



## Social unrest paves the way: A fresh start for economic growth with social equity

*UN Secretary General Ban Ki-Moon has emphasised that the wave of popular revolt that has erupted in the North Africa and West Asia region constitutes a “situation which calls for bold reforms”. Indeed, these momentous events also reflect massive social discontent and crises. The push for political change has been mirrored by equally vocal calls for alleviation of poverty, more and better jobs, better wages and social security, access to basic commodities at affordable prices and equitable distribution of national income. In its economic dimensions the upheaval represents a day of reckoning for the trade and economic policy choices made in the region over past decades. But for policy makers in countries facing similar pressures this is an opportune moment to rebuild neglected public institutions so they can lead the process of reshaping economic and labour governance. This can provide a platform for a re-assignment of macroeconomic policies for sustained growth in ways that trigger a virtuous circle of investment, productivity growth, income growth and employment creation so that the income gains from productivity growth are distributed equitably between labour and capital.*

### **The socio-economic fallout from globalization**

The downside of rapid and poorly sequenced liberalization, sweeping privatization programmes, restrictive macroeconomic policies and export led growth strategies has manifested itself vividly in the first weeks of the second decade of this third millennium. Vulnerable countries in North Africa and West Asia, especially non-oil exporters, face significant social and political pressures though the economic policy space necessary for appropriate response has been shrinking over the last decades. More often than not, liberalization has not been able to prevent income concentration and the emergence of legions of educated, unemployed urban youth whose job prospects are dim. One of the defining features of the globalization process in the last three decades has been to create growth in economies ill-prepared to absorb burgeoning urban and rural labour forces in productive and decent employment. While policy “reforms” proceeded apace, and even generated GDP growth, this was accompanied by bubbles of wealth and skewed, unsustainable income distribution, which has improved only marginally in many such countries.

For today’s developed countries, the creation of strong labour market and social security institutions was an important element in the structural transformation that accompanied their industrialization. The participation of labour in productivity gains was a necessary condition for the advancement of this process. But in developing countries the link between growth and formal employment is weaker than in developed countries partly due to the fact that changes in informal employment and self-employment dampen cyclical growth effects. Having pursued export-growth strategies to their limits, at best many developing countries have witnessed jobless growth episodes whereby workers laid off in the formal sector in bad times often tend to move into the informal economy because of the lack of social safety nets.

In more open economies strengthening a country’s international competitiveness has often resulted in downward pressure on wages, a dynamic strengthened by the move of surplus rural labour into the urban or

formal sectors. However, wage competition can only be sustained for a limited period of time in some, but not all, countries; the lack of adequate domestic demand generation would eventually affect economic and employment growth and could fuel social unrest. Moreover, in such a situation, it becomes more difficult to achieve the right balance between external and domestic sources of growth and foster resilience to cope with external demand shocks. This is the new policy challenge facing developing countries whose export markets have been hit by global recession and exchange rate fluctuations and where tolerance to wage compression has been stretched to the limit.

### **Labour pays the price of the structural adjustment**

Policy reforms in developing countries since the 1980s involved reorientation of macroeconomic policies, with priority given to combating inflation, attracting foreign direct investment, and greater openness to trade and capital flows. With market liberalization, the economic role of governments was reduced, and the goals of full employment and equitable income distribution lost their former pre-eminence. According to the structural adjustment paradigm that has since been widely advocated, the leading role in development hitherto accorded to industrialization was deemphasized and prominence was accorded to whichever sector was seen as reflecting a country’s comparative advantage. In this view of what best promotes development, liberalization was expected to permit a reallocation of productive resources from protected, inefficient industries to export-oriented competitive sectors that were supposedly more employment intensive.

As shown in the Trade and Development Report (TDR 2010), more than 20 years of policy reform have had a limited impact on strengthening the potential for rapid and sustainable growth in Africa. Indeed, they may even have reduced that potential by hindering crucial investments in physical and social infrastructure. Financial liberalization since the 1990s altered growth trajectories in ways that were inimical to employment generation by preoccupying central bankers with



exchange rate stabilization instead of investment promotion and promoting full employment. Furthermore, when governments in the region opened up to foreign capital, the investment they attracted was concentrated in capital intensive sectors (telecom, energy, etc), which is the opposite of what neoclassical trade theory and comparative advantage predict. Typically, recessionary episodes with high unemployment weakened the bargaining power of organized workers and lowered their share in national income. This also encouraged greater labour market flexibility and aggravated wage compression.

What has taken place recently in Tunisia, Egypt and other countries in the region is thus symptomatic of a wider policy malaise that has inspired a rapidly evolving social transformation agenda. Even though acceleration of GDP growth in the 2000s has been accompanied by higher labour productivity and declining incidence of vulnerable employment and of the working poor, labour market characteristics in North Africa have remained largely unchanged since the 1990s. Participation rates increased marginally, and in the late 2000s were at about 44 per cent of the labour force. Registered unemployment has shrunk from around 15 per cent in the late 1990s, although, at close to 10 per cent during the past decade for Africa and at between 10-13 per cent in countries of North Africa, it remains high relative to other developing regions.

The limited available data on the evolution of the share of wages in national income suggests that it has been, with some exceptions, on a declining trend over the past three decades in both developed and developing countries. For the group of three North African non-oil producing countries for which data is available (Egypt, Tunisia and Morocco), despite sustained GDP growth and labour productivity gains, the wage share has not tracked that path. Rather, the share of wages for this group of countries hovered around 33 per cent of national income since the mid-1990s, with some short-lived improvement until 2005, after which it has declined (see Chart). In Egypt, the wage share has fallen recently below a quarter of national income.

This trend is explained partly by greater labour market flexibility and export orientation, which tended to limit increases in wages to boost international competitiveness. But the decline in real wages and in the wage share in most developing countries in the 1980s and the 1990s was mostly due to wage compression, with workers bearing the burden of export-oriented industries losing competitiveness in international markets. At the root of the problem was restrictive monetary policy involving high interest rates to attract foreign capital, which led to weakened competitiveness by fostering real exchange rate appreciation and at the same time discouraged domestic investment by raising the cost of credit to producers.

### Starting anew: policy action is within reach for socially vulnerable developing countries

TDR 2010 emphasised that employment growth critically depends on the expansion of aggregate demand, and much less – if at all – on the price of labour relative to that of capital. The conventional wisdom about “export-led growth” has focused policy makers’ attention on lowering unit labour costs to improve a country’s global competitive position, sometimes to the detriment of economic growth prerequisites and social justice goals.

But there are still alternatives that policy makers can consider even in a period of crisis and institutional transformation. To begin with, a more sustainable macroeconomic strategy would rely more on investment and new capacity creation for absorbing surplus labour and on domestic demand expansion based on wage increases in line with aggregate labour productivity increases. For all countries, the ability to achieve sustained growth of income and employment on the basis of productivity growth depends critically on how the resulting gains are distributed within the economy, in particular how much goes to consumption of domestically produced goods and services and for

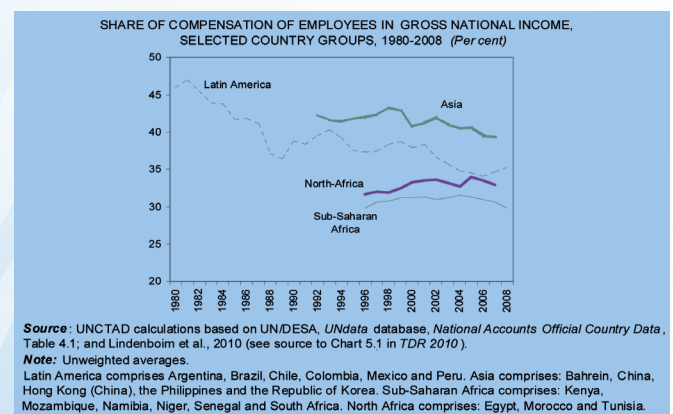
investment in activities that create more employment. For countries facing severe social pressures, such strategic criteria are central to a successful recovery and reconstruction strategy and to maintaining the “social contract” between the state and labour.

Sustainable growth can be enhanced based on seeking synergies between employment and wage growth in line with productivity and output growth. For a virtuous circle of investment, productivity growth, income growth and employment creation to occur, policies need to be oriented towards ensuring that the income gains from productivity growth are distributed appropriately between labour and capital. This means that over time there should not be a decline in the share of wages in national income; for developing countries, this includes incomes from self-employment in agriculture and non-agricultural informal activities. This is not enough, however; an improving share of wages in national income does not in itself imply improved income distribution. This social equity goal calls for complementary policies to avoid declines in relative and absolute real incomes of the vast majority of the population, and to empower public institutions to lead the private sector along a new national development path.

From this perspective it is not greater wage flexibility that leads to faster employment growth, but rather the orientation of changes in the general wage level along the path of average productivity growth in the economy. This will not only create additional jobs that produce additional value added, but also allow for the emergence of profit differentials and an incentive structure that strengthens innovation, the dynamic forces in the economy and, thus, investment in productive capacity. Moreover, linking wage increases to productivity growth would tame cost push inflationary pressures and thus free central banks to pursue pro growth and employment-friendly monetary policy.

UNCTAD has proposed in TDR 2010 several labour policy instruments that could be considered in the context of such a broad macroeconomic reorientation, especially:

- **Encouraging collective bargaining** involving revitalised labour and employer organizations in support of an incomes policy;
- **Considering legal minimum wages**, especially where responsible tripartite institutions, including labour unions, employers and the government, remain to be created or restructured;
- **Funding public employment schemes** to establish a floor by improving both earnings and conditions of work in all sectors;
- **Improving incomes of small rural producers** through mechanisms that link agricultural producer prices to the overall productivity growth in the economy; and
- **Finding the right balance in taxation** for establishing important linkages between export industries – be they traditional extractive or modern manufacturing industries – and the rest of the economy.



For a more detailed discussion, see UNCTAD, Trade and Development Report 2010.