Expanding employment in the global economy: the high road or the low road?

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Expanding Employment in the Global Economy: The High Road or the Low Road?[1]

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I. INTRODUCTION[2]

A most pressing problem before the world community today is that of unemployment and underemployment - the existence of mass unemployment in advanced economies (the North) and the lack of adequate employment opportunities in many developing countries (the South) for their fast-growing labour forces. The emergence of a much more integrated and liberal world economy in the last decade or so as a consequence of globalization and freer movements of capital and trade, has apparently made little contribution towards meeting this global employment challenge. Whether or not one agrees with those who argue that globalization is a part of the problem rather than its solution, it is quite clear that unless people's legitimate needs for remunerative jobs and productive work can be met, the new liberal international economic order will be in serious jeopardy. As Sir John Hicks observed with respect to the 1930s,

> The main thing which caused so much liberal opinion in England to lose faith in Free Trade was the helplessness of the older liberalism in the face of massive unemployment, and the possibility of using import restriction as an element in an active programme fighting unemployment. One is, of course, obliged to associate this line of thought with the name of Keynes. It was this, almost alone, which led Keynes to abandon his early belief in Free Trade.[3]

Apart from its implications for the liberal world economic regime, there are other obvious, but no less important, reasons for the employment question to head the world economic agenda. These were commented on in an earlier paper Singh (1995c) (hereafter referred to as "Institutional Requirements"), to which the present paper is a sequel. Institutional Requirements specifically examined the issue of mass unemployment in the North and argued that new instruments and policies would be needed if the purpose was to restore full employment in industrial countries. It departed from much of the literature by adopting an explicitly historical and institutional approach to the analysis of mass unemployment in the

North. The present paper complements that analysis by considering also the current and potential underemployment and unemployment problems in the South. This paper will outline the linkages between the employment problems in the two regions and examine them within a common framework in the context of a liberalised world economy. It will advance the following main theses:

1. The first-best solution is for the two regions to co-operate by following positive-sum policies which help to create employment in the North as well as the South in a virtuous circle of cumulative causation. These policies, whose essential core is a trend increase in the rate of growth of real world demand and output, can in principle, not only lead to full employment with rising real wages in the North but can also help the South to provide the jobs required for its rapidly expanding labour force.

2. This is the "high road" and in economic terms it is perfectly feasible. This is in part because, it will be argued here, there exists a backlog of technology represented by the information and communications technology revolution. The full potential of this technological revolution has not been harnessed so far in most parts of the world owing to an insufficient rate of growth of demand and output.

3. The paper contrasts the demand growth approach to reducing unemployment with that of labour market flexibility, currently recommended by the IMF, the OECD and other international organisations for countries in the North as well as in the South. The latter is, however, regarded here as the "low road". Flexible labour markets, it will be suggested, will not be able to provide full employment with rising real wages in the North, nor will they be able to create sufficient job opportunities in the South. With a constant level of aggregate demand, more labour market flexibility will simply lead to greater competition among job seekers and hence

reduce the price of labour, often resulting in an increase in disguised unemployment. Moreover, at the international level, if each country tries to improve its competitive position by reducing wages, the net result may be competitive devaluations of the kind which occurred in the 1930s and hence even greater instability for the international economy.

4. The successful implementation of the high road approach requires important institutional changes which emphasise cooperative relationship between workers, employers and governments in individual countries as well as between nation states in both the North and the South.

UNEMPLOYMENT AND UNDEREMPLOYMENT IN THE NORTH AND THE SOUTH

Mass unemployment in the North

In the 1980s, fifty years after the Great Depression, industrial countries came again to be haunted with the spectre of mass unemployment. The unemployment situation, into the 1990s, continues to be dire in several European Union countries. As OECD (1994) has noted, the 35 million people presently unemployed in the member countries "represent an enormous waste of human resources, reflects an important amount of inefficiency in economic systems, and causes a disturbing degree of social distress (p.9)." The study estimates that unemployment in the form of involuntary part-time work, short-time working and discouragement of job seekers from looking for new employment could add 40 to 50 percent to these unemployment figures.

The current mass unemployment stands in striking contrast to the situation which prevailed in the industrial countries in the not too distant past. During the period 1950-1973, which has been aptly described as the Golden Age of the world economy, leading industrial countries not only enjoyed full employment but had over-full employment. In addition to being able to employ all their own people, these countries also provided jobs for additional labour from abroad. In countries like France and West Germany nearly 10 percent of the labour force came from other nations. Most developing countries also participated in and benefitted from the worldwide prosperity ushered in by the Golden Age. The Golden Age of simultaneous prosperity for the North and the South evidently came to an end with the first oil shock in 1973. Since then, the rate of growth of the OECD and the world GDP has nearly halved.

Employment challenge in the South

It may come as a surprise to some that the recorded rates of unemployment in most developing countries tend to be relatively low. This is because in the virtual absence of a publicly provided social security system, people are obliged to engage in any economic activity, however non-remunerative and non-productive it may be. The problem of unemployment in poor countries, therefore, manifests itself generally in the form of what Joan Robinson called "disguised unemployment", or as "underemployment". To illustrate, in 1988-89 in Ghana, the proportion of labour force unemployed was, according to World Bank estimates, only 1.6%. However, nearly a quarter of the workers were "underemployed" , i.e they worked "less than full time, not because they choose to but because more work was unavailable" (World Bank, 1995).[4]

Nevertheless, the actual employment situation in many Third World countries, particularly in Latin America and Sub-Saharan Africa, is dire. There are not only current high rates of urban, especially youth and "educated" unemployment, but more importantly, it is necessary to provide productive jobs for a labour force which is growing at approximately 3 per cent a year. On the basis of past relationships between economic variables, to create jobs at this rate in order to meet the employment needs of new entrants to the labour force, the economies of these countries need to grow at a rate of about 6 per cent per annum (UN,1993). Unfortunately, in what has been rightly called the "lost decade" of the 1980s for the developing continents of Latin America and Africa, the rate of economic growth was considerably less than was required; it was only of the order of 2.1 per cent per annum in Sub-Saharan Africa and 1.6 per cent per annum in Latin America.[see Table 1]

In the 1990s, as a consequence of large scale private capital flows to Latin America, there has been a revival of economic and industrial growth in a number of economies on that continent. However only one or two of them (Chile and perhaps Argentina) have so far shown signs of reverting back to their previous (ie. pre-debt crisis) long-term trend rates of growth. For most countries in the region the prospect for faster long-term economic growth has again been put into jeopardy by the recent financial crisis in Mexico. The economic situation in the African countries in the 1990s is if anything even less promising.

To illustrate the implications of this slow long-term economic growth for employment, consider the case of Mexico. Between 1990 and 1992, the economically active population (EAP) in that country is estimated to have increased by 1.2 million persons each year. However, during this period only 339,974 jobs, ie. 28 per cent of the EAP, was absorbed by the formal labour market. Yet it is important to observe that in the two years before the debt crisis, 1980 and 1981, the Mexican economy expanded at an average rate of about 7 per cent per annum and created three quarters of a million new jobs each year in the formal sector.[5]

Employment, poverty and economic growth

At the macroeconomic level, there is an important indirect relationship between the employment question and that of the reduction of poverty. Just as the creation of sufficient employment opportunities requires a reasonable rate of economic growth, so does the eradication of poverty and meeting the minimum basic needs of the people.[6] In its influential 1976 report, the ILO estimated that even allowing for some redistribution of incomes, if the minimum basic needs of the poorest 20% of the Third World's population were to be met by the year 2000, their economies would have to grow at an annual average rate of 7 percent a year. These rates are coincidentally not all that different from those required to create sufficient employment opportunities for the South's growing population.

Real wages, employment and economic growth in developing countries the 1980s

Those economies (mainly in Asia) that were able to achieve high rates of growth have succeeded in significantly reducing poverty, as well as recording fast growth of both real wages and employment. On the other hand, low economic growth in the Latin American and African countries over the recent period has had a serious negative effect both on poverty and formal sector employment generation in these economies. To illustrate, ILO (1995) provides evidence that in the last decade, in the fast-growing East Asian economies (e.g. Malaysia, Singapore, Taiwan,Korea), labour shortages emerged and there was significant immigration of labour from neighbouring lower-income countries. Manufacturing employment grew at a rate of over 6 percent per annum during the 1980s for the dynamic economies of the region. Real earnings rose during this decade at an average rate of 5 percent per annum.

In contrast, in slow-growing Latin America, there was a steady fall in modern-sector employment between 1980 and 1992, with paid employment falling at a rate of about 0.1 percent per annum during the 1980s. This reversed the trend of the previous three decades, when steady economic growth had led to a significant expansion of modern-sector employment. In most countries, the average real wage fell during the 1980s, recovering in only a few countries towards the end of the decade. Minimum wage fell on average by 24 percent in real terms across the region, while average earnings in the informal sector declined even more sharply (by 42 percent).

The question of why Asian countries succeeded and the Latin American and the African countries failed in the 1980s and into the 1990s is the subject of an important debate. The contrast between the Asian and Latin American economic performance in the recent period is particularly striking as in the previous 15 years (1965-80), the two groups of economies had been growing at much the same rate, ie at an average rate of about 6 per cent per annum.[See table 1]. For reasons of space, this debate will not be reviewed here. Suffice it to note that the Bretton Woods institutions ascribe the Latin American failure in the "lost decade" of the 1980s essentially to internal causes, e.g., inherent inefficiencies of the Latin American regimes, too pervasive a role of the state.[7] However, in a series of contributions, Banuri (1991), Fishlow (1991), and Singh (1994), have provided detailed analysis to suggest that the reason for these intercontinental differences in economic performance was not the internal economic factors but rather external shocks. The magnitude of these external shocks and their adverse impact on the balance of payments and on economic growth of the Latin American economies was much greater than that for the Asian countries. The Latin American countries were particularly hard hit by the capital supply shock which is either ignored or not properly examined in the orthodox analyses of these issues.

THIRD WORLD COMPETITION AND ITS IMPACT ON ADVANCED ECONOMIES

Since 1980, the labour markets of the North's industrial economies have been dominated by three significant tendencies, namely a) de-industrialisation, b) high overall unemployment, c) increasing inequality between skilled and unskilled workers, particularly in the US. Popular opinion in industrial countries increasingly blames competition from LDCs for these job losses or for stagnating real wages for unskilled workers. So, unlike the 1950s and 1960s, when free trade with advanced countries was feared by developing countries, today it is the former who are more concerned about the ill effects of a liberal trading regime.

With a few exceptions, mainstream economists have generally denied these unfavourable consequences of North-South trade. However, Wood (1994) has presented important analyses and evidence to challenge this conventional wisdom. He estimates that Southern competition has reduced manufacturing employment in the North by 12 percent. Further, to the extent that Southern competition induces labour-saving technical progress in the North, Wood suggests that this may have resulted in additional job losses of equal magnitude. Thus for Wood, the fast growth of imports from the South, despite a sizeable trade balance in favour of the North, is a main cause of both de-industrialization and overall unemployment in industrial countries. He also marshalls impressive evidence to suggest tentatively that the rising inequality between skilled and unskilled workers in the North is due largely to Southern competition rather than technical change.

These conclusions are controversial and have generated a large critical literature.[8] The essential point is that although Wood's analysis may be correct within the terms of his own traditional Hecksher-Ohlin model, the model is rather limited in that it excludes aggregate demand and capital accumulation. If a rise in real global demand (as a result, for instance, of better policy coordination among industrial countries) leads to a higher trend rate of growth of output, the negative impact of Southern competition on unskilled workers in the North may be more than outweighed by what Bhagwati calls the lift-all-boats effect of faster overall growth. Such considerations may also help resolve some of the controversy in this area by explaining why, during the 1950s and 60s, countries like the US, the UK and West Germany were able to absorb not only fast growing imports from the then low-income countries (eg. Japan) but also greater immigration than now, without experiencing mass unemployment or stagnant real wages.[9]

LABOUR MARKET FLEXIBILITY, GROWTH OF DEMAND AND UNEMPLOYMENT IN THE NORTH AND THE SOUTH

There is a continuing debate in the North about the causes and remedies for the current mass unemployment. Orthodox economists argue that the main causes are labour market rigidities and the welfare state. Theoretically, this thesis is justified in terms of the concepts of the natural rate of unemployment or that of NAIRU (non-accelerating inflation rate of unemployment). It follows from this analysis that the remedy for unemployment lies in making real wages more flexible, deregulation of the labour market by relaxing restrictions on dismissal of workers, reducing trade union power, and pruning the welfare state. The proponents of this view cite the better unemployment record of the United States with a less regulated labour market as evidence in support of the labour market flexibility thesis.

This thesis has been challenged by several analysts. First,it has been pointed out that labour market performance should not be judged in terms of a single variable such as the rate of unemployment. In terms of other relevant indicators such as growth of overall national productivity and per capita income, it turns out that the performance of European economies has been superior to that of the US (CEPR, 1995).

Second, as noted in Institutional Requirements, in the absence of an adequate social safety net in the US, people are pushed into disguised unemployment, i.e. they are forced to accept very low productivity, low wage jobs in order to survive. Eatwell (1995) and UNCTAD (1995) have formalised the concept of disguised unemployment and estimated its empirical significance for a group of leading advanced countries. They postulate a segmented labour market: in the high productivity, high wage sector, the level of employment is determined by aggregate demand, while in the low productivity, low wage sector employment, it is determined by the supply of labour to that sector. If there is a fall in aggregate demand leading to layoffs in the former sector, in the absence of a social safety net, the latter sector would act as a perfect sponge for displaced workers. Measured employment in that case will become independent of aggregate demand. This, UNCTAD (1995) suggests, "is the full-employment that would be attained with a highly flexible labour market (page 210)." Empirical estimates of disguised unemployment indicate that if it is added to open unemployment, "true" unemployment is much higher than measured underemployment in the US and Japan. These estimates show that corrected for disguised unemployment, true unemployment rates have tend to converge among the leading industrial countries in the 1980s.

The US-European comparison of labour market practices and outcomes also raises other questions about the labour market flexibility thesis. The first point here is that the US labour market was more flexible than the European market not just in the recent period, but also in the Golden Age. However, the European unemployment record in the Golden Age was much superior to that of the US. Secondly, continuing with this kind of analysis of changes in labour market conditions and performance over time, it may be observed that the European labour market has been much more flexible in the 1980s compared with the 1950s and 1960s, yet there was more or less full employment in the earlier period whilst the later period is characterised by mass unemployment. As noted in Institutional Requirements, the same difficulty with the labour market flexibility hypothesis arises in explaining the fact that the labour market was much more flexible in the 1930s compared with the post-war Golden Age. Matthews and Bowen (1988) show that real product wages rose far more in the 1950s and 1960s in the UK compared with the 1930s, yet the earlier period had the Great Depression and the later period more or less full employment.

At the policy level, the limitations of the labour market flexibility programme were exemplified by the experience of the UK in the 1980s and into the 1990s. During this period, the UK labour market became much more flexible as a result of a sustained attack on the trade unions and the welfare state by the conservative governments. This, however, has not lead to more job creation or less unemployment. On the contrary, there has been a huge trend increase in unemployment in that country compared with the 1970s, let alone the golden age. It may be recalled that the average rate of unemployment in the UK between 1960 and 1973 was only 1.9 percent; in the period 1974-1979 it was 4.2 percent; while between 1980 and 1994 it was 8.9 percent.

The reason for these empirical failings of the labour market flexibility thesis lie in part in its theoretical limitations. The hypothesis is rooted in micro-economics and is based on a partial equilibrium approach. It assumes that other things being equal, faced with a cut in wages as a consequence of competition among the unemployed, a profit maximising firm will increase employment and output. An alternative view, conceptualised by Keynes, is that the firm will expand its output only if it can be sure that it will be able to sell it. In other words, employment will expand only if there is an increase in demand and output and not just because there is a cut in wages. A cut in wages could reduce aggregate demand and therefore employment.

The reason why there was full employment in the Golden Age in spite of the welfare state and labour market rigidities is to be sought in the much higher rate of growth of real demand and output in that period. As observed in Institutional Requirements, the Golden Age was the outcome of a specific economic regime, a new development model which differed significantly from the one which prevailed in the industrial countries in the inter-war period, or the one which has ruled in the post-1980 period. The Golden Age model involved a social consensus with respect to institutional arrangements regarding the setting of wages and prices, the distribution of wages between income and profits, and with respect to government policies in relation to state fiscal, credit and welfare policies which guaranteed minimum living standards and maintained aggregate demand. Employers agreed to productivity wage bargaining and the trade unions acted with restraint. Whether or not there was a voluntary consensus at the international level, under US hegemony, the international economy worked under stable and orderly monetary and trading arrangements. The net result was a virtuous circle of high rates of growth of demand, investment, productivity growth and real wages which ratified and maintained high rates of accumulation. This enabled trade unions to satisfy the aspirations of their members without inflationary wage demands, which in turn made it possible for employers to continue to have high rates of accumulation.

Strikingly, the experience of the developing countries also does not provide any support for the labour market flexibility thesis. As aggregate data on real earnings in manufacturing for the three developing continents in table 2 indicates, there were enormous declines in earnings in the 1980s in Latin America and sub-Saharan Africa. However, as noted earlier, these large reductions in real earnings did not lead to any increase in employment growth in these two continents. On the contrary, there was a substantial fall in modern sector job expansion. In sharp contrast, table 2 shows that in East Asia, earnings rose at a rate of 5.1 percent per annum over the period 1981 - 90. However, as suggested earlier, in the East Asian case, this was accompanied by a large rise in employment, particularly in the modern sector.

The essential reason why both real wages and employment expanded in East Asia, whilst both fell in Latin America and sub-Saharan Africa, lies in the differences in the real rates of growth of demand for countries on the three continents. The Latin American and African economies became severely balance-of-payments constrained during the 1980s as a consequence of the debt crisis and therefore had low rates of growth of real aggregate demand. The East Asian economies escaped the debt crisis and were thereby able to maintain their previous high rates of growth of real demand.

TECHNICAL PROGRESS, PRODUCTIVITY, GROWTH AND EMPLOYMENT

It is widely believed that the world is undergoing a new, far reaching technical revolution as a result of the rise and spread of information technology. Freeman (1989) has argued that the "information and communication technology (ICT) paradigm" presently sweeping the globe is as important in terms of its spill over effects and overall economic impact as any of the three major technological revolutions of the past two centuries. This raises the important question of whether high rates of unemployment and underemployment in developed and developing countries are due to the new technology. Has the pace of technological progress become so fast that there is 'jobless growth' - i.e. economic growth does not create any employment at all - or in a less extreme form, the hypothesis would be that a given percentage change in economic growth leads to a smaller increase in employment than was the case in the past.

It is shown in Institutional Requirements that available evidence for advanced economies does not support either of these hypotheses. The data show that productivity growth in these countries has fallen rather than increased since 1973, which suggests that the full potential of the new technology is not being realised. Similarly, there is no evidence of any decline in the recent period in the employment elasticity of output (Boltho and Glyn, 1995). The reason why there is mass unemployment in industrial countries today is not that there has been jobless growth, but that these countries have been expanding at a slower rate than before.

Freeman et al (1995) provide evidence of the purposive use of the ICT technology in one part of the world, namely East Asia. The authors show how in that region a virtuous circle of high output and productivity growth, greater international competitiveness, and high growth of employment have been created. This has however not happened in other regions because of slow economic growth. Freeman et al note that a revolutionary new technology can only provide the basis for a virtuous circle of growth. Whether this virtuous circle can be realised and sustained depends on macroeconomic, employment and trade policies. They point out that a "good match between technologies, policies and institutions can result in prolonged periods of full employment."

SUMMARY AND CONCLUSION

This article has outlined some main issues in analyzing mass unemployment in the North and severe underemployment as well as unemployment in the South. It is an urgent task for the international community to find policies which can achieve both full employment in the North and provide jobs for the South's fast growing labour force.

It is suggested here that the pursuit of labour market flexibility is unlikely to achieve full employment in the North with rising real wages. Moreover, this strategy runs the danger of increasing disguised unemployment and leading to a competitive erosion of labour standards. It will also be socially divisive and pit first world workers against third world workers. Past history suggests that the net result will be a negative sum ad-hoc protectionism in industrial countries.[10]

The goal of full employment in the North, with rising real wages, can only be attained with a substantial trend increase in the rate of growth of real demand and output. That will not only lead to faster growth of employment, but by harnessing the potentialities of the new information and communication technologies revolution, it will also promote productivity growth in a virtuous circle of cumulative causation in accordance with Verdoorn's Law.

Faster economic growth in the OECD economies will help developing countries by increasing demand for Southern products; by improvements in the South's terms of trade; by greater capital flows from the North to the South and hopefully also by the governments of the North being able to afford and willing to provide larger aid programs. This should, ceteris paribus, lead to faster employment and output growth in the LDCs. Similarly, greater employment and faster output growth in the South would help the North by a positive feedback through greater Southern imports.

However, as noted in Institutional Requirements, in the present circumstances, the pursuit of these positive-sum-policies by Northern governments is not a straightforward proposition. The faster expansion of real aggregate demand and production cannot be achieved simply by the usual Keynesian method of changes in demand management policies of the leading industrial countries. Past evidence would suggest that, in the absence of an appropriate restraining institutional framework at the national and international levels, reliance on such policies would simply result in an excessively sharp rise in commodity prices (as occurred in the early 1970s), an increase in trade union militancy and higher inflation, which in turn would thwart the expansionary process. Instead of the post-1980 labour market flexibility doctrine, the restoration of full employment with only moderate inflation requires more co-operative institutional arrangements involving workers, employers and governments in individual countries. It will also require more co-operative relationships between nation states, within the North (to achieve inter alia macroeconomic policy coordination), and between the North and the South (in order to obtain for example, more orderly movements in commodity prices).[11]

[1]. I have enjoyed Geoff and Joan Harcourt's generous and warm friendship from the time I first came to Cambridge over thirty years ago and they took me in hand. It is a pleasure to dedicate this essay to Geoff on the occasion of his 65th birthday. The paper addresses issues which have for long been Geoff's importanr concerns. For his recent writing in this area, see Harcourt 1992, 1993 and 1995.

[2]. The paper draws on material in Singh and Zammit (1994) and Singh (1995a).

[3]. Hicks (1959), quoted in Bhagwati (1994) on p.233.

[4]. It will be argued below that the concept of disguised unemployment is not only pertinent to developing countries, but also has application today in advanced economies.

[5]. See further Singh (1988) and Peters (1994).

[6]. For the relationship between employment, basic needs, poverty and economic growth, see Singh (1979, 1992). See also ILO (1976).

[7]. See further World Bank (1991). See also Sachs (1985), Maddison (1985) and Summers and Thomas (1993).

[8]. See among others Krugman and Lawrence (1993), Leamer (1994), Sachs and Schatz (1994), and UNCTAD (1995).

[9]. UNCTAD (1995) observes that between 1958 and 1975 import penetration by Japan, as well as by Italy, both in the United States market and in the national markets of the other five then members of the European Economic Community (EEC) was on a scale comparable to the rise of today's late industrializers.

[0].0. For a fuller discussion of this issue see Singh (1995b).

[1].1. For a fuller analysis of the institutional requirements for full employment in advanced countries see Institutional Requirements.

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