycles waste materials

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Informal Employment In Non-Agri

Region/country	Informal employment as percentage of non-agricultural employment	Women's informal employment as percentage of women's non-agricultural employment	Men's informal employment as percentage of men's non-agricultural employment
North Africa	48	43	49
Algeria	43	41	43
Morocco	45	47	44
Tunisia	50	39	53
Egypt	55	46	57
Sub-Saharan Africa	72	84	63
Benin	93	97	87
Chad	74	95	60
Guinea	72	87	66
Kenya	72	83	59
South Africa	51	58	44
Latin America	51	58	48
Bolivia	63	74	55
Brazil	60	67	55
Chile	36	44	31
Colombia	38	44	34
Costa Rica	44	48	42
El Salvador	57	69	46
Guatemala	56	69	47
Honduras	58	65	74
Mexico	55	55	54
Rep. Dominicana	48	50	47
Venezuela	47	47	47
Asia	65	65	65
India	83	86	83
Indonesia	78	77	78
Philippines	72	73	71
Thailand	51	54	49
Syria	42	35	43

UN, Women and Men in Informal Economy (2002)

Table 8.5 Estimated Share of the Urban Labor Force in the Informal Sector in Selected Developing Countries

Area	Share (%)
Africa	
Ghana	60–70
Ivory Coast	31
Kenya	44
Nigeria	50
Senegal	50
Tunisia	34
Asia	
India	50
Indonesia	45
Malaysia	35
Pakistan	69
Latin America	
Argentina	53
Bolivia	61
Brazil	56
Chile	51
Colombia	62
Costa Rica	46
Ecuador	54
Honduras	52
Mexico	57
Panama	40
Paraguay	69
Peru	56
Venezuela	45

Sources: S. U. Sethuraman, *The Urban Informal Sector in Developing Countries* (Geneva: International Labor Organization, 1981) for Asia and Africa; International Labor Organization, *World Employment 1996/7* (Geneva: International Labor Organization, 1996), tab. 5.5 for Latin America.

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Unemployed Here, But Need Labor There

- Migration is selective and therefore has implications for economic growth in general and particularly for its distributional manifestations.
- Emigrants are often drawn from the *best and the brightest*, yet they compete with one another.
- So emigration depletes the rural countryside of valuable human capital: “**brain drain**”

TABLE 8.6 Urban Open-Unemployment Rates in Twenty Developing Countries, 1993–1998

Country	Year	Unemployment Rate (%)
Algeria	1995	23.8
Argentina	1994	18.6
Barbados	1994	21.9
Chile	1994	6.3
Colombia	1994	9.2
Egypt	1993	8.3
Indonesia	1998	10.0
Jamaica	1994	15.4
Morocco	1998	15.5
Nicaragua	1995	20.2
Panama	1995	14.3
Peru	1994	8.8
Philippines	1995	9.5
Saudi Arabia	1993	15.5
South Africa	1995	33.0
South Korea	1998	6.4
Sri Lanka	1995	13.6
Thailand	1998	5.8
Uruguay	1994	10.7
Venezuela	1994	10.3

Sources: International Labor Office, *World Employment, 1996/97* (Geneva: International Labor Office, 1996), tabs. 5.1a and 5.1d; *Economist*, April 25, 1998, p. 72; United Nations, *Report on the World Social Situation, 1997* (New York: United Nations, 1997), pp. 108–109.

Shantytowns

• Definition

- Dwellings are built by the current or original occupant.
 - Rudimentary construction materials
 - Did not receive a construction permit
 - Do not follow norms in terms of housing and sanitation
- Inhabitants have no legal title to the land.
 - Most are located in areas being declared inhabitable
 - Own by the municipality
 - Abandoned private land
 - Exploiting a legal vacuum of land ownership
- Lack of urban services.
 - tap water, electricity, roads, public transportation, and sewage

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Slum in Rio (Brazil)



Kibera slum, Nairobi, Kenya



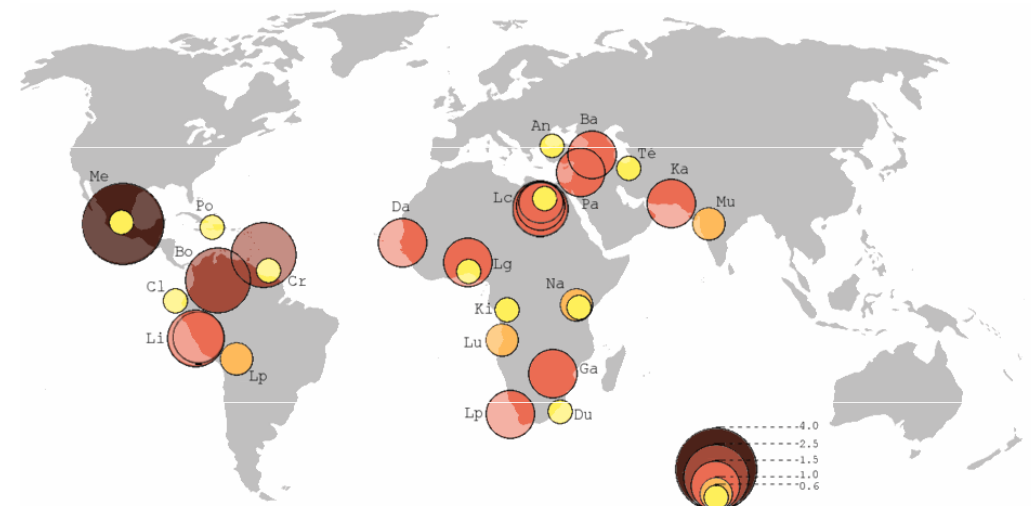
TABLE 8.3 Slums and Squatter Settlements as a Percentage of Urban Population

City	Slums as Percentage of City Population
Latin America	
Bogotá, Colombia	60
Mexico City, Mexico	46
Caracas, Venezuela	54
Rio de Janeiro, Brazil	20
Middle East and Africa	
Addis Ababa, Ethiopia	79
Casablanca, Morocco	70
Ankara, Turkey	60
Cairo, Egypt	60
Dar es Salaam, Tanzania	53
Asia	
Calcutta, India	67
Karachi, Pakistan	44
Manila, Philippines	35
Jakarta, Indonesia	26

Sources: Population Crisis Committee, *World Population Growth and Global Security*, Report No. 13 (Washington, D.C.: Population Crisis Committee, 1983), p. 2; Daniel Litvin, "Dirt poor: A survey of development and the environment," *Economist*, March 21, 1998, p. 8.

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The Planet Of Slums



Many of these slums grow at phenomenal rate, faster than the city itself!

Source: Planet of Slums (2006), Mike Davis

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Shantytowns

- Who?
 - Many of the new urban dwellers, particularly women and their children, are among the poorest people in the world.
- Why? Difficulty to access housing
 - Economic costs, availability
 - 100 million people are homeless.
 - 1 billion live in precarious housing conditions.
- How?
 - Shantytowns; informal habitat or squatter housing.
 - Called *favelas* (after a hill outside Rio, Brazil), *Pueblos jóvenes* (Young towns, Peru), *Asentamiento irregulares* (Irregular settlements, Mexico), *Villas miserias* (Miserable villages, Argentina)

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Shantytowns

- Implication
 - the most visible sign of widespread poverty
 - About 25% of the surface of cities in developing countries is covered by shantytowns.
 - 30-60% of the urban population.
 - emerged in all Third World cities following the demographic explosion
 - now the norm more than the exception
 - Incapacity of private and public provision
 - Housing crisis that could not be solved

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Shantytowns

- Growth process
 - People expelled from gentrification in downtown areas.
 - Inflow of people expelled from poverty in rural areas.
 - In several cases, rightful owners of land have divided it in small lots and sold it in order to have a higher profit.
 - In some instances, land was illegally sold to dwellers being framed.
- Is there any hope?
 - Housing has always been a priority for investment.
 - As the population of Third World cities gets higher income, the priority will be improving their housing conditions.
 - On the long run, shantytowns are likely to disappear (or at least become less significant).

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CONCLUSION

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Improving Labor Market Conditions

- Does it make sense to promote “flexibilization” ?
- Does it make sense to protect workers by international norms (ILO’s “decent work”, prohibition of child labor)?
- Removing distortions in the labor market
 - Decreasing public employment in order to increase private employment:

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Improving Labor Market Conditions

- Labor market regulations, often designed to protect the interests of poor workers, can restrict **formal** labor markets and the access of poor workers.
 - Labor union nowadays is seen as a drag to efficiency

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Reducing Migration

- Need to have a comprehensive *Migration and Employment Strategy*
 - Feedback effects: population growth, informal sector, education, urban bias
- “New migration economics” findings point to the role of
 - Reduction in inequality
 - Implementation of social insurance mechanisms and safety nets (social security, old-age)
 - Reduction of market failures in capital market (as capital is complement to labor)

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