



# Economic Premise

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## Fewer Jobs or Smaller Paychecks? Labor Market Impacts of the Recent Crisis in Middle-Income Countries

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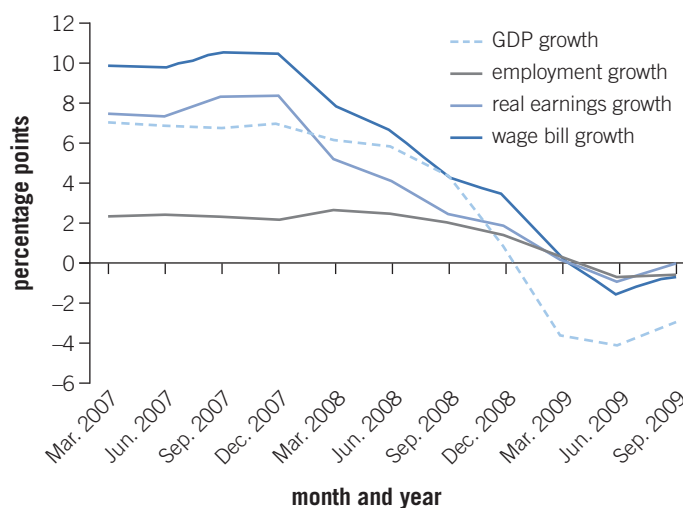
*This note<sup>1</sup> presents early evidence on the labor market impacts of the recent economic crisis in 41 middle-income countries.<sup>2,3</sup> A broader geographic coverage is prevented by the lack of high-frequency labor market data in other middle-income countries and in the low-income countries. Whereas the economic downturn has threatened recent progress in enhancing employment opportunities, the impact has fallen disproportionately on the quality of employment rather than on the number of jobs. Slower growth in earnings accounts for nearly three quarters of the total adjustment for the average country. The bulk of the earnings adjustment was driven by a reduction in working hours, as well as a shift away from the better-paid industrial sector. Evidence of the adjustment's nature and magnitude suggests a policy package that combines (1) income maintenance programs—that is, cash transfers to low-paid poor workers; (2) interventions that facilitate flexible-hours arrangements; and (3) innovative policies that provide workers access to income maintenance mechanisms to compensate for temporary reductions in standard working hours—for example, by granting partial compensation from the unemployment benefit system or by providing paid training opportunities.*

### Workers Were Hit Hard

Figure 1 shows how recent positive trends in the growth of the *real wage bill*<sup>4</sup>—that is, of the aggregate labor income in real terms—have stalled since the beginning of 2008. The initial fall in wage bill growth resulted from increased inflation caused by the food and fuel crisis, and continued after the sharp downturn in GDP in the last quarter of 2008.<sup>5</sup> Nearly every country was affected because the wage bill growth fell in 25 of the 28 countries for which data are available.

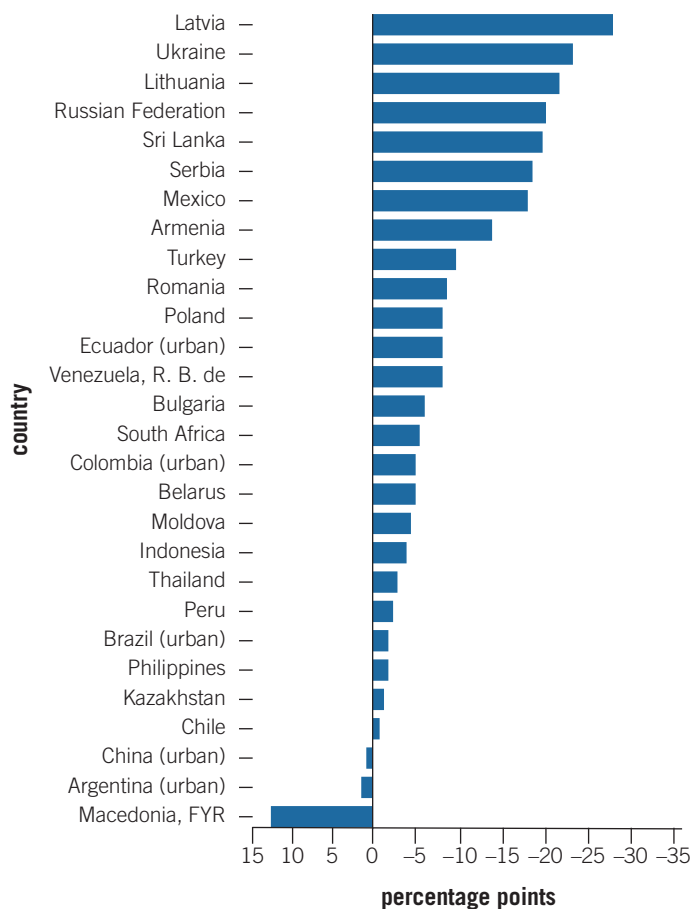
On average, the wage bill growth rate fell by 8 percentage points; but the magnitude of the slowdown varied considerably across countries (as shown in figure 2). The impact was particularly severe in the wealthier countries and those with fixed exchange-rate regimes.<sup>6</sup> In line with the severe GDP downturn, the impact was especially acute in the countries of Eastern Europe and Central Asia, but also in

Figure 1. Trends in the Growth Rates of Main Indicators across Time



Source: Authors' calculations.

**Figure 2. Crisis-Related Change in Wage Bill Growth, Selected Countries**



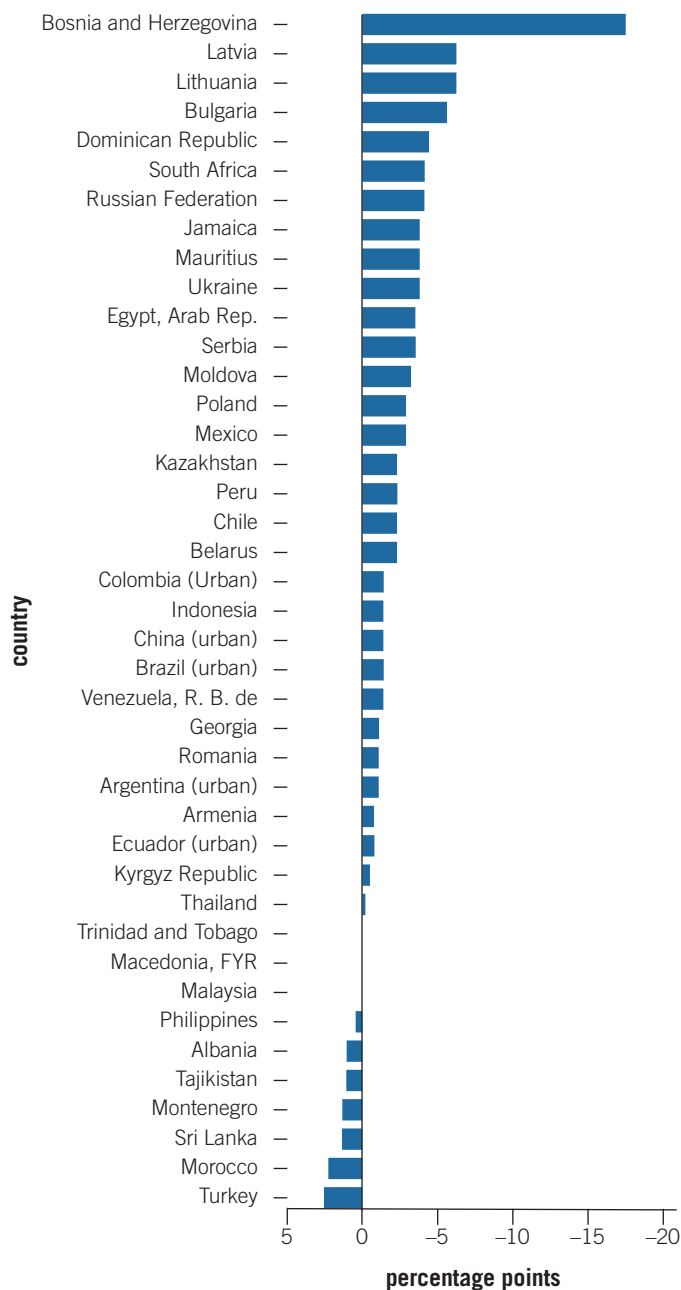
Source: Authors' calculations.

Mexico and Sri Lanka. By contrast, the wage bill continued to grow at an accelerating rate in Argentina, China, and the former Yugoslav Republic of Macedonia, thanks to sharp drops in the growth of consumer price indexes and corresponding reductions in the growth of real earnings.

### But the Number of Jobs Changed Little

Employment growth also slowed in more than three quarters of the countries (figure 3). On average, however, the decline was moderate (2.1 percentage points in the 41 countries sampled); and employment continued to grow in 60 percent of the countries. The reduction in employment growth was particularly severe in Eastern Europe and Central Asia, where eight countries experienced reductions of 2 percentage points or more. In contrast, employment growth in the Eastern Asia and the Pacific region was barely affected, declining by only 0.1 percentage points. Differences based on currency regimes are also stark: on average, countries with fixed currency regimes saw a decline of 1.7 percentage points, compared with only 0.4 percentage points in countries with floating rates.

**Figure 3. Change in Employment Growth, Selected Countries**

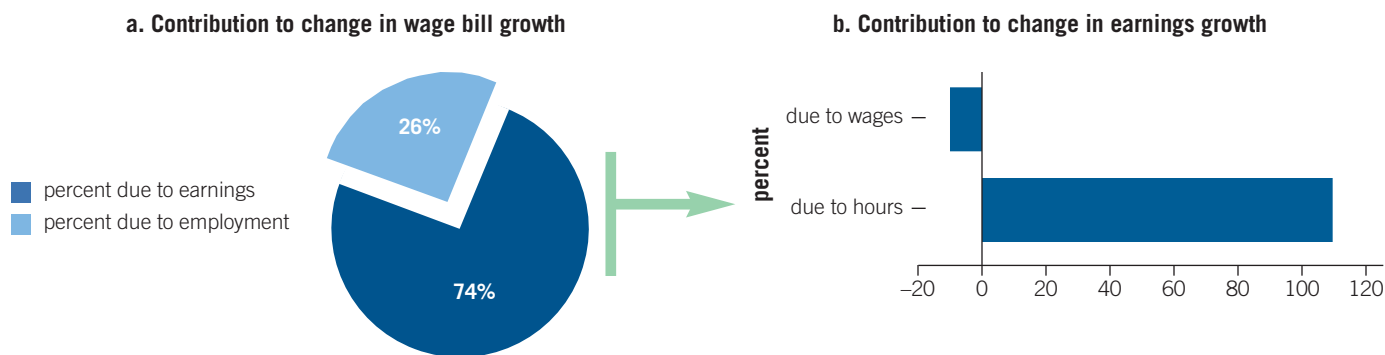


Source: Authors' calculations.

### The Bulk of the Burden Fell on Earnings

Workers suffered most from the sharp slowdown in monthly earnings growth.<sup>7</sup> As evident from figure 1, earnings growth began to slow down in early 2008, as the food and fuel crisis increased inflation and eroded workers' real earnings. For the average country, earnings growth fell 5.4 percentage points. For the average country, this decline amounted to nearly three quarters of the total slowdown in wage bill growth (figure 4). Earnings played a markedly smaller role in some countries, however—for example, in South Africa and in the

**Figure 4. Decomposition of the Change in Wage Bill Growth and the Change in Earnings Growth**



Source: Authors' illustrations.

mid-range, middle-income countries. Moreover, the drop in earnings was small, compared with that experienced in previous crises: wages dropped by more than 40 percent in Mexico, the Russia Federation, and Indonesia, and by 28 percent in Romania in past crises.

### Earnings Declined through a Combination of Reduced Hours and Shifts to Less-Well-Paid Sectors

The decline in the number of hours worked was a major factor in the reduction in earnings.<sup>8</sup> Hours worked fell by 5 percent or more in one third of the 14 countries for which data are available, and increased only in Uruguay and in the West Bank and Gaza.

Earnings growth also fell because of the shift in employment away from the traditionally better-paid industrial sector. This shift occurred in most countries; but was especially significant in East Asia, and in the Eastern Europe, and Central Asia region where the share of industrial employment declined by 0.7 and 0.6 percentage points, respectively. This shift contributed to reduced productivity and earnings.

### Why This Matters for Policy Makers

The magnitude and nature of the adjustment have important implications for the design of policy interventions. The mode of adjustment determines the winners and losers and how they are affected. For example, employment declines tend to concentrate losses among an unlucky few who lose their jobs. In this case, income replacement programs are effective ways of compensating them for the loss. These programs include unemployment insurance or, in countries with low institutional capacity, public works. In contrast, when the labor market adjustment occurs through earnings, losses are spread more widely across the workforce and income maintenance programs—such as cash transfers or income tax credits—be-

come particularly important. If, as in the current context, the reduction in earnings is mainly driven by a reduction in hours worked, effective interventions include innovative policies that offer workers access to income maintenance mechanisms to compensate for temporary reduction in standard working hours—for example, granting partial compensation from the unemployment benefit system or providing paid training opportunities. In addition, targeted income maintenance programs—that is, cash transfers to low-paid poor workers—also would protect the livelihoods of the most vulnerable households from long-term deterioration. Several policies implemented by countries of the Organisation for Economic Co-operation and Development—such as partial unemployment insurance, expanded cash transfers to poor workers, and temporary wage subsidies—may be priority interventions in those countries where hours and earnings adjustments dominated.

### The Political Economy of Interventions

Most developing countries facing a labor market crisis face three policy constraints. First, monitoring systems and high-frequency labor market indicators are usually lacking, and decisions are often made against a backdrop of extreme uncertainty about who is hit the hardest and how. Second, the fiscal space for policy intervention is often narrow and shrinking, and many countries have a limited scope for such responses. Third, policy makers may be confronted by institutional and political economy constraints, such as few pre-existing social insurance mechanisms on which to build, limited administrative capacity, and little maneuvering space to pursue economically optimal but politically unpopular reforms.

Policy makers also may face two thorny trade-offs. First, policies that ease the short-term effects on employment may destroy incentives for long-term recovery, especially during a prolonged structural crisis involving significant sectoral re-

allocation. Second, limited resources mean that policy makers also may have to choose between support for those people who are most directly affected by the crisis (typically urban-based exporters and those involved in construction and manufacturing) and interventions directed to chronically poor groups.<sup>9</sup>

## Notes

1. This note draws on Khanna, Newhouse, and Paci (forthcoming).

2. The countries included in the analysis (in decreasing order of impact on GDP growth) are Armenia, Ukraine, Latvia, Lithuania, Russia, Georgia, Turkey, Romania, Thailand, Mexico, Dominican Republic, Bulgaria, Malaysia, Paraguay, Peru, Kazakhstan, Kyrgyz Republic, Moldova, República Bolivariana de Venezuela, Serbia, Belarus, Brazil (urban), Colombia (urban), Chile, FYR Macedonia, South Africa, Jordan, Argentina (urban), Uruguay, China (urban), Poland, the Philippines, Ecuador (urban), Sri Lanka, Mauritius, Jamaica, the Arab Republic of Egypt, Indonesia, West Bank and Gaza, Albania, and Morocco. The following countries have labor market data, but not data on GDP growth: Bosnia and Herzegovina, Montenegro, Tajikistan, and Trinidad and Tobago

3. Results should be interpreted with appropriate caution, given differences in data sources across countries. For example, in one quarter of the countries, employment data cover only formal workers; and earnings data ignore self-employed workers in one third of the countries. In some Latin American and Caribbean countries, data cover only urban areas. Despite these inconsistencies, the data provide a useful general indication of recent trends.

4. The real wage bill is defined as the product of total employment and average earnings.

5. For more details, see Khanna, Newhouse, and Paci (forthcoming).

6. Countries are classified on the basis of their precrisis per capita GDP. In the poorest group of countries, the per capita GDP ranges from \$230 (Tajikistan) to \$1,800 (China). The countries at moderate levels of development range from FYR Macedonia, where per capita GDP is \$2,000, to Mauritius, where it is \$4,700. The wealthiest

group ranges from Malaysia, with \$5,000 GDP per capita, to Trinidad and Tobago, with \$10,100. For more details on the findings, see Khanna, Newhouse, and Paci (forthcoming). After controlling for the drop in GDP growth, the differences in labor market slowdowns across regions are minor.

7. Thirty-one countries have data on average monthly earnings, and 28 of these countries have data on employment as well. The countries with earnings growth data (in decreasing order of severity) are Latvia, Sri Lanka, Ukraine, Lithuania, Russia, Serbia, Mexico, Turkey, Romania, Armenia, República Bolivariana de Venezuela, Poland, Paraguay, Colombia (urban), Belarus, Thailand, Indonesia, the Philippines, South Africa, Ecuador (urban), Brazil (urban), Bulgaria, Moldova, Peru, Kazakhstan, Chile, West Bank and Gaza, Uruguay, Argentina (urban), China (urban), and FYR Macedonia.

8. Fourteen countries have data on hours worked.

9. For a more detailed discussion of how to best deal with these trade-offs, see the forthcoming *Economic Premise* titled “Coping with Crises: Policies to Protect Employment and Earnings.”

## Reference

Khanna, Gaurav, David Newhouse, and Pierella Paci. Forthcoming. “Fewer Jobs or Smaller Paychecks? Labor Market Impacts of the Financial Crisis in Middle Income Countries.” In *The 2007–09 Financial Crisis: Labor Market Impacts and Policy Responses*, ed. D. Newhouse, P. Paci, and D. Robalino. Washington, DC: World Bank.

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