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**BUREAU FOR ASIA AND NEAR EAST
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
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by

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INTRODUCTION: THE ECONOMIC ENVIRONMENT IN THE NEAR EAST REGION¹

There is agreement within the international development community that serious economic reform in Near East countries is needed in the decade of the 1990s. Of course this agreement on economic direction will be greatly facilitated by any diminution in regional political tensions that may result from the Arab-Israeli peace talks. But according to senior staff at the World Bank, ". . . the truly essential ingredient for a period of prolonged stability is a wide-ranging reform of domestic policy."²

The need for economic reform in the Region is a result of the aftermath of the decline in oil revenues, which began in 1982, and which led to the disappointing economic performance of the remainder of the decade. Beginning in the latter half of the 1980s, several Near East countries adopted formal economic reform programs. While these programs stabilized and even improved the various fiscal and balance of payments situations that existed, fundamental structural problems remain. Before sustainable economic growth can be established in any Near East country, several major problems must be resolved: the domination of production by the public sector, excessive reliance on governmental control rather than markets to allocate resources, and protected trade.

Bold growth targets for the countries of the Region will be required in order for them to productively absorb their growing labor forces and increase incomes. With average population growth rates at 2.5 percent a year, a per capita GDP growth of around 3 percent a year in the 1990s and around 5 percent to the year 2010 could lead to a doubling of regional income.³ It is essentially axiomatic that the factors affecting human resource development and use will be key determinants of the success of economic reform policies in the Region. Less obvious is the extent to which a resolution of human resource issues important to economic reform in the Near East might hinge upon well-functioning labor markets. This paper examines labor markets from this perspective and based on the strength of the evidence, identifies ways to include labor markets in reform strategies and complementary assistance programs.

¹ In this paper, the "Near East" Region refers to Morocco, Tunisia, Egypt, Jordan and the Republic of Yemen. Israel, Cyprus, Oman, and Lebanon are also in AID's Near East Region, but are not discussed.

² Diwan, I. and Squire, L., "Economic and Social Development in the Middle East and North Africa", Discussion Paper Series No. 3, Middle East and North Africa Division, The World Bank, October 1992.

³ Ibid., p. 1.

LABOR MARKETS AND SUCCESSFUL ECONOMIC REFORM PROGRAMS

There are usually two stages in economic reform programs--stabilization and structural adjustment--and both have been followed in Near East countries.

Stabilization programs generally involve revenue, expenditure, exchange rate and credit measures aimed at first, reducing fiscal and balance of payments deficits, second, restoring a country's international reserve position and third, slowing inflation. Ideally, such programs would reduce national expenditures without reducing output. To the extent that output markets are not perfectly competitive, and wage rates do not fall in response to reduced demand for labor, total output and employment are reduced from what they would be otherwise. Eventually, as output grows, increased employment can be expected in the medium term.

Structural adjustment programs emphasize the "supply side" of an economy. Trade liberalization and real devaluation create the conditions for national output to follow relative price movements and shift towards import-competing and exportable sectors and away from those that are "non-tradeable". As output shifts, so should labor and other factors of production through their respective markets. If adjustment policies are to work as intended, relative real wages should reflect reductions in the demand for labor from formerly-protected import substitution and non-tradeable sectors and increases in such demand from growing tradeable sectors.

Important questions arise, therefore, as to whether Near East labor markets behave in ways that complement or otherwise reinforce structural reform measures, or whether they tend to impede them. If they are generating poor economic signals to other input and output markets about the price of labor, they would contribute to slowing economic reform, or in the worst case, to derailing it.

Looking beyond the explicit economic objectives of reform programs, the workings of labor markets have profound equity and political implications for countries' development. For most people everywhere, and especially for those in the lowest income groups, the largest component of income is earnings from labor. Thus, the determinants of earnings, as mediated through labor markets, are major determinants of the distribution and level of material well-being of a country's residents, and thus of social stability. So, even if labor markets work well enough during economic reform to permit some degree of economic liberalization to occur, the level and distribution of income which result will be ongoing social concerns.

WAGE FLEXIBILITY IN NEAR EAST COUNTRIES

Given the importance of wage flexibility to successful adjustment programs in principle, what is known about the responsiveness of wages to the economic reforms that have occurred so far in Near East countries? Based on a recent review of the literature of labor markets in the Near East, real wages seemed to have declined in the 1980s, although the accuracy of the supporting data is questionable.⁴ Overall, there is no clear evidence that real wages have been "downwardly-rigid" as economic reforms have been implemented.

The best examples to suggest that shifts in wage rates may be signalling appropriate shifts in the use of labor are found in Tunisia and Morocco, where trade liberalization has led to growth in exports.^{5,6}

On the other hand, other evidence suggests that the decline in public sector wages relative to private sector wages was accomplished primarily through inflation rather than through changes in relative employment opportunities. No data are available to show that any Near East country has increased the proportion of its total employment in manufacturing. And even in Morocco and Tunisia, the two Near East countries in the most advanced stages of economic reform, it cannot yet be determined with certainty whether the shift in relative wages is moving towards tradeables and away from non-tradeables, as called for under adjustment.

⁴ Hollister, Robinson, Jr., "Reforming Labor Markets in Countries of the Near East (NE) Region: Implications for Structural Adjustment Programs and the Operation of Market Economies", paper prepared for AID/NE/DP, December, 1992, p. 53.

⁵ Decreasing capital/labor ratios in applications for export licenses between 1987 and 1990, suggest that labor in Tunisia may be moving to exporting industries. (See Rucker, Robert, "Export Investment and New Employment in the 1990s: A Success Story Apparently in the Making", June 1990.)

⁶ In Morocco, exports of agricultural commodities increased along with rural male employment (but not rural wages). While manufactured exports increased, the number of jobs thereby created was not sufficient to significantly reverse the trend of an increasing urban open unemployment rate (12.3% in 1982, 14.3% in 1987, 16.3% in 1989 and 15.8% in 1990). The reasons cited for this trend are the large numbers of job losses from contracting industries, the large numbers of urban migrants and the increasing labor force participation rates of females (Hollister, op. cit., pp. 66-67).

UNEMPLOYMENT AS EVIDENCE OF DISEQUILIBRIUM IN NEAR EAST LABOR MARKETS

Unemployment is a large, potentially explosive, political and social, as well as economic, issue in the Near East region.⁷ The problem is closely linked to conditions in the international market for oil, and how its rise and fall in the early 1980s and its turnaround in recent years have affected the economies of the Region. NE countries' present economic reform programs can be viewed as a continuation of a ten year effort to build an economic capacity to respond flexibly to external shocks emanating from this market. Complementary efforts in labor markets have not yet begun.

The urgency of increasing the labor absorption capacity of Near East countries emanates both from the reduced labor demand from the oil producing states of the Gulf and Europe, and the increased supply of labor implied by the demography of the population and emerging labor force participation rates.⁸ As discussed below, because participation rates by females are very low, but rising, labor force growth is likely to exceed population growth in the near future.

In all Near East countries, the average annual growth rates of the urban population outstrip overall rates of population growth.¹⁰ A major contributing factor to urban growth is rural to urban migration. This internal migration has been attributed to,

⁷ According to World Bank sources, the 1990 unemployment rates (as a percent of the labor force) in Near East countries are 15% in Egypt, 25% in Jordan, 26% in Yemen, 15.8% in Morocco and 15% in Tunisia (Diwan and Squire, op. cit.). Upon closer examination of the data in Jordan and Yemen in 1992 by U.S. Bureau of the Census staff, the rates in both countries appear to be closer to 20% and 12.2%, respectively.

⁸ For the decade of the 1980s, population growth rates in Yemen (3.7%), Jordan (3.7%), Egypt (2.4%) and Morocco (2.4%) were above average for lower-middle-income countries (2.2%). Tunisia (2.1%) was the only Near East country to have a rate lower than this average. (World Bank, World Development Report, 1992, World Development Indicators, Table 26).

⁹ Pissardes, Christopher, "Labor Markets in the Middle East and North Africa", Discussion Paper Series No. 5, Middle East and North Africa Division, The World Bank, February 1993.

¹⁰ Between 1980 and 1990, the average annual growth rates of urban populations in Near East countries were 3.1% in Egypt, 4.3% in Morocco, 4.1% in Jordan, 2.9% in Tunisia; and 6.9% in Yemen (World Bank, World Development Report, 1992, World Development Indicators, Table 31).

although not substantiated by, declining agricultural wages relative to urban wages.¹¹

The relationships between urban and rural economies and their labor forces vary across Near East countries and are not well understood anywhere. In general, the size of agricultural work forces is on a secular decline, as agricultural sectors decrease in relative economic importance. However, these sectors are still large, contribute in major ways to export earnings and can flexibly absorb workers. But the regional trend of workers and especially new labor force entrants to distinctly prefer living in urban rather than rural areas persists, even in the face of high urban unemployment rates, deteriorating infrastructure and rising social and political discontent.¹²

However, measurement of unemployment in Near East countries suffers from a variety of problems.¹³ Actual rates of "open" unemployment, to the extent they are known, only include those registered as unemployed in the formal sector, public and private. Official unemployment statistics exclude "discouraged workers", those who have dropped out of the labor force, and "added workers", often women, who join the labor force to replace household income lost from the long-term unemployment of primary (often male) household members. There is almost no information about workers in the informal sectors in Near East countries and far less information about all workers in rural areas, as compared to those in urban areas.¹⁴

Neither do existing unemployment statistics account for persons of working age who have found work outside of the formal sectors while maintaining their official unemployed status. Such cases are particularly prevalent in Egypt, but also in Jordan, which guarantees public employment for graduates of secondary schools and universities. In Egypt, unemployment rates among new job entrants with secondary school and university education are twice as high as would otherwise be expected in these age groups. In contrast,

¹¹ Pissardes, op. cit., p. 5.

¹² In 1988, urban unemployment rates in Egypt were almost three times greater overall than those for rural areas and almost four times greater for urban women as compared to rural women. (see Fergany, Nader, "Overview and General Features of Employment in the Domestic Economy", CAPMAS Labour Information System Project, Cairo, April 1991).

¹³ AID's Near East Bureau is funding support for governmental efforts in Yemen and Jordan to improve the quality and inclusiveness of official unemployment statistics.

¹⁴ Hollister, op. cit., p. 17.

those with less education, the very young and those above 60, seem to be underrepresented statistically.¹⁵ These latter groups are more commonly employed in the informal and agricultural sectors.

Depending on the country, the causes of unemployment can stem from the improper functioning of the labor markets themselves, from imperfectly competitive product markets, or from interactions between the labor markets and external factors, such as aggregate demand.¹⁶ Economic reforms that reorient trade policy, adjust exchange rates, and otherwise remove biases favoring the use of capital instead of labor are standard features of economic reform programs which should eliminate important causes of chronic unemployment in Near East countries.

As such reforms are initiated, a short-term increase in unemployment can be expected. This added unemployment will be temporary to the extent that labor markets are functioning properly to signal the appropriate shifts for labor, and labor is mobile enough to be able to respond to those signals.

With the possible exception of Morocco, where urban unemployment may have increased as a result of stabilization, sharp rises in open unemployment were not observed in the 1980s as Near East countries began economic reform programs. While open unemployment rates rose somewhat as economic reforms were initiated, most of the increase was a result of new entrants to the labor force.¹⁷ The abrupt changes in unemployment in Egypt, Jordan and Yemen following the Gulf War are continuing to diminish for various reasons. Yet, the persistence of official open unemployment rates at levels that are considered high, raises more questions than can be answered about the changes that economic reform may have introduced in the

¹⁵ Assaad, Ragui and Shaban, Radwan, "Labor Markets in the Middle East and North Africa", The World Bank, October 1992 (preliminary draft), and Fergany, op. cit., Table 3.

¹⁶ In the simplest supply and demand model, unemployment is prima facie evidence that the wage rate is above the "market clearing" rate, at least for the short run. It is therefore useful to assume that markets could adjust to a clearing rate eventually and search for such evidence. If unemployment cannot be explained through this line of inquiry, alternative models must be sought to explain persistent high rates of unemployment. Indeed, such alternative models are frequently used to explain high unemployment in developed countries (see Hollister, op. cit., pp. 6-13, and Horton, S., Kanbur, R. and Mazumdar, D., "Labor Markets in an Era of Adjustment: An Overview", Economic Development Institute, The World Bank, May 1991, pp. 4-5).

¹⁷ Hollister, op. cit., p. 69.

labor markets of Near East countries and the future trends in these markets. There are at least three possible reasons for this.

First, as mentioned, data on employment and wages for the formal sectors in Near East countries are not accurate or timely enough to either fully capture the changes that occurred when economic reforms were initiated or track the ongoing consequences of their accrued effects.

Second, almost nothing is known about the changes that economic reform is bringing about in employment, wages and productivity in the informal sectors in Near East countries. The informal sector typically absorbs the unemployed from, and unsuccessful entrants to, the formal sector, including the bulk of rural-urban migrants. It has important links to the export sector, as a flexible supplier of labor and other inputs, as discussed below. But, when "crowding-in" occurs, informal sector wages can be pushed to exceedingly low levels, increasing absenteeism and high turnover, as well as the likelihood that female workers are replaced or otherwise disadvantaged by increased numbers of male job seekers.

Third, Near East governments have avoided undertaking certain economic reforms that would likely increase unemployment rates for fear of political repercussions.¹⁸

Available statistical analyses of Near East labor force data can neither support nor refute a case about the adequacy of wage flexibility as a signal for labor reallocation or that unemployment is much more than a temporary phenomenon in Near East economies during economic reform. Clearly, the problems of the validity and reliability of the data are urgent ones to address in order to track and understand the relationships between changes in labor markets the progress of economic reform.

Notwithstanding these problems, economic reformers in the Region can look beyond the official statistics and find palpable signs of deep-seated inefficiency in Near East labor market operations and inequity in their outcomes. As discussed below, these signs derive from reviewing the demand and supply characteristics of specific labor markets in Near East countries and the likely results of their interactions. Extrapolating present trends suggests that labor market performance over time is not likely to be compatible with a successful progression of other economic reforms or the development of a stable, equitable social order.

¹⁸ Some Near East governments even increased public employment slightly following initiation of economic reforms to counterbalance expected private sector unemployment (Diwan and Squire, op. cit.).

OBSTACLES TO LABOR FORCE MOBILITY AND WAGE FLEXIBILITY

To reiterate, apart from the inadequacy of an economy's rate of growth, high and chronic levels of unemployment can result from "imperfections" in labor markets which either block movements in the price of labor or restrict labor's mobility in response to wage movements. The most effective obstacles to labor force mobility and wage flexibility in Near East countries are various forms of labor market "segmentation", a mismatch of workforce skills and those needed in a market-based economy, and governmental and other institutional restrictions on wages and access to jobs. These topics are overlapping, but for expositional simplicity, each is discussed individually below.

Labor force segmentation based on separation of the workforce by public or private, "formal" or "informal" sector employer is the major form of restriction operating in Near East countries. Location and patterns of labor force migration are also very important in affecting the extent to which labor can flexibly respond to relative wage changes between sectors and uses. Finally, all forms of labor force segmentation can be attributed to some degree to issues of gender and thus particularly affect female labor force participation rates.¹⁹

The economic reform programs of the 1980s all but halted the **public sector employment growth** of the '60s and '70s in Near East countries, but did not reduce absolute levels of public employment.²⁰ As a result, public bureaucracies are still overstaffed. The public sector continues to be the largest employer of professional and skilled labor and, at least in Egypt, of female professional labor. It is also the sole "producer" of professional and skilled labor, as explained in the following section. Governments' payroll costs have been reduced in real terms by "freezing" nominal wages in the face of relatively high rates of inflation, not through the economically more efficient course of reducing employment and adjusting the wage and benefits system to reflect occupational scarcity. The resulting reduction in real wages has led to widespread "dual job-holding" or "moonlighting" in the private sector by large numbers of public sector employees. The consequent reductions in the amount and efficiency of work effort harms both public and private sector

¹⁹ Hollister, op. cit., pp. 43-64; Assaad and Shaban, op. cit.

²⁰ The percent of the 1986 workforce estimated to be employed in the public sector, both government and public enterprise, was 48% in Jordan and 25% in Tunisia (Hollister, op. cit., p. 49). In Egypt, 25% of the entire workforce and 41% of the urban workforce in 1988 was employed in the public sector (Assaad and Shaban, op. cit.).

efficiency, by making it more difficult for the private sector to hire full-time, skilled workers.²¹

Segmentation by "informal" or "formal" sector employment of countries' workforces derives in large part from the skills and certification needed to move from one to another and a shortage of opportunities for the active workforce to acquire such skills. In addition, various institutional factors have created large wage (and benefit) differentials between the formal and informal sectors, with the result that wages in the former (public and private enterprise) are usually above market-clearing levels while wages in the latter are depressed and highly competitive²²

Women, especially skilled and professional women, are underrepresented in the formal private sector and are subjected to discriminatory wage practices when they are employed. For example in Egypt in 1988, 73% of female wage workers were employed in the public sector. For males, the corresponding figure was 52%. Between the 1976 and 1986 censuses, 76.5% of all net new jobs for women were in general government, 9% in public enterprises and only 14% in the private sector. This compares to 36% of net new jobs for men in general government, 17% in public enterprises, and 37% in the private sector. These differences strongly suggest that there are substantial barriers to entry for women in the formal private sector in Egypt.²³ And despite fluctuations in overall wage levels, women's wages hold at a steady fraction of men's wages, i.e., one-half to two-thirds.²⁴

The respective **location and migration patterns** of males and females may restrict the flexibility of the labor force to move to where jobs are created through economic reform. The agricultural labor markets in Near East countries present striking examples of how these patterns may be constraining the necessary movements. As a result of male migratory patterns, the proportion of women in the agricultural labor force is increasing in all Near East countries except Jordan.²⁵ While the total proportion of the labor force in agriculture is declining in the countries of the region, the agricultural sectors have demonstrated more strength in exports than have the manufacturing sectors. For these reasons, and because Near East countries still import large quantities of food which negatively affect balances of trade, agricultural labor force

²¹ Hollister, op. cit., p. 57.

²² Ibid., p. 9-11.

²³ Assaad and Shaban, op. cit.

²⁴ Hollister, op. cit., p. 40.

²⁵ Ibid., p. 30.

mobility issues that pertain to women are very important to the future success of economic reforms.

No overall rural labor shortages in Near East countries have been attributed to internal migration, but localized, seasonal shortages can occur even when labor is in surplus generally.^{26, 27} International migration, mainly a male phenomenon, has created selected domestic shortages of certain kinds of labor, even though it generally served as a "safety valve" for containing large rises in unemployment in the region. For example, in the mid 1980s Egypt experienced labor shortages in agriculture and construction as the demand for these workers (in large part from the Gulf States) lead to their migration abroad.²⁸

There are no hard data to show that the lack of labor mobility on the part of rural females contributed to labor shortages in the past. But women in the Near East are far less geographically mobile than men because of the burdens of reproduction, family ties, and religious and cultural traditions. In rural areas, women face an additional array of possible gender-based discrimination in their access to credit and inputs, and based on their high relative rates of illiteracy, to information and new technologies.²⁹

Within the old economic structure, it was not important for women to be geographically mobile. As this structure is changing, the issue of women's mobility is becoming very important.³⁰ If agricultural export growth continues to be a necessary underpinning of economic reform in the Near East region, gender-specific trends

²⁶ United Nations Food and Agricultural Organization, Intraregional Labour Mobility and Agricultural Development in the Near East, Rome, 1990.

²⁷ Rural-to-rural migration is an important phenomenon accompanying economic growth throughout the world. While no information was found about it in the Near East, the possibility that such migration may result in rural labor shortages in the region should be considered. Hollister, op. cit., p. 19-20.

²⁸ Assaad, Ragui and Commander, Simon, "Egypt: The Labour Market Through Boom and Recession", prepared for the World Bank symposium, "Labor Markets in an Era of Adjustment", Washington, D.C., May 1990.

²⁹ Hollister, op. cit., p. 39.

³⁰ Remittances from absent males may dampen the need for females to move into traditionally male agricultural roles, but these remittances fluctuate widely in the Near East. There are no data to support the hypothesis that the two phenomena are linked (Hollister, op. cit., p. 39).

and patterns of migration and rural labor force participation rates will have an impact on economic success.

The **skills mismatch** between the rapidly growing number of graduates from secondary and higher educational systems and the requirements of the productive sector of Near East economies is probably the most visible, and potentially socially volatile, manifestation of improperly-functioning labor markets. Current analyses reveal that new entrants to the job market with some degree of secondary schooling comprise the bulk of the unemployed in certain Near East countries.³¹ Yet between 1985 and 1990, enrollment ratios in secondary schools and above have continued to rise, while those in primary schools have stagnated or declined.³²

In Egypt, Morocco and, to a lesser extent, Jordan, the policies that have led to high levels of unemployment and underemployment among graduates of secondary schools and universities are well known: the heavy subsidization, and therefore over-expansion, of these systems; guaranteed public employment for their graduates; and relatively few private sector employment alternatives.³³

The initiation of economic reforms in Egypt and elsewhere is leading countries to reconsider the policy of guaranteed public employment, and to pursue increased growth of alternative private sector employment opportunities. Complementary technical education and training opportunities linked to that employment may have increased somewhat, but mostly as a result of donor involvement.

Reform of public sector (government and public enterprise) hiring, wage and education policies are yet to occur. Eventually, policies

³¹ Diwan and Squire, op. cit., p. 4. In Egypt, the urban unemployment rate for new entrants in 1988 was close to 45%, while it was only 5% for those who entered the work force 6 years earlier (Assaad and Shaban, op. cit.). In Yemen, new job entrants in 1992 accounted for almost one-third of the unemployed (Wetzels, James, "Trip Report to Sana'a, Yemen", December 1992).

³² Only in Egypt did total and female primary and secondary enrollment ratios increase between 1985 and 1990. In Morocco and Tunisia, both fell at the primary level. No data are available for Jordan after 1983. For the former Yemen Arab Republic, total and female primary and total secondary school enrollment ratios rose between 1983 and 1985; female secondary enrollment ratios remained constant during this period. More recent data are not available for the Republic of Yemen (World Bank, World Development Report, 1990 and 1992, World Development Indicators, Table 29).

³³ Assaad and Shaban, op. cit. and Employment and Structural Adjustment: Egypt in the 1990s, ed. H. Handoussa and G. Potter, The American University in Cairo Press, 1991, pp. 1-21.

based on guaranteed employment must yield to those based on labor efficiency. Wages must be linked to occupational scarcity and, in turn, to productivity. In education, some reallocation of expenditures from higher to primary education is necessary, and should be based on the principle of maximizing labor market rates of return (and balancing individual and societal benefits).

Reform of educational policies in the Near East region could benefit from recent empirical work based on aggregate growth theory. This work strongly suggests that health and human capital formation are critical factors in explaining the convergence in per capita income growth across countries. These findings are arrived at by analyzing new sources of empirical data, ie, the human capital stock by level of education and the rental value of human capital associated with health care and on-the-job training. In particular, the work suggests that information about the differential returns to individuals from specific types of human capital investments could be used to guide the direction and nature of public investments and fiscal policies in the education sector, and thereby increase overall returns.³⁴ Limitations of data and measurement problems are being overcome to obtain these refined indicators of economic returns to human capital investments.

In the Near East region, educational reform must be particularly sensitive to the mix of social and cultural attitudes and practices that are powerful determinants of females' access to education and, in turn, to employment. The complexities surrounding the gender issue are manifested in a variety of ways, for example, the lack of agreement on the formal definition of employment as opposed to "women's work". Until an attempt was made to reconcile different sets of labor force data in Egypt, female labor force participation rates and unemployment among the least educated in rural areas had been severely underestimated while those of educated males had been overestimated. Among the open unemployed in Egypt, female graduates from secondary school experience the highest rates: 30% overall and 36% in rural areas. Males with similar education have an overall unemployment rate of 9%, and in rural areas, 7%, reflecting their relative ease in finding work in the private sector.³⁵

The consequences of these differential educational achievement and unemployment rates are far-reaching for Egypt as well as for other restructuring Near East economies which share its cultural traditions and practices towards women. First, the rates at which these economies must grow to absorb labor may be underestimated as

³⁴ Schultz, T. Paul, "The Role of Education and Human Capital in Economic Development: An Empirical Assessment", Yale University, November 1992.

³⁵ Assaad and Shaban, op. cit.

a result of underestimating female participants in the labor markets. Women in the Near East have the lowest labor force participation rates of any geographic region of the world, but there are various indications that these rates are increasing in all countries.³⁶ Second, growth of agricultural and rural export industries may depend on the availability of educated as well as mobile female labor. Third, allocation of expenditures for education may require major revisions as the returns on womens' earnings and their subsequent impact on household income and welfare are taken into account. The social benefits of educating women that extend beyond the individual include reduced child mortality, decreased fertility and increased educational achievement and mobility of their children.³⁷ Very importantly, permanent mitigation of the extremely high rates of population growth in the Near East may not be possible until there are incentives to invest in female education linked to improved opportunities for women to enter the work force and earn wages comparable to those of men.³⁸

The term, "**labor laws**" usually includes a variety of governmental and other institutional restrictions on wages; terms of employment and access to jobs; and unionization. In the Near East such labor laws predate economic reform and apply only to the formal sectors.³⁹ In principle, labor laws could facilitate the movement of labor with capital necessary to carry out structural adjustment as well as provide economic security and protection from "predatory" employer practices for workers. For example, laws to reduce the extent of open discrimination against women in the workplace on issues such as pay, hiring preference and job security could not only increase the efficiency of labor markets, but also produce the socially desirable effects mentioned above.

³⁶ Between 1980 and 1990, female labor force participation rates have increased in Egypt (4.8% to 5.7%), Jordan (3.6% to 4.9%), Morocco (10.8% to 13.2%) and Tunisia (12.6% to 15.2%) (*ibid.*).

³⁷ Schultz, *op. cit.*

³⁸ Summers, L., "The Most Influential Investment", Scientific American, August 1992.

³⁹ In mid-1992, World Bank sources reported that both Jordan and Egypt were actively drafting new labor laws, but officials from neither country were willing to disclose the terms of the legislation. In Tunisia, a key policy measure of the 1992 adjustment program includes revising the labor code to enable "firms to better adapt the size of their labor force to changing market conditions" (IMF Staff Report for the 1992 Article IV Consultation and Review Under Extended Arrangement, May 1992).

But labor laws also could have the opposite effect: "Economic theory is rich (weak) enough to provide arguments for interventions as well as against them".⁴⁰ Case investigations of how specific interventions and institutions work in countries are necessary to decide the issue.⁴¹ It should be noted, however, that the current weight of economic opinion regards the effects of such institutional factors on overall economic growth--as well as on exports, employment, and equality of income distribution--to be negative.⁴²

Among developing countries in general and Near East countries in particular, few have effective minimum wage laws outside of the public sector.⁴³ However, since the "public" sector in Near East countries is the major employer and includes commercially-important enterprises, these laws potentially have wide scope. Egypt, Morocco and Tunisia have such laws, but only in Tunisia are they thought to be enforced. While the mere existence of these laws might inhibit economic activity, it is not possible to determine if in fact this has happened. Neither is there evidence of the actual effects of the Tunisian laws on structural adjustment.

With regard to job security regulations, those governing hiring and firing, stronger cases have been made that "they have hindered and biased private sector job growth in Egypt, Tunisia and Jordan".⁴⁴ Morocco's regulations are highly detailed but are not uniformly enforced, presumably because of overstretched resources.

The strength of unions' opposition to structural adjustment in Near East countries, or the potential for it, is unclear. While union membership in these countries is not sizeable in absolute numbers,

⁴⁰ Freeman, Ronald, "Labor Market Institutions and Policies: Help or Hindrance to Economic Development?", 1992 Conference on Development Economics, World Bank.

⁴¹ In 1992, the World Bank began labor market investigations in Egypt and Jordan. Work on these investigations is currently in progress.

⁴² Riveros, Luis, "Labor Costs and Manufactured Exports in Developing Countries: An Econometric Analysis", World Development, Vol. 20, No. 7 (July, 1992), pp. 991-1008; Fields, Gary, "Employment, Income Distribution and Economic Growth in Seven Small Open Economies", The Economic Journal, Vol. 94 (March 1984), pp. 74-83; Fallon, Peter R., and Riveros, Luis A., "Adjustment and the Labor Market", Policy, Planning and Research Working Paper 214, Country Economics Department, The World Bank, June 1989.

⁴³ Hollister, op. cit., p. 58.

⁴⁴ Ibid., pp. 58-59.

it is concentrated in urban areas and thus may be able to exert a disproportional influence. Unions in Egypt (25% of the workforce), Tunisia (11-48% of the workforce depending on whether "unionization" or "collective agreements" definitions are used), and Morocco (5-11% of the workforce) are on record as opposing various parts of their countries' reform programs. Ten percent of the labor force in Jordan is unionized but union activity there is said to be disproportionately low-keyed.⁴⁵ Because unions have exerted both positive and negative influences on structural adjustment programs elsewhere in the world, recommended policies in dealing with them are complicated. The role of unions in creating consensus for labor market reforms is discussed in the final section below.

Other than governmentally-imposed restrictions on wages and employment, large private sector employers in the formal sector of developing countries often impose their own restrictive wage policies. Such firms maintain above legally-mandated minimum and market-clearing wages despite the surplus availability of qualified workers, because it is efficient in a broader context for them to do so.

For example, employers might pay higher wages in order to assure that their workers could adequately provide for their own nutrition, and thereby return gains in productivity on the job. Paying higher than market-clearing wages has also been explained by the gains in productivity which have resulted when workers are able to bring their families to the job site, instead of migrating back and forth to them.⁴⁶

The nature of labor market segmentation revealed in these examples suggests that it is important for reformers to understand the institutional and social as well as economic contexts within which labor markets operate. It may be necessary to go beyond expectations of mechanistically equilibrating labor demand and supply in order to facilitate structural adjustment goals. Rather than seeking to eliminate existing legal and institutional structures, the desired flexibility in these markets may be achieved by introducing new forms of organization and incentives for labor, management and government.⁴⁷

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⁴⁵ Ibid., p. 60.

⁴⁶ Ibid., pp. 6, 9.

⁴⁷ Ibid., pp. 6-13.

Labor markets matter to the achievement of economic reform goals, even though the so-called "hard evidence" needed to clarify our understanding of these markets is not yet in hand.

In recent years, the World Bank has been "putting increased emphasis on the sequencing and pacing of economic reforms, on the devising of adequate social safety nets and on increasing the demand for labor in adjusting member countries' economies."⁴⁸ In his September 1992 opening address to the Board of Governors of the International Monetary Fund (IMF), Michel Camdessus, the IMF's Managing Director, called for "creative adaptation of social policies, to improve the working of labor markets and make social safety nets more effective".

The World Bank and the IMF have good reasons for rethinking the sequencing of economic reform programs to take account of labor market performance. Today, nontraditional export promotion is of central importance to successful economic reform programs, and labor costs have been shown to affect such exports significantly. A recent international study cites "labor market distortions" as major culprits responsible for depressing international competitiveness of countries' nontraditional exports and calls for the deregulation of these markets as essential to promote such exports.⁴⁹

It is possible to **alleviate poverty while pursuing growth through adjustment**. In fact, empirical work has demonstrated that liberalized market economies, pursuing export-oriented trade policy, can achieve rapid growth with full employment, rising real wages, diminished absolute poverty and low-to-moderate levels of relative inequality.⁵⁰ A key component to this paradigm, as it relates to poverty alleviation, is the level and allocation of investments made in human capital.

The point of deregulating and otherwise increasing the efficiency of labor markets is to bring the price of labor, the wage rate, in line with productivity, not to continually depress it. Increasing investment levels are essential to increasing economic productivity and thereby growth. In developing countries, investments in human capital generally yield returns as great as or greater than those in physical capital, both at the private and social level.⁵¹ Since

⁴⁸ IMF Survey, November 30, 1992.

⁴⁹ Riveros, op. cit.

⁵⁰ Fields, op. cit.

⁵¹ Schultz, "The Role of Education and Human Capital", op. cit. and "Recent Findings on Living Standards, Work Levels, Health and Mortality: An International Comparison", American Economic

such investments, for example in education, health and nutrition, increase the productivity of labor, they allow labor to realize increasing returns in an economically-efficient way. This relationship also applies in the reverse. That is, the extent to which actual economic gains from human capital investments can be realized depends critically on whether such investments are mediated through properly-functioning labor markets. The educated unemployed neither receive individual nor produce social returns (economically-speaking) for the investments incurred on their behalf.⁵²

Targeted "social safety net" programs can facilitate adjustment in the short term and assure equity and "social efficiency" of market outcomes in the long term. Social safety nets of various kinds are designed for those segments of reforming countries' populations that experience a reduction of benefits. In this context, safety nets compensate the "losers" of the reform program, even if the losers are not necessarily all, or in large measure, from the most economically-disadvantaged groups.

Social safety net programs are important for two reasons. The first is for their perceived fairness in replacing abolished benefits (e.g., consumption subsidies or guaranteed employment) with other forms of benefits (e.g., training, social services, lump sum payments). The second is for the actual contribution these programs should make to protect the material welfare and improve the productive capabilities of the most economically vulnerable population groups.

In the Near East region, effective social safety nets are critical to carrying out economic reform because of the pervasiveness of public employment, as discussed above, and governmental control of prices and subsidies for basic goods and services. Dismantling the extensive subsidy programs of Near East governments, one of the factors that led to unsustainable government budgets and the need for economic reform in the first place, is proving to be particularly difficult. Because these subsidies have never been well-targeted, the impact of their removal will be felt broadly across the population and social protest could be difficult to

Association annual meetings, Anaheim, California, January 1993.

⁵² These conclusions are consistent with The World Bank's preferred strategy for poverty alleviation, as articulated in its World Development Report 1990. It consists of two mutually-supporting elements: first, promotion of the productive use of labor, and thus economic growth, and second, provision of social services to enable the poor to take advantage of new economic opportunities.

contain.⁵³ At the same time, actual income distribution will become more unequal to the extent that prices of basic goods are raised and their distributional effects not offset by targeted safety-net measures.

Egypt, now in the process of reducing subsidies, is a case in point. Increases in the prices of food and beverages have outstripped the rise in the overall consumer price index. There can be little doubt that the impact of these price rises falls most heavily on the lowest income groups. The cost of Egypt's 1989-90 food subsidy program was one-half of what it was five years earlier in nominal terms. Still, 93% of the population receive some form of ration card.⁵⁴ Another concern has been the privatization program, which has been stalled over the issue of its net employment effects.

The usefulness of social safety nets extends beyond the limits of the economic reform programs that may prompt their creation. Targeted social safety net programs play a secondary but necessary role in factor and product markets themselves. These programs provide various services, income transfers and subsidies to people who are not active in a labor market or whose returns from the market are inadequate to maintain minimal consumption standards, temporarily or permanently. Social safety nets exist in all developed market economies, and the more carefully targeted and efficiently financed they are, the more equitable and efficient are the results they produce.

The proper sequencing of the economic reform programs in Near East countries is critical to their success because of the interaction of reforms in the labor markets with those in subsidy programs. Attempting these reforms simultaneously, while other macroeconomic changes are occurring, would likely create "transitional unemployment in the private formal sector and downward pressure on earnings in the informal sector", leading to great economic and social turmoil and perhaps pressure to reverse the reforms.⁵⁵ Suggestions about the optimum sequencing of reform for individual countries should be made in light of the particular characteristics of their labor markets, tax structures, expenditure patterns, laws and regulations.

Looking at specific countries, some experts have suggested that labor market reforms should take place prior to reforms in the trade policy regime, i.e., exchange rates and tariffs, because of

⁵³ Hollister, op. cit., p. 71.

⁵⁴ Hollister, op. cit., pp. 65-71.

⁵⁵ Hollister, op. cit., p. 89.

their importance in promoting exports.⁵⁶ A recommendation for sequencing reforms in Egypt focuses on parastatals and the advantages of introducing them early to a form of worker compensation known as "share contracts".⁵⁷ These contracts take the form of bonuses, profit or revenue sharing in order to create incentives for workers to be concerned with the efficiency of enterprise production. In addition, the contracts might link workers to the performance of enterprises by granting them institutional power, e.g., collective bargaining rights, to negotiate a share of future gains.⁵⁸ The sequencing of reforms would then consist of lifting the labor code as applied to parastatals, phasing out parastatal subsidies and instituting compensation for discharged employees. Civil service and subsidy reform would then occur, together with improvements in social safety net targeting.⁵⁹

DESIGNING NEAR EAST PROGRAMS TO COMPLEMENT ECONOMIC REFORM

The issues relating to labor market operations and their inefficiencies described in this paper, arise repeatedly in the course of designing and implementing AID programs and projects. It appears likely that labor market operations could significantly affect the outcomes of several large, established AID programs. Of course, the relative importance of particular labor market issues will vary according to countries' respective development efforts and status. But it appears that none of the Near East country program portfolios gives labor market issues enough attention even to determine how important they may be to achieving established goals and objectives.

Declared objectives of export promotion, privatization, agricultural modernization, and improved balance of trade all rest ultimately upon the ability of a country's resources to shift from one use to another. For years, AID has focused on improving capital markets because without effective mechanisms to allocate capital, these objectives cannot adequately be achieved. Less attention has been devoted to "human capital" markets.

The research reviewed in this paper underscores two major points: first, the importance of properly-functioning labor markets to supporting the growth targets of formal economic reform programs; and second, their importance in guiding human resource development

⁵⁶ Hollister, op. cit., p. 88.

⁵⁷ Ibid., pp. 89-90.

⁵⁸ Freeman, op. cit., p. 99.

⁵⁹ Hollister, op. cit., pp. 88-90.

strategies which can provide to the poor the means to participate in expanding economies and thus escape their poverty. The following suggestions to modify AID programs address both of these points and thereby aim at restructuring labor markets to fit better the economic goals of the countries of the Near East region.

Privatization and Policy Reform programs could address labor issues pertaining to alternative ways to reduce the size of public sector employment and redeploy it to the private sector. Trials of innovative ways to sequence privatizing efforts within adjustment programs could be supported, for example, in the context of introducing "share contracts". Country case studies of the legal and institutional context of labor policy could be conducted to yield information about the likely affects of these factors on the progress of reform generally, and privatization, employment and labor costs specifically.

AID is involved in promoting Near East countries' export growth through its **Trade and Investment program**. It is in a position to work with countries to gather the information needed to document the rate of growth of export industries and the direction, composition and level of shifts in their wages, employment and labor costs. If then warranted, AID could work with countries to design appropriate interventions to encourage movement of labor into these industries. This information gathering and analysis should extend to the informal sectors of Near East economies, given the latter's presumed links to exporting industries and the obstacles they could present to labor force mobility.

Agricultural programs in the Near East are seeking to encourage non-traditional exports and agro-industries. Thus, they have a key interest in understanding factors affecting the mobility and productive capabilities of the rural agricultural and non-agricultural labor force and could support appropriate studies to do this. In the Near East, international migration and its remittances are also important variables affecting both urban and rural growth patterns and the movement of labor important to agriculture. Both should be monitored consistently during adjustment.

As women continue to increase as a proportion of rural populations in the Near East, the factors which affect their labor force participation rates, skills and productivity become more critical to designing interventions to support agricultural reform. These factors are not well understood and should be studied more closely with the aim of improving Near East agricultural programs.

The human capital investments made in the Near East in **Education, Health and Family Planning programs** are critical for raising the economic productivity of both the active labor force and future ones, and thus for alleviating poverty. Potentially, AID's contribution to these investments could yield the largest economic

returns of its entire NE program. However, in order to realize these returns, various modifications in the design of these programs would be necessary.

First, increased efforts could be made to identify and target population groups made vulnerable by economic reform programs, and include them in the "safety net". Such targeting could be institutionalized in order to continue as a dynamic process after adjustment is complete.

Second, the tendency to deemphasize the "economic" in favor of the "humanistic" benefits of these activities should cease. Both types of benefits can be accommodated within the proper analytical context. Levels of investments across these activities should be determined by relative levels of economic benefits returned, both at the individual and societal levels. To do this, existing programmatic divisions that allow investments in these different activities to occur in isolation of one another should be eliminated. Instead, emphasis could be placed on allocating investments across traditional program areas according to their combined impact on individuals' earnings returned through labor markets (with corrections, if needed, to account for social "spillovers" that the market may not capture). As the research cited in this paper reveals, if AID adopted this allocation paradigm, it might be working with governments to invest, for example, more in female education than in health and family planning services to reduce childhood mortality and fertility rates, respectively.

It is necessary that labor markets efficiently perform the role of pricing labor in order to signal appropriate human capital investment opportunities. The more these investments, like investments in physical capital, can be mediated through markets rather than bureaucracies, the greater their payoffs will be to individuals and the whole society. Near East governments could be encouraged to review and adjust tax and fiscal policies to increase their reliance on markets to guide their human capital investments and sustain and bolster their payoffs, during adjustment and after.

This synthesis of labor market studies in the Near East yields major implications for the way AID's **Women in Development program** is designed and implemented. Gender-based issues are responsible in a large way for segmenting the labor force, and frustrating efforts to alleviate poverty and high population growth rates. They will affect the course and pace of economic reform, but in ways that can only be guessed at with existing information. As pointed out by repeated examples in the paper, gender-based issues permeate all facets of labor market issues and cannot be separated from them, except artificially so. It follows that the Women in Development program in the Near East would be well-advised to integrate its data collection efforts and analytical focus on gender-based issues directly into AID's other programs, rather than remaining apart from them.