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Employment Policies in Developing Countries

By Dr Rasul Shams, Hamburg *

The ILO World Conference on Employment was held in Geneva from June 4 to 17, 1976 and after long discussions adopted an action programme which provided for quite a number of measures designed to ensure full employment in developing countries until the year 2000. The problems posed by a policy of full employment in developing countries are indicated in the following article which demonstrates that a change in the inherited power structures is a major prerequisite for an effective policy of full employment.

The expectation that the employment problem in the developing countries will be automatically solved as a result of planned industrialization has until now not been fulfilled. Despite considerable advances in industrialization overt unemployment has risen further and developed into a pressing political problem in many of the developing countries¹. Full employment is in consequence given a higher rating among economic priorities. From the point of view of development policy the crucial question now is this: By which measures can full employment be achieved in the developing countries and which repercussions will such measures have on other development objectives such as growth and incomes redistribution?

In the following discussion of this question no attention will be paid to measures which either form part of emergency programmes or cannot be regarded as more than supplementary strategies. They include for instance public work procurement programmes, increased assistance for individual sectors like housing, or support for labour-intensive export products. The employment effects of such measures are either transient or else not comprehensive enough to deserve the epithet of employment strategy.

An intensification of industrialization efforts beyond what has been done up to now on the other hand clearly offers one possible kind of comprehensive employment strategy. Since the industrialization process in the developing countries has to date been marked by a high capital intensity, this strategy would however call for the investment of larger sums than these countries will probably be able to raise in any foreseeable period.

An alternative employment strategy could be based on a variation of the aggregate of products made in the developing countries. In theory products can be given a scale rating according to their labour intensity, with those involving a maxi-

imum of labour ranking highest. Any production shift towards products at the top of the scale would require a larger labour input and thus tend to increase employment. Such a change of the product mix could continue until full employment has been achieved, but this is obviously only possible if the demand structure is adjusted to the new supply structure as and when required, and this in turn would require a highly effective flexible policy of incomes redistribution.

Redistribution as Strategical Starting Point

In practice it will be simpler not to correct the demand structure *ex post facto* through a redistribution policy but to choose the opposite course of making the redistribution the starting point of the employment strategy. In view of the great inequalities in developing countries an improvement of the incomes distribution would be attended by an improvement of the employment situation, provided that it can be assumed that the goods bought by wage-earners have a larger labour content than those demanded by the higher income groups².

This kind of conclusion will always be warranted if on the one hand the products can be placed in a definite rank order according to their labour content and on the other the demand structure is such that the products with a low labour content are in demand exclusively or overwhelmingly from higher incomes groups and vice versa. For an improvement of the incomes distribution will from the point of view of employment policy always be less effective if individual products are produced by different technologies and thus involve different degrees of labour and capital in-

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¹ Concerning experience with development policies in the post-war period cf. D. T. Healy, *Development Policy: New Thinking about an Interpretation*, in: *The Journal of Economic Literature*, Vol. X, 1972, p. 757 ff.

² This is the view taken by the ILO in the case of Colombia for instance. Cf. ILO, *Towards Full Employment, A Programme for Colombia*, Geneva 1970, p. 139 ff.

tensity. This is so even if the structure of the demand from the higher income groups includes also labour-intensive products of high income elasticity (e.g. services). In this case the employment created by the incomes redistribution would in great measure be merely compensatory for employment lost as a result of it, so that the net effect would in some circumstances be very small indeed.

Empirical studies which have been undertaken on the methodological basis of simulation with the help of input-output analyses confirm that the facts are as described. The effects on employment were as a rule slight, even when quite massive redistributions took place³.

Indirect Effects of Redistribution

Incomes redistribution to the benefit of poorer sections may however be expected to have also indirect effects on employment. As the luxury consumption of the prosperous sections may be assumed to have a very large import content, this kind of redistribution would cause the luxury imports to decline and thereby release foreign currencies for imports of capital goods. This in turn would improve the employment situation. This conclusion is however warranted only if the fall in luxury imports exceeds the possible rise of imports of goods for wage-earners brought about because they now have higher incomes, and this will not be the case if despite the lower import propensity of the poorer sections the demand for import goods for wage-earners expands substantially because there are so many of them.

A more accurate assessment of the employment effects of an improved incomes distribution calls for additional considerations which are outside the scope of a static input-output analysis. Apart from the intrinsic problems of any redistribution policy in developing countries, a large once-for-all redistribution poses considerable adjustment problems for the economy of the country concerned. Insofar as the sectors producing goods for wage-earners — agriculture in particular — have a low supply elasticity, a massive increase in imports rather than the hoped-for expansion of employment may be expected to be the first result, and this may in some circumstances hamper or prevent the long-term adjustments in these sectors. A greater prospect of success would seem to attend a slower redistribution process spread over several years which would take the limited adaptability of an underdeveloped economy into account.

Weightier consequences than follow from such adjustment problems stem from the fact that the evolution of the new supply structure will go hand in hand with a shift in the sectoral investment

structure — a result which at a first glance seems altogether desirable. In the ambit of a dualist economy in which the multinationals achieve increasing ascendancy in the modern sector such a shift in the investment structure would however also enable them to penetrate deeper into the ordinary goods sector. The result could easily be an increased capital intensity in these sectors, and this would of course be contrary to the aim of full employment.

An improvement of the incomes distribution can therefore not by itself be expected to bring about a lasting improvement of the employment situation in the developing countries. A negative effect on growth would indeed have to be accepted in some circumstances. But how the effect on growth is to be assessed depends essentially upon the particular model-theoretical concept which is chosen as the starting point of such contemplations. If the argument proceeds in the framework of a Harrod-Domar model and the higher income groups are assumed to have a higher marginal and average saving ratio than the lower income groups, it follows that any redistribution benefiting the latter group will cause the growth rate to slow down. This negative effect could, it is true, be offset at least in part by the mentioned decline of imports due to the redistribution, for an improvement of the balance of current transactions — similar to an increase in savings — causes the growth rate in the Harrod-Domar model to increase.

Another positive effect on the growth rate arises if an improvement of the incomes distribution has the result of lowering the marginal capital coefficient in the whole economy. This will happen whenever the marginal capital coefficient for wage-earners' goods is lower than that for luxury goods and it can be assumed that the incomes redistribution will not lead to factor substitution⁴. The net effect on growth thus depends largely upon the extent to which the mentioned assumptions about savings attitudes, imports and sectoral marginal capital coefficients do in fact apply.

If the Harrod-Domar model is put aside and interest is concentrated on the changes in current production due to the improved incomes distribution, the technological production structure comes

³ Cf. W. R. Cline, *Potential Effects of Income Redistribution on Economic Growth*, New York 1972; V. E. Tokman, *Distribution of Income, Technology and Employment: An Analysis of the Industrial Sector of Ecuador, Peru and Venezuela*, in: *World Development*, Vol. 2, Nos. 10-12, 1974, p. 49 ff. A description of the methods of investigation and a summary of the results is given by: P. B. Clark, *Intersectoral Consistency and Macroeconomic Planning*, in: C. R. Blitzer, P. B. Clark and L. Taylor (ed.), *Economy Wide Models and Development Planning*, London 1975, p. 129 ff.

⁴ The precise conditions for the different effects have been worked out by W. G. Tyler in a simple model. Cf. W. G. Tyler, *A Model of Income Distribution and Economic Development*, in: *Weltwirtschaftliches Archiv*, Vol. 109, 1973, p. 321 ff.

to the fore again. Given that wage-earners' goods are more labour-intensive, an increased demand for these accompanied by a reduced demand for luxury goods would tend to increase employment, but if the capital equipment of an economy is limited, the effect of the incomes redistribution on current production will depend in great measure upon the amount of capital required per product unit. Increased production of wage-earners' goods at the expense of luxury goods would result in a lower total production whenever it takes not only more labour but more capital per unit of production to produce wage-earners' goods, for it will in this case be impossible to match the saving of capital through reduction of the production of luxury goods by an equivalent increase in the production of wage-earners' goods⁵. In the light of empirical experience this cannot be ruled out as impossible as the mentioned studies indicated an — albeit slight — decline of total production owing to improved incomes distribution. Even in this case however there would be no negative effect on growth and in certain circumstances a positive one if factor substitution could be tolerated and a general lowering of the capital coefficient in the economy at large could be brought about.

The Role of Factor Substitution Policy

Reflections of this kind show that factor substitution is of importance not only for employment planning but for an assessment of the effects of such planning on growth and distribution. Factor substitution may therefore suggest itself as a starting point for a self-sustaining strategy for full employment.

If a factor substitution policy is recommended as an employment strategy, it is presupposed that there are products which can be made by alternative factor employment, but this supposition is not by any means made in all the literature on development policy. It was assumed at an early stage already that the factor proportions are as a rule not variable⁶. In the theory of development planning in particular this view was based on empirical results obtained from a comparison by means of input-output tables of the production structures of various economies.

Attempts have been made of late under the pressure of actual problems in the developing countries to build factor substitution variants into the planning models. In the simplest case this can be done by confining the possible substitutions within

⁵ Cf. L. F. Mansfield and J. G. Wogart, *Income Inequality and Unemployment in LDCs: Some Implications of a Simple "Structuralist" Model*, in: *Weltwirtschaftliches Archiv*, Vol. 111, 1975, p. 333 ff.

⁶ Cf. R. S. Eckaus, *The Factor-Proportion Problem in Underdeveloped Areas*, in: *AER*, Vol. 45, 1955, p. 539 ff.

the programme model to the factor matrix and expressing this by introducing sectoral production functions instead of predetermined fixed factor coefficients⁷. If the total production is predetermined, the optimum capital and labour inputs can in this case be calculated under selected alternative factor price conditions. A policy of full employment implies as a premise in the framework of this model that the presumed factor price relation is the one which reflects the relative scarcity of capital in comparison with labour in a developing country.

Such planning models suffer from a critical drawback in that the substitution is confined to primary factors and the coefficients in the intra-industrial sphere are assumed to be fixed. But the possibility of changes of these coefficients is implicit in factor substitution. In the ideal case alternative input vectors should be available to provide a possibility of choice. But this is difficult because every single sector in an input-output table is composed of a multitude of products. To obtain significant technology vectors the input-output

⁷ Cf., e.g., H. B. Chenery and W. J. Raduchel, *Substitution in Planning Models*, in: H. B. Chenery (ed.), *Studies in Development Planning*, Cambridge, Mass., 1971, p. 29 ff.

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table has therefore to be greatly disaggregated in order to make the specification of technological alternatives feasible. With increasing disaggregation however the number of possible solutions decreases in linear programme models.

Multistage Planning Methods

This problem complex has been largely circumvented of late by the development of multistage planning methods. This planning method makes it first of all possible to identify technological alternatives on a sector level (e.g. in agriculture) and to build them into a sector model as alternative technology vectors. When this is done, optimum technology vectors can be deduced from such a sector model by introducing alternative factor shadow-price vectors originating from the solution of a model covering the whole economy. The optimum technology vectors thus determined can in turn be built into the model for the whole economy as technological alternatives⁸. The required information can be obtained in this way, and under the specific conditions of the developing countries the solution of the global model would imply an increase in employment.

Multistage planning thus makes it possible to give consideration to substitution variants without recourse to sectoral production functions. All that is achieved thereby however is the possibility of presenting a full employment strategy based on factor substitution in the form of a model. For the purposes of practical development policy it will still be necessary to find out which instruments can help to apply the discovered optimum technologies in practice. What matters in this respect is the right factor price relation, i.e. one which reflects the existing factor price conditions, so that the prevailing high unemployment must be understood as the outcome of wrong factor price relations. A full employment strategy would, in other words, call for an appreciable raising of the cost of the factor capital as compared with the factor labour. But it is at this very point that problems arise which impose narrow limits on a substitution strategy taking its queue from the factor prices.

Institutional Changes Required

It must be pointed out in the first place on the level of the conflicting objectives that the success of such a strategy depends upon continual raising of rent, interest and profit rates compared with the wages, and this could have an unfavourable effect on the incomes distribution or would at least be unlikely to improve it. Secondly there is the fact —

⁸ For details cf. J. H. Dulooy and P. R. Hazell, *Substitution and Nonlinearities in Planning Models*, in: C. R. Blitzer, P. B. Clark and L. Taylor (ed.), *Economy Wide Models and Development Planning*, *ibid.*, p. 307 ff.

which carries more weight — that in the absence of institutional changes factor prices are by no means variables for economic control in the developing countries. The economic dualism in these countries finds especially clear expression in the insufficient development of their market structure. In agriculture for instance small family holdings exist side by side with large agricultural estates with paid labour as their characteristic feature. Because of the particular institutional set-up the labour costs on smallholdings are as a rule lower than on big farms⁹. The smallholdings have for this reason a much higher labour intensity than big farms. Raising the cost of the factor capital has therefore an employment effect only as far as the big land-owners are concerned who are as a rule themselves lenders of money and enjoy easy access to the sources of credit. In such institutional conditions it is not so much the factor prices which come into question as control variables as changes in these conditions themselves, and that means a redistribution of the available assets.

Moreover, the progressive invasion of the agricultural sector by foreign investors tends to dissociate the technology choice from the internal factor price structure in the developing country. As the developing countries are unable to influence the factor price structure in industrialized countries, the use of factor substitution as an instrument of employment policy is to that extent denied to them.

To sum up, it may be stated that in the existing conditions no employment planning can hold out a promise of success unless the institutional framework is changed. In the economic sphere this means that an incomes and property redistribution and control over foreign investments alone can clear the way for more balanced development. The effective enforcement of a development policy in this sense however is bound to come up against political limits because it also presupposes in the final analysis a change of the power structures. Deferment of the necessary institutional changes would make the economic situation even more critical and render a redistribution of political power more and more urgent. In the present phase of economic development in the Third World the road to further economic advancement of these countries will not be smoothed by technocratic proposals but rather by the crumbling-away of inherited power structures inside these countries and between them and the industrialized countries. Economic understanding can speed up this process but is certainly not a substitute for it.

⁹ Cf. A. Sen, *Employment, Technology and Development*, London 1975, p. 60 ff.