GLOBALISATION AND EMPLOYMENT IN DEVELOPING COUNTRIES

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Globalisation has not had a systematic effect on formal sector employment in emerging developing countries. In some countries, it stimulated employment growth and depressed productivity; in others it stimulated productivity growth and depressed employment. On the other hand, globalisation seems to have had a systematically adverse effect on employment conditions outside the formal sector; growth of output per worker in the non-formal part of the economy slowed down in most developing countries during the globalisation period. This resulted from the fact that the growing trade orientation induced a reallocation of investment from the non-formal to the formal part of the economy. Overall, even in those developing countries that have derived growth benefits from globalisation, the employment effect has tended to be negative.

My objective in this paper is to take stock of what we know about the employment effects of globalisation in developing countries. As we shall see, there is much that we do not know. There are two main explanations for this inadequacy of knowledge. The first, and the more important, explanation is that the analytical framework generally used to investigate the effects is quite inappropriate in the context of developing countries. This framework, developed by mainstream economists in advanced countries (particularly in the United States), takes no account of the specific structural characteristics of developing economies. As a result, the questions asked and the hypotheses explored are often of limited relevance for developing countries. Examples of such questions are: whether or not the existence of labour market rigidities influences the effects of globalisation on employment; whether or not globalisation has been associated with social dumping and a race to the bottom; whether or not globalisation has widened wage inequality; whether or not globalisation has weakened trade unions and thus increased the share of capital in value added, etc. Such questions are really of marginal relevance in the context of developing countries simply because they relate to the modern sector, which employs only a small (often minute) proportion of the labour force. The answers to these questions do not tell us much about whether, to what extent and how, the overall employment situation has been affected by globalisation.

The second explanation lies in the non-availability of relevant statistical data for many developing countries. This leads to a situation wherein empirical investigation into the experience of developing countries is rather rare. Much of the existing empirical research is actually based on data from developed countries (and some data from developing countries such as Mexico and Turkey, which are members of the OECD), and yet the results are assumed to be extendable to developing countries in general.

These observations define my tasks. My first task is to identify the right questions. And my second task is to review the answers to these questions that are currently available. In order

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to define the questions, it is necessary to look into the specific structural characteristics of employment and labour markets in developing countries as well as into certain characteristics of what we call ‘globalisation’.

I. NATURE OF EMPLOYMENT AND LABOUR MARKETS IN DEVELOPING COUNTRIES

Most economists know yet habitually ignore the fact that developing economies are dual economies, with a modern or formal sector that employs a small proportion (often less than 10 per cent) of the labour force, and a traditional or non-formal sector that employs the bulk of the labour force. In the modern sector, workers are employed as regular, full-time wage employees. In the traditional sector, workers are either self-employed or work as casual wage labourers. In the modern sector, wages are set through government regulations and collective bargaining. In the traditional sector, where both self-employment and casual wage employment involve extensive work sharing, the income per worker from self-employment serves as the basis for setting the wage rate for casual labour.

This last point needs elaboration. Workers in the traditional sector generally have the option of sharing the work available in household activities and of sharing the income arising from these activities. Thus, the potential income per worker in self-employment constitutes the opportunity cost for a casual labourer. The income per worker from self-employment (which can be taken as a constant fraction of the output per worker), however, can only be known for a full production period while a casual labourer is paid a daily wage. How is this daily wage determined? Here we need to recognise that markets in casual labour must always be characterised by excess supply of labour, for the users of casual wage labourers, for the users of casual wage labour must have the certainty of finding labourers whenever they need to hire them. Thus, a casual labourer always has a less than unity probability of finding employment on any given day during the production period. Thus, the income per worker from casual wage employment over a production period equals the daily wage rate for casual labour multiplied by the total number of days during the production period multiplied by the probability of finding employment on any given day. It is this that gets equalised to the income per worker in self-employment over the same production period.

An important implication is that the casual wage rate can be arbitrarily set and, once set, tends to remain stable because the probability of finding employment serves as an adjustment variable. A rise (fall) in the casual wage rate does not affect the income per worker from casual wage employment over the production period as long as the income per worker from self-employment remains unchanged. This is because if there is a rise (fall) in the casual daily wage rate, some self-employed persons would enter (withdraw from) the casual labour market. The probability of a casual labourer finding employment on any given day would fall (rise) as a result, so that the income per worker over the production period would remain unchanged. On the other hand, if there is an increase (reduction) in the earning per worker from self-employment, the income per worker in casual wage employment would rise (fall) even if the daily wage rate remains unchanged. This is because some casual wage labourers would move to self-employment (casual wage employment) so that for those who remain casual wage labourers, the probability of finding work on any given day would rise (fall).

Government regulations and collective bargaining processes usually set a wage in the modern sector that is much higher than the income per worker in self-employment. Labour supply to this sector is thus unlimited; there is no such thing as equilibrium. Those who cannot
find employment in the modern sector must either find work (self-employment/casual wage employment) in the traditional sector or remain unemployed. Most must work in the traditional sector. For, in a situation wherein no unemployment benefit or institutionalised social security is available, only a few, who are from relatively well-off households, can afford to remain unemployed in the hope of eventually finding jobs in the modern sector.

These characteristics of labour markets in developing economies have two important implications. First, the measured rate of unemployment is usually low and tells us something about the extent of queuing for jobs in the modern sector; it tells us little or nothing about the extensive under-employment that exists in reality. Second, growth in the number employed in the traditional sector often means growth of work sharing, that is, under-employment. Since the traditional sector employs the bulk of the labour force, growth in the number employed in the economy as a whole tells us very little about the growth of employment. Only the growth in the number employed in the modern sector can be meaningfully interpreted as growth of employment.

How then do we know if there has been any improvement or deterioration in the employment situation in a country over any particular period? Recall that a rise in the casual daily wage rate does not necessarily indicate a rise in income per worker from casual wage employment because it could be associated with an increase in under-employment. On the other hand, a rise in output per worker in self-employment increases per worker income from casual wage employment even if the daily wage rate is constant because it is associated with reduced under-employment. A good indicator of improvement in employment conditions in the traditional sector, therefore, is a rise in the output per worker in self-employment (and not a rise in the casual wage rate). Although poverty is not discussed in this paper, it is worth noting at this point that, as a rule, persons employed in the modern sector are not poor. Poverty is concentrated in the traditional sector and arises from a combination of under-employment and low labour productivity, which results in very low output and hence very low income per worker for the self-employed and the casual wage labourers. Poverty reduction requires growth of output per worker in self-employment, that is, an improvement in employment conditions in the traditional sector.

Growth of output per worker in self-employment, of course, requires growth of labour productivity in self-employment activities. But it is also helped by reduction of under-employment, which can result if employment in the modern sector grows faster than the labour force in the economy. And growth of employment in the modern sector is always a positive development because jobs in the modern sector are ‘good’ jobs (being associated with higher labour productivity and wages). It thus follows that an unambiguous improvement in employment conditions requires, simultaneously, (a) growth of employment in the modern sector that is faster than the labour force growth in the economy, and (b) growth of output per worker in the traditional sector (which can be taken as a good proxy for growth of output per worker in self-employment activities).

Thus, if we want to know whether globalisation has had favourable or unfavourable effects on employment in developing countries, we need to ask two basic questions. How has globalisation affected employment growth in the modern sector? And how has globalisation affected the growth of output per worker in the traditional sector? We can also ask an additional question: how has quality of employment in the modern sector been affected? But the significance of any change in the quality of employment in the modern sector for an assessment of the change in overall employment situation is not very obvious. The reason is that there could well
be a quality-quantity trade-off. Real wage growth in the modern sector, for example, could restrain employment growth in the sector and this would have repercussions for growth of output per worker in the traditional sector because labour transfer out of the sector would be adversely affected. On the other hand, if a little lowering of quality means a higher growth of employment in the modern sector, the overall effect can legitimately be judged as positive because it would also mean a higher growth of output per worker in the traditional sector. In short, ambiguities creep in the moment we consider change in the quality of employment in the modern sector as an indicator of change in the overall employment situation. For this reason, I think the focus should be on the first two questions.

One further point is worth noting here. The direct effect of globalisation can only be on the modern sector, which produces tradable products and is linked to the external world. Any effect on labour productivity in the traditional sector is a secondary, derived effect. This means that an analytical understanding of transmission mechanisms is required to study the effect of globalisation on employment in the traditional sector. I come back to this point later in the paper.

II. GLOBALISATION AND DEVELOPING COUNTRIES

Globalisation, as everybody knows by now, refers to the apparently rapid growth of the cross-border flows of goods, capital and people that has occurred since about 1990 (there could be a debate about the precise date of the onset of globalisation, but that would be an entirely sterile debate). A close scrutiny modifies this broad view in several important ways.

Firstly, globalisation has meant rapid growth of trade not in all goods but in manufactures and, more recently, in services. In the early stages, advances in transport and communications technology together with widespread trade liberalisation stimulated trade in manufactures. This trade growth was associated with a fundamental change in the international division of labour; there was rapid growth of two-way trade in manufactures between developed and developing countries. The process was sustained by the growth of global production systems. As particular parts of a manufacturing process were separated out and located in different countries to take advantage of differences in labour and other costs, trade in intermediate goods grew rapidly. During more recent periods, a similar development began to occur in the case of commercial services and there was rapid growth of what is now called ‘trade in tasks’ during the post-2000 period. But advances in technology and widespread trade liberalisation had very little impact on trade in primary commodities. In fact, stagnating demand and persistent excess supply characterised international markets in primary commodities, resulting in sharply declining prices until the end of the century.

Secondly, globalisation has meant rapid growth of cross-border flows of private capital but not growth of investment in developing countries. In theory, increased capital flows should have led to a substantial transfer of capital from developed countries, where it is abundant and hence earns a low return, to developing countries, where it is scarce and hence should earn a high return. The reality has been very different, as the data in Table 1 show. The net inflow of foreign private capital into developing countries was, in fact, quite small. This, moreover, was highly concentrated in a few countries such as Brazil, China and Mexico, which could not be called saving-poor. The really saving-poor countries—the least developed countries—received negligible net inflow of foreign private capital; a reasonable rate of investment was sustained in these countries only because of the substantial inflow of foreign aid. Another important fact highlighted by the data in Table 1 is that even the few developing countries that received a
substantial net inflow of foreign capital ended up achieving a lower rate of investment than their domestic saving rate would have permitted. This suggests a crowding out of domestic investment by foreign investment, a major consequence of which was the massive growth of foreign currency reserves. It is not very difficult to see the reasons why this crowding out has occurred, but this is no place to discuss them.

Table 1
Net Inflow of Foreign Capital, Saving and Investment in Developing Countries, 1990-2003 (as % of GDP)

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<tr>
<td>Medium-income developing</td>
<td>2.2</td>
<td>0.4</td>
<td>-1.3</td>
<td>1.3</td>
<td>-0.1</td>
<td>25.8</td>
<td>24.8</td>
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<tr>
<td>excluding Brazil, China</td>
<td>1.4</td>
<td>0.3</td>
<td>-1.3</td>
<td>0.4</td>
<td>0.0</td>
<td>21.6</td>
<td>22.8</td>
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<td>and Mexico</td>
<td></td>
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<tr>
<td>Least developed</td>
<td>1.0</td>
<td>0.0</td>
<td>-0.9</td>
<td>0.1</td>
<td>7.4</td>
<td>9.4</td>
<td>19.1</td>
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<tr>
<td>countries</td>
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Note: (1) Foreign direct investment; (2) Portfolio equity investment; (3) Private bank loan; (4) Total private capital; (5) Foreign aid; (6) Domestic saving; (7) National investment.

Thirdly, there is no evidence to suggest that globalisation has been associated with a growing cross-border flow of people. The stock of international migrant population in the world increased from 154 million in 1990 to 189 million in 2005; as a percentage of the world population, however, it remained unchanged at 2.9 per cent. The available evidence also suggests that migration from developing to developed countries showed no tendency to rise during the globalisation period (though migration from Mexico and some Central American and Caribbean countries to the United States increased). All this is not very surprising since migration regimes, unlike trade regimes, have not been liberalised. However, migration from developing to developed countries has always meant brain drain (see Table 2), and there is some evidence to suggest that brain drain increased during the globalisation period. In other words, while the overall migration did not increase, the share of skilled persons in all migrants increased. This again does not come as a surprise; globalisation caused a sharp increase in the demand for skilled labour in developed countries and, in response, governments took measures to facilitate the immigration of high-skilled labour while severely restricting immigration of low-skilled labour. While all developing countries suffer brain drain, it is not an equally serious problem for all of them. The really discouraging fact about brain drain is that it is most serious for some of the poorest countries of the world. More than 50 per cent of the adult population with tertiary education of Gambia, Guinea-Bissau, Haiti and Mozambique, for example, lived and worked in developed countries in 2000.

Table 2
Adult Migrants from Developing to Developed Countries as a Percentage of Adult Population of Developing Countries, 2000

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<tr>
<td>Medium-income developing</td>
<td>1.06</td>
<td>0.62</td>
<td>2.33</td>
<td>8.09</td>
<td></td>
<td></td>
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<tr>
<td>Least developed</td>
<td>0.59</td>
<td>0.25</td>
<td>4.19</td>
<td>14.80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All developing</td>
<td>1.01</td>
<td>0.57</td>
<td>2.40</td>
<td>8.38</td>
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Note: 1: Adult emigrants as % of adult population; 2a: Adult emigrants with up to lower secondary level education as % of adult population with same level of education; 2b: Adult emigrants with “above lower secondary and up to higher secondary” level education as % of adult population with same level of education; 2c: Adult emigrants with above higher secondary level education as % of adult population with same level of education.
These facts suggest two main conclusions about how developing countries have fared in the course of globalisation. First, the cross-country distribution of the world’s productive resources was hugely unequal in 1990; the world’s low-skilled labour was concentrated in developing countries while its capital and skilled labour were concentrated in developed countries. Globalisation held out the promise of bringing about a redistribution of these productive resources, thereby improving both the growth prospects of developing countries and the global efficiency of resource use. In reality, none of this has happened; the world’s productive resources remain as unequally distributed across countries as ever. Second, globalisation has led to a polarisation of developing countries into two groups: a marginalised group that continues to depend heavily on exports of primary commodities, receives very little inflow of foreign private capital and suffers large and growing brain drain; and a group of what are now called emerging economies, which exports manufactures (and, of late, services) to developed countries, receives substantial inflow of foreign private capital and suffers only small brain drain.

Two qualifying remarks need to be added. First, in the case of the marginalised group, the counter-factual is not clear; they might have suffered marginalisation even in the absence of globalisation. Their fundamental problem lies in the fact that they have persisted with specialisation in primary commodities for too long and, consequently, have failed to gain any meaningful manufacturing experience. Second, in the case of emerging economies, the substantial inflow of foreign private capital generally failed to raise the investment rate above the saving rate because of the crowding-out problem.

III. THE EMPLOYMENT EFFECTS OF GLOBALISATION

It should be clear from what has been said above that it is not very meaningful to ask how globalisation has affected employment in the marginalised countries. These are the countries that have raced to the bottom, and it does not require any analysis to say that employment conditions have deteriorated in them. The evidence, if any is required, is that the incidence of poverty has been rising in most of these countries. But, as noted above, whether or not the deterioration in employment conditions, which derives from a growth crisis, can be legitimately attributed to globalisation is not quite clear.

It is in the case of the emerging economies—the economies that have derived economic benefits from globalisation—that it is meaningful to ask if the employment effect has been positive or negative. This, as noted above, requires us to ask two separate questions: What happened to the share of the modern sector in total employment? What happened to the output per worker in the traditional sector?

Some relevant estimates are presented in Table 3. The countries in the table have been so chosen as to bring into sharp focus the patterns that are observed in a larger sample of countries. The period chosen is what would generally be designated as the globalisation period. Two basic facts emerge from these estimates. First, as a rule, either the share of the modern sector in total employment increased or the output per worker in the traditional sector increased; simultaneous increases in both were rare. Second, as a rule, wherever the share of the modern sector in total employment increased, the output per worker in the modern sector declined; in other words, significant increases in modern sector employment were usually achieved at the expense of productivity.

These facts suggest a simple conclusion: there was no unambiguous improvement or deterioration in employment conditions in developing countries during the period of
globalisation. However, before we accept this as evidence that globalisation has not had much of an impact on employment in developing countries, we need to analytically consider the mechanisms through which globalisation could affect employment.

The inflow of foreign capital can affect employment in the modern sector (to which alone it flows) in two possible ways: by directly creating labour-intensive, export-oriented manufacturing (often in special economic zones), and by facilitating technology upgrading in import-substitution industries (some of which may begin to develop as export industries). In the first case, the growth of employment in the modern sector is stimulated as labour-intensive industries expand at a faster pace than capital-intensive industries. In the second case, there is, in effect, displacement of labour-intensive industries by capital- and technology-intensive industries so that employment growth is restrained while the growth of labour productivity is stimulated.

These employment effects of foreign capital cannot in reality be isolated from the employment effects of trade growth in the modern sector, which is the main producer of tradable goods and services. It is the increased openness to trade that creates the basic stimulus for structural change in the modern sector and thus defines the role of foreign capital. The need to expand exports brings comparative advantage in labour-intensive industries into play and competition from imports generates pressures for technological change in import-substitution industries. The employment effects of trade are thus expected to be very similar to those of capital inflow. The employment effects of globalisation are, in essence, the combined effects of the growth of trade and capital inflow.

Thus, the evidence cited above really suggests that globalisation has affected employment in the modern sector either by altering the output structure (as in the Latin American emerging economies) or by altering technology (as in the Asian emerging economies). In the first case, employment growth accelerated while labour productivity stagnated or declined because the share of labour-intensive products in all industrial products increased. In the second case, labour productivity growth accelerated while employment stagnated or declined because the share of capital- and skill-intensive products in all industrial products increased. Across the emerging economies, therefore, a systematic effect of globalisation on employment in the modern sector is neither theoretically expected nor empirically found.

On the other hand, there is evidence to suggest that, across emerging economies, the effect of globalisation on the growth of output per worker in the traditional sector has been systematically negative; a country that achieved a higher rate of trade expansion also achieved
a lower rate of growth of output per worker in the traditional sector. Thus, globalisation seems to have slowed down the process of improvement in employment conditions in the traditional sector. And since the trend in the incidence of poverty in a developing economy is linked to the trend in output per worker in its traditional sector, it appears that globalisation actually slowed down the process of poverty alleviation. It is routinely asserted in the mass media that globalisation has lifted millions out of poverty. This assertion is baseless. Millions more might have been lifted out of poverty but for globalisation.

Now this particular effect of globalisation seems quite surprising at first sight. Why should globalisation, which has very little to do with the traditional sector, negatively affect the output per worker in that sector? A little reflection suggests a very good reason. Trade growth is associated with a re-allocation of investment from the sectors producing non-tradable products to the sectors producing tradable products. In the context of developing countries, this means a re-allocation from the traditional to the modern sector. If this investment re-allocation occurs in a context wherein aggregate investment is declining or stagnant or increasing very slowly, investment in the traditional sector declines so that output growth in the sector slows down. As we have seen above, globalisation has certainly not boosted investment in developing countries; indeed, the available evidence shows that the aggregate investment rate declined in about half the developing economies, and even in half the emerging economies, during the globalisation period. Trade growth, therefore, had the effect of slowing down the growth of output per worker in the traditional sector of many developing economies.

IV. CONCLUDING OBSERVATIONS

The overall conclusion that emerges from the analysis is somewhat pessimistic. Globalisation has not had a systematically positive effect on employment in the modern sector while it has had a systematically negative effect on employment in the traditional sector; overall, therefore, globalisation can be said to have had a negative employment effect in developing countries.

It has to be acknowledged, however, that the conclusion is tentative in character. Limitations of statistical data have imposed limitations on the analysis; a good deal of manipulation of the available statistical data was required, for example, to derive estimates of output and employment in the two sectors. Although I believe that the estimates are good enough for deriving qualitative conclusions, better estimates clearly remain desirable. Furthermore, the methodology employed in the analysis can be legitimately criticised. I have basically analysed the experience of a set of emerging economies in the globalisation period. I have also relied mainly on cross-country comparisons. Ideally, individual country experiences should be analysed and the experience during the globalisation period should be placed in the context of long-term development experience.

I end with my opening observation: there is much that we don’t know or don’t know for certain. And this means that there is much for the researchers to do. Hopefully, the analytical framework suggested in this paper will help researchers carry forward the work.

References