

ISLAMIC DEVELOPMENT BANK
EXPERT GROUP MEETING ON ADDRESSING
UNEMPLOYMENT IN IDB MEMBER COUNTRIES
IN THE POST CRISIS WORLD

Labor Market Challenges in OIC Member
Countries

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Contents: Labor Market Challenges In ICs



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Introduction

- Islamic Countries a diverse group of poor and rich.
- All Countries are Developing, None is member of OECD.
- In Theory the Absence of Government Welfare Support for the unemployed means that Unemployment should be low.
- Many of the countries are poor, people cannot afford to be unemployed
- Average Unemployment in lcs from Available data is around 10 % compared to global rate of 8%.
- Youth Unemployment ranges from 2 to 4 the Adult rate
- Average Youth Unemployment Rate is 17% compared to 6 % for the Adult.
- Despite good Economic Growth (2004-2008), poverty and unemployment are the major economic and social challenge facing most ICs

Unemployment Rate, Ics

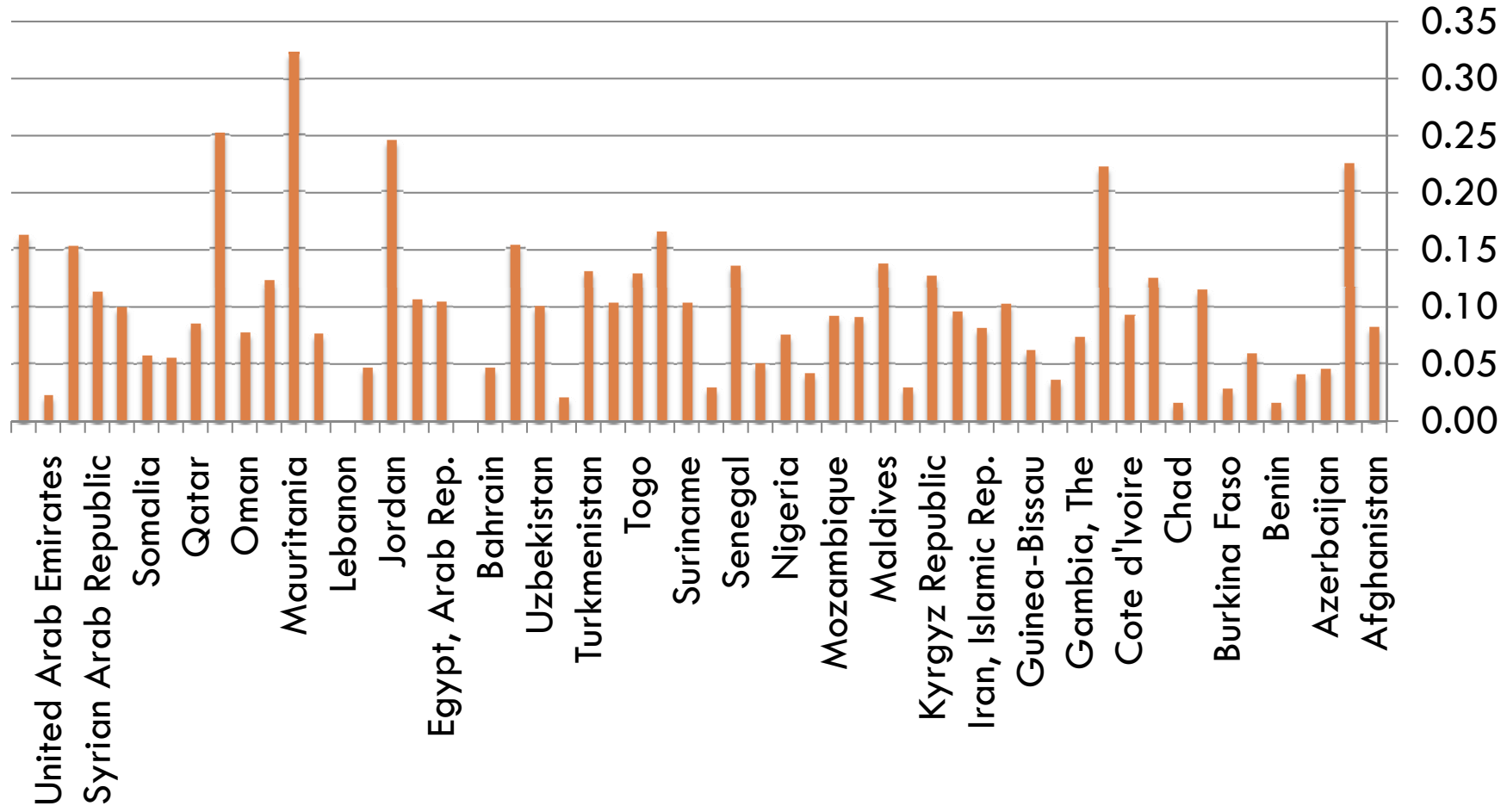



Table 1: Some Basic Indicators of Economic Development

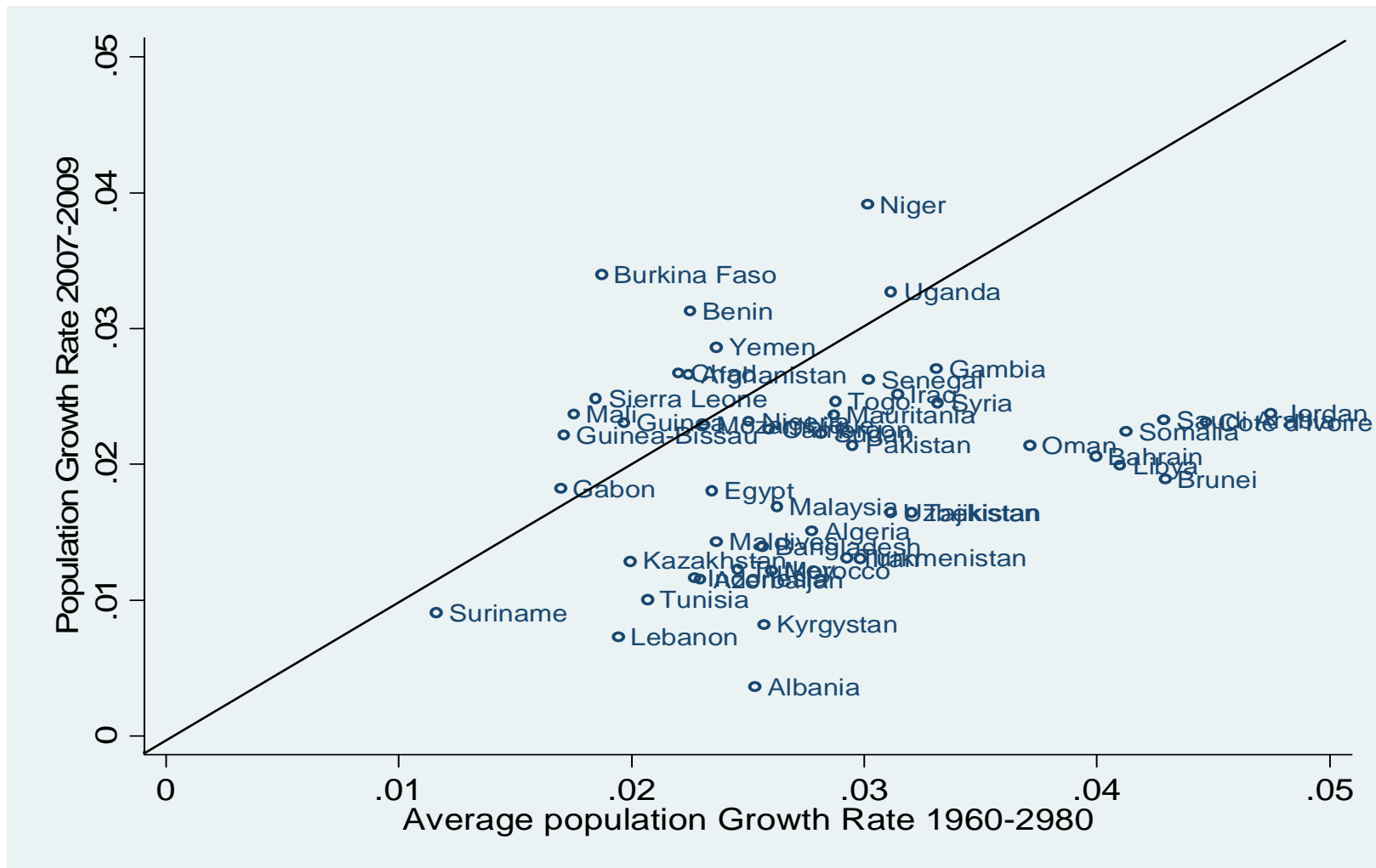
Indicator (Sample of 53 lcs)	TIMMS Score 2007 (World Benchmark 500)	Human Capital (Average Years of Schooling)	Unemployment Rate	GDP Per Capita PPP 2009	% Population Living Under 2 US\$ a Day PPP
Average	396.9	6.3	11.8	12081.6	41.9
Max	541.0	10.4	59.5	159246.9	90.0
Min	211.0	1.8	0.5	534.1	0.3
Standard Deviation	70.2	2.4	11.1	25312.1	29.0

Understanding Why Unemployment is High in ICs

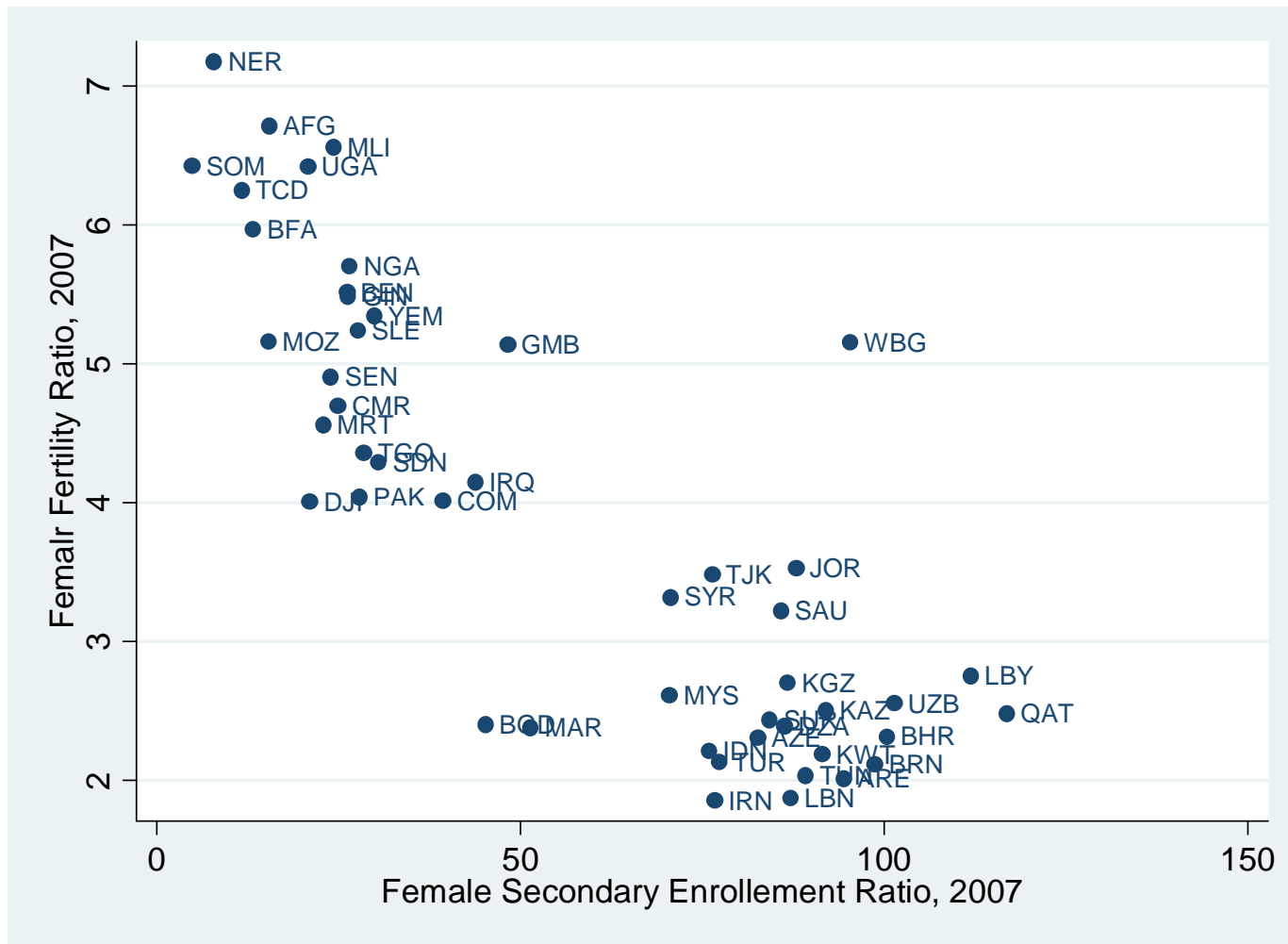
- Labor Force is to a certain extent the Image of Population Dynamics and is mainly affected by Female education and fertility
- Population in Ics increased from 485 Millions in 1960 to 1490 Millions in 2007 with average population growth rate of 2.4 % pa (2.2 % from 1980 to 2007)
- Labor Force increased from 280 Millions in 1980 to 585 % in 2007 with average growth rate 2.7 %
- Average ICs labor force participation rate increased from 66 % in 1980 to just 67% in 2007. Average labor force participation rate for middle income developing countries was around 71% of working age population.
- Ics have a population gift of 0.5 % (or Population Burden ?)

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- Female Education increased Rapidly to 93 % in Primary, 56 % in secondary and 18 % in Tertiary
 - This also led to decline in Fertility from 7 in 1960 to just 3.5 in 2007.
 - The issuing decline in population growth rate in more than offset by increasing female participation rate in the labor market.
 - Female labor force participation in the labor market increased from 41 % in 1980 to 47 % in 2007 (Average Middle Income Developing is 50 %)

Labor Supply: Population Growth



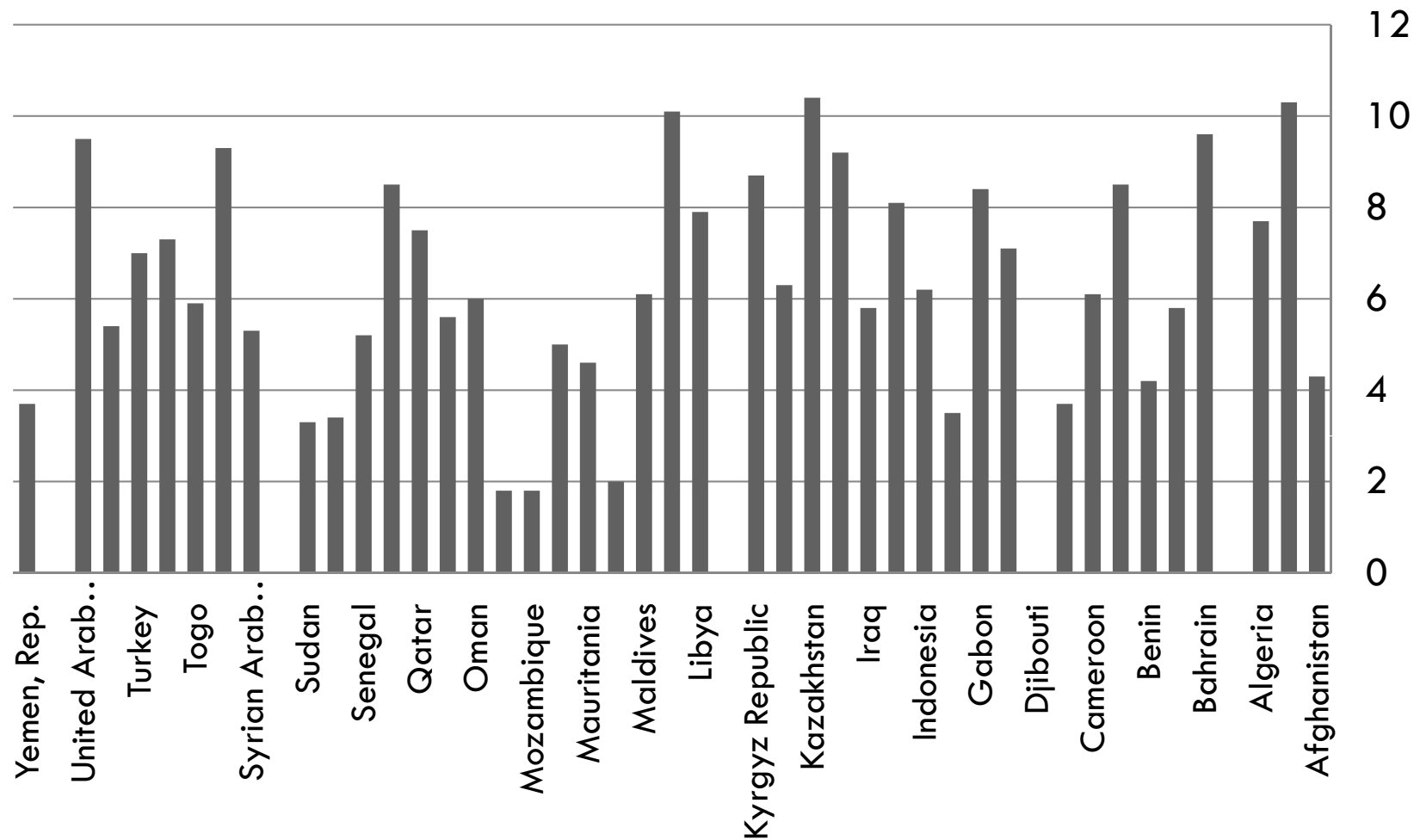
Population Growth: Female Fertility and Female Education



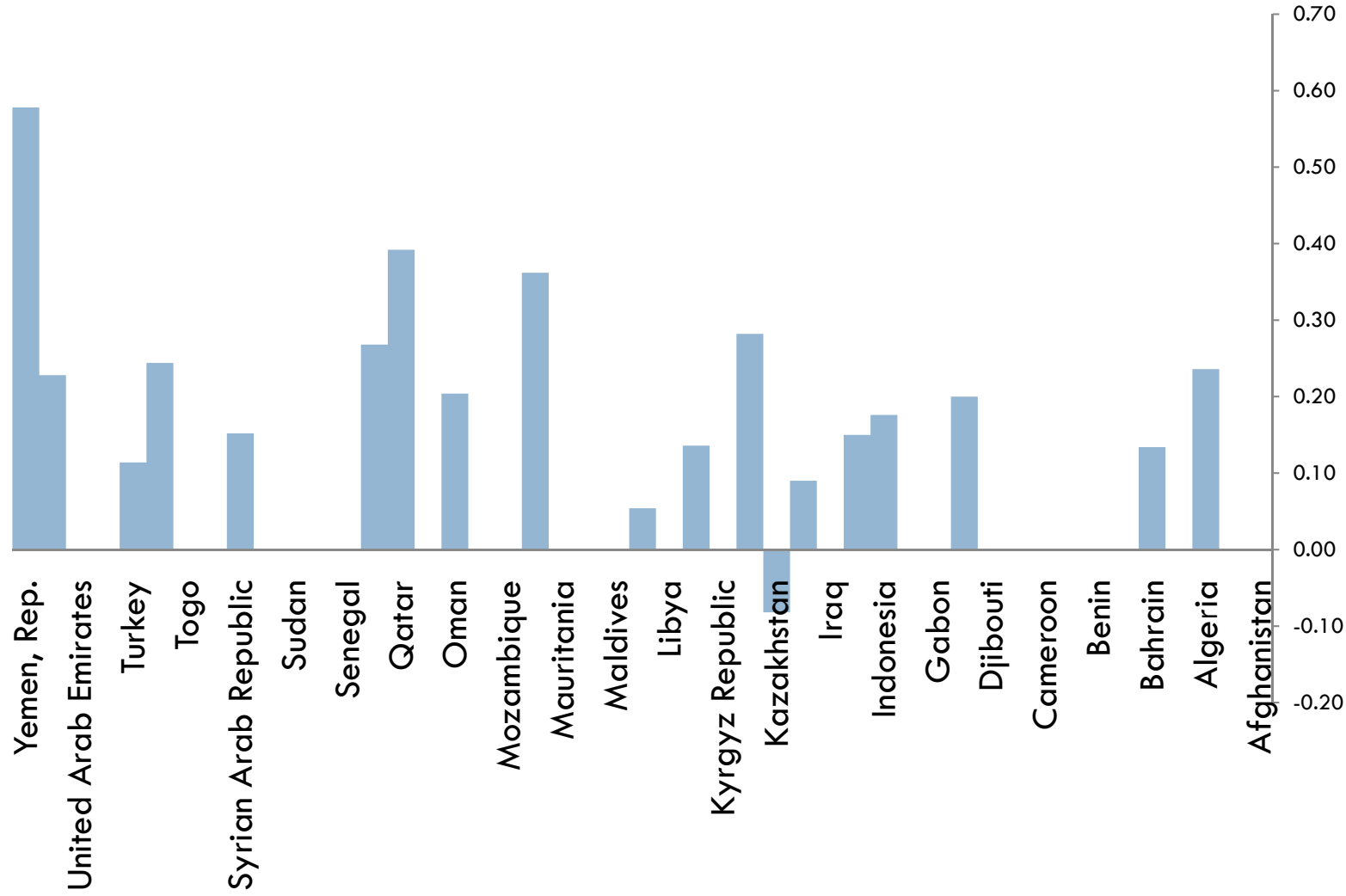
Human Capital and Education Quality

- ❑ Labor quantity and quality is a major production input.
- ❑ The education system is pivotal in building human capital and the required skills
- ❑ Low human capital quality is thought to hinder economic growth by lowering total factor productivity.
- ❑ The incentive system and labor market signals creates a value system that eventually will distort education choices of people.
- ❑ Guaranteed government employment schemes tend to bias education choices towards more humanities and creates job mismatches as skill supply is not commensurate with labor demand.
- ❑ Higher real wages will encourage people (Females) to enter the labor market
- ❑ Higher Real Wages increases the cost of production thus shifting the production factors mix to more capital intensive technology.
- ❑ Compared to World Average Benchmark Education quality gap is estimated at 21% and could reach as much as 58% in some countries
- ❑ Average Human Capital is 6 Years of Education Compared to 14 Years in Developed Countries

Human Capital Level :Average Years of Schooling 2010- Barro and Lee




Education Quality Gap (500-TIMMS)/500

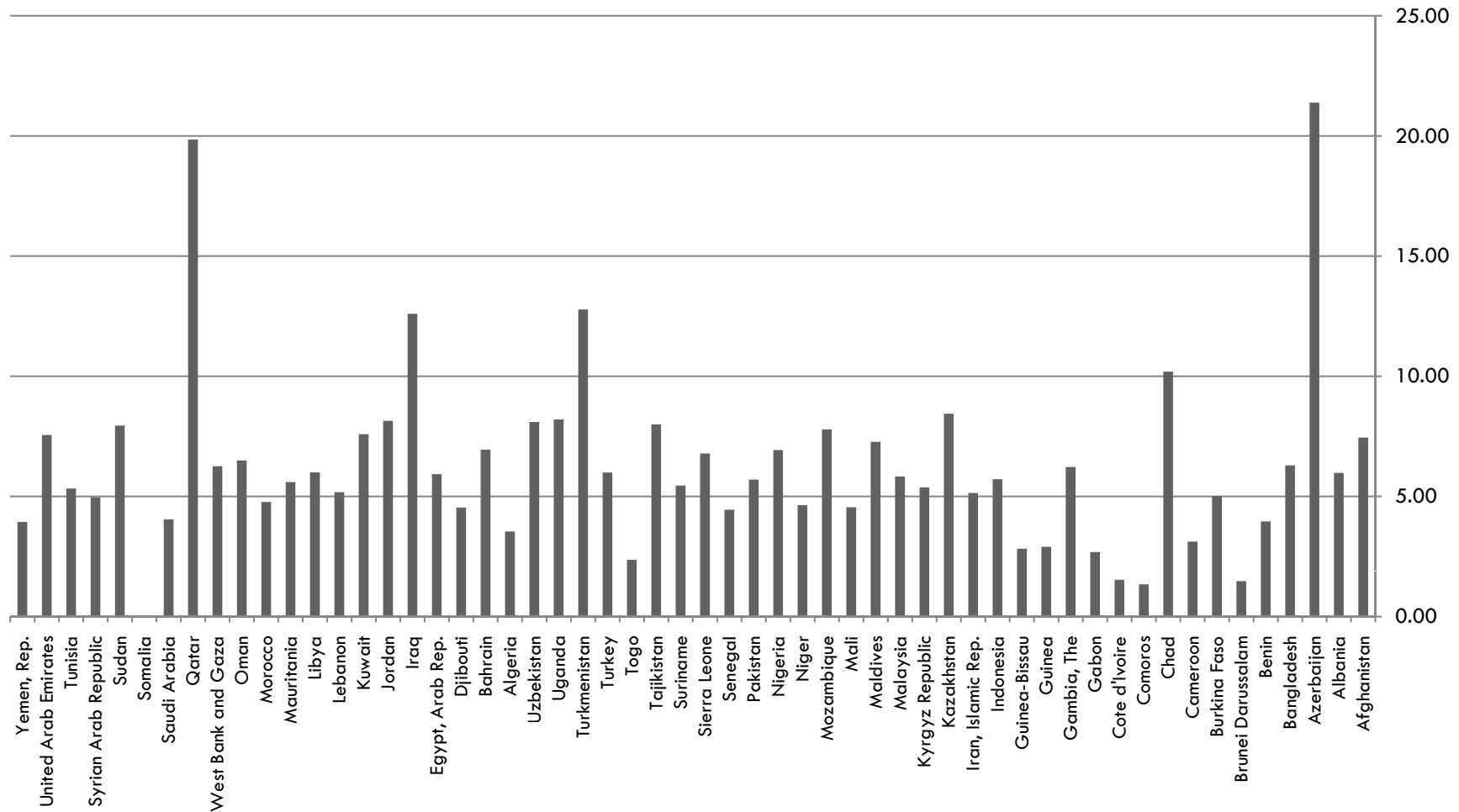


Labor Demand and Job Creation

- Notwithstanding the labor force inflow to labor market, labor demand (employment) is the other element responsible for high unemployment.
- Employment Data is scarce and Fragmented.
- Labor demand is tightly related to the capacity of the economy in creating permanent jobs and to the nature of growth (technology, productivity or capacity expansion)
- The nature of labor demand elasticity of output i.e by how much labor demand increase if output increases by 1 % summarizes the dynamics of job creation.

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- Growth Literature is vast and there is disagreement on the exact causes of Growth (policies, Institutions, Capital and resources, technology and ideas, fixed effect factors)
 - Over the period of 2004-2008 average economic growth was robust and around 6 % pa
 - some countries suffer from high growth volatility.
 - Average volatility measured by the coefficient of variation was 0.44, which means that average growth was more than double the standard deviation.

Average Output Growth 2004-2008



Assessing Job Creation in ICs

- Employment elasticity estimated by dividing the average (2004-2008) employment growth rate by the average (2004-2008) real GDP growth rate:

$$\varepsilon_i = \frac{\Delta \text{Ln}(E_i)}{\Delta \text{Ln}(Y_i)}$$

- By assuming that the above relation is stable, the rate of job creation is related to economic growth:

$$\Delta \text{Ln}(E_i) = \varepsilon_i \cdot \Delta \text{Ln}(Y_i)$$

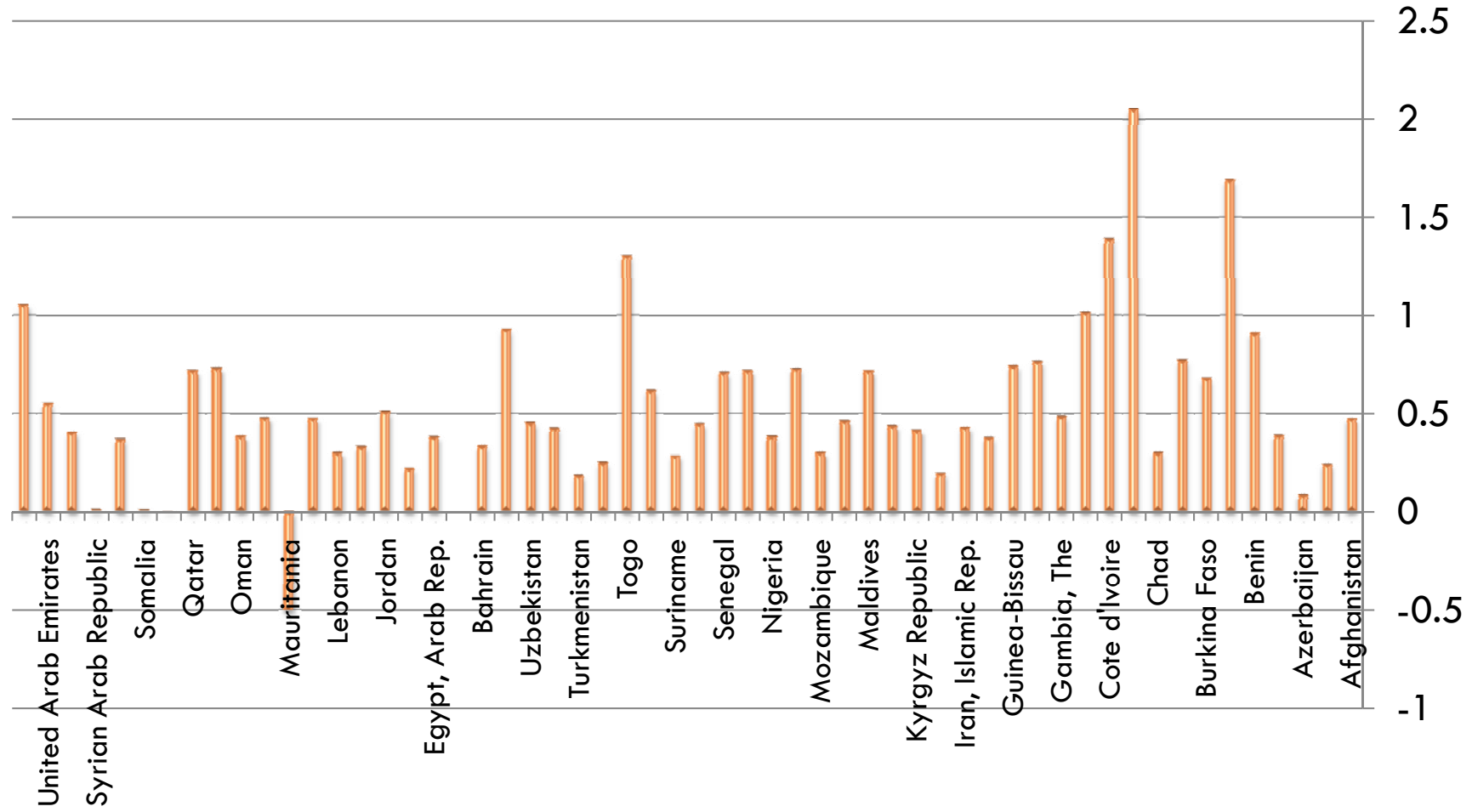
Assessing Job Creation in ICs

- Unemployment is the difference between labor force and employment,
- Growth of the unemployment level is:

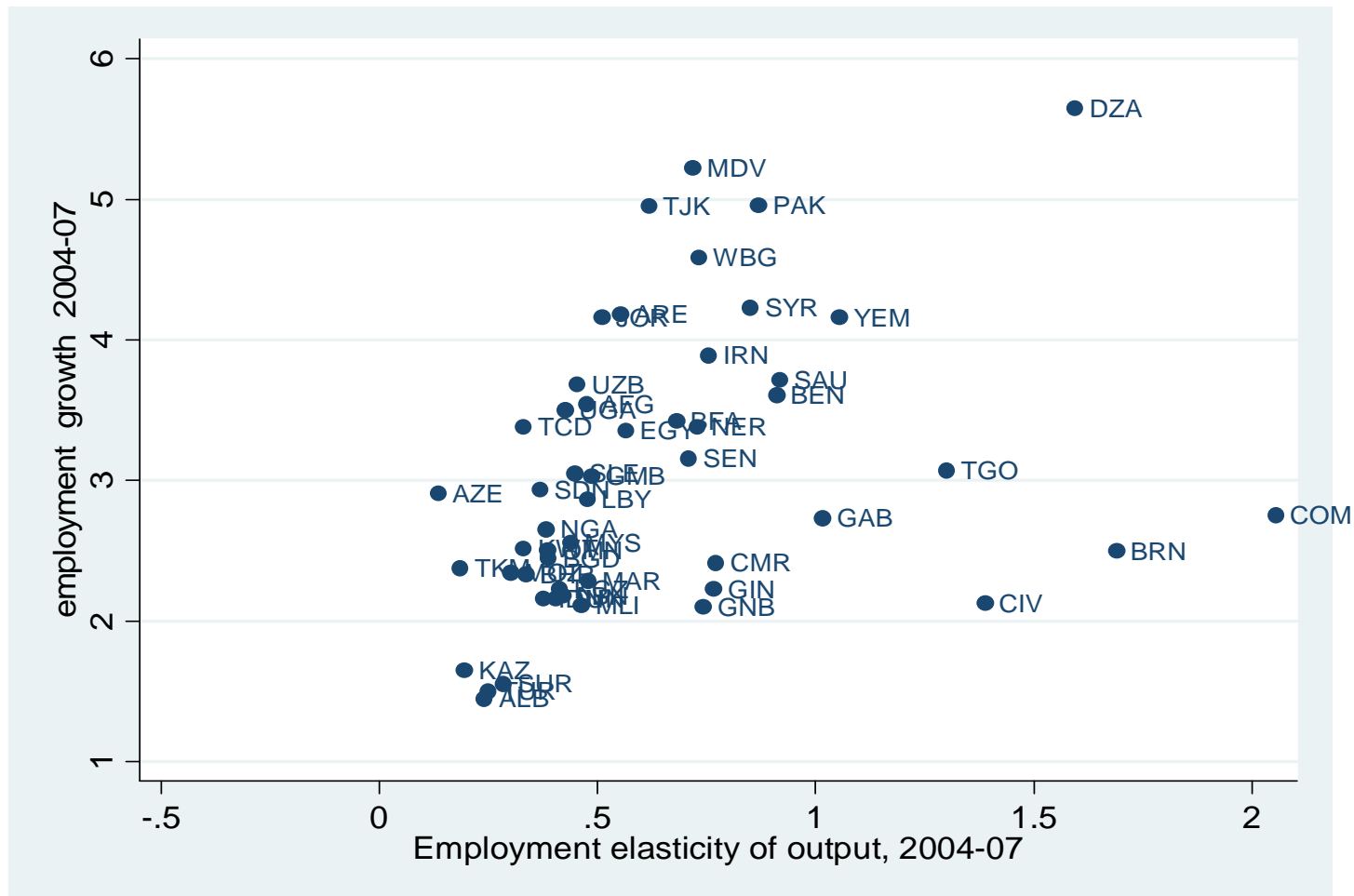
$$\Delta \ln(U_i) = \Delta \ln(LF_i) - \Delta \ln(E_i) = \Delta \ln(LF_i) - \varepsilon_i \cdot \Delta \ln(Y_i)$$

- This equation is an Okun curve that states a negative relationship between economic growth and the percentage change in the level of unemployment
- Average elasticity is around 0.6, average economic growth should 40% higher than labor force growth in order to achieve a negative growth in the level of unemployment.
- Given the fact that growth over 2004-2008 was about 6% pa and that labor force growth was around 3%, unemployment level was decreasing only by 0.6% or 6% over 10 years if historical growth level is sustained.

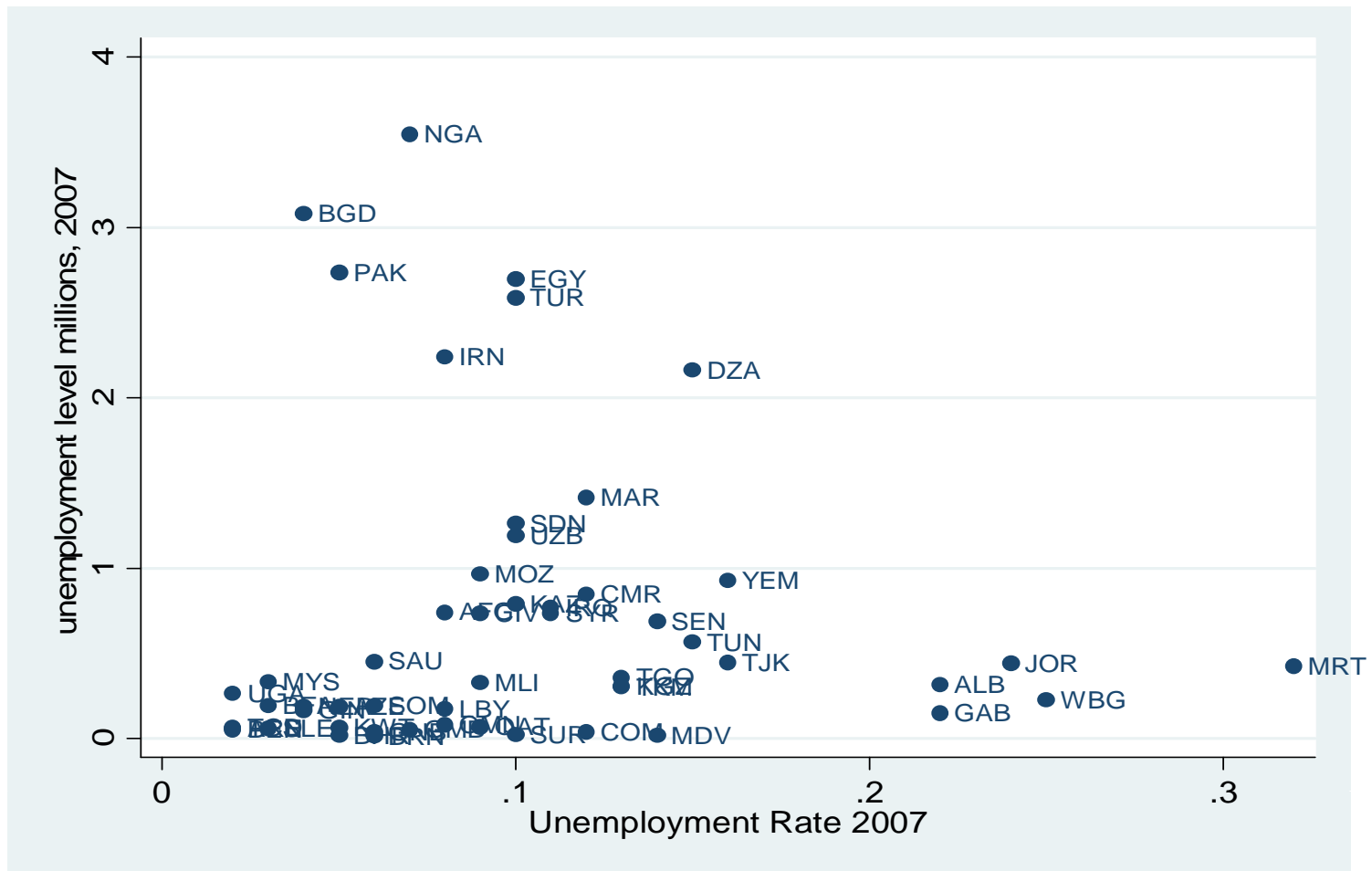
Employment Elasticity



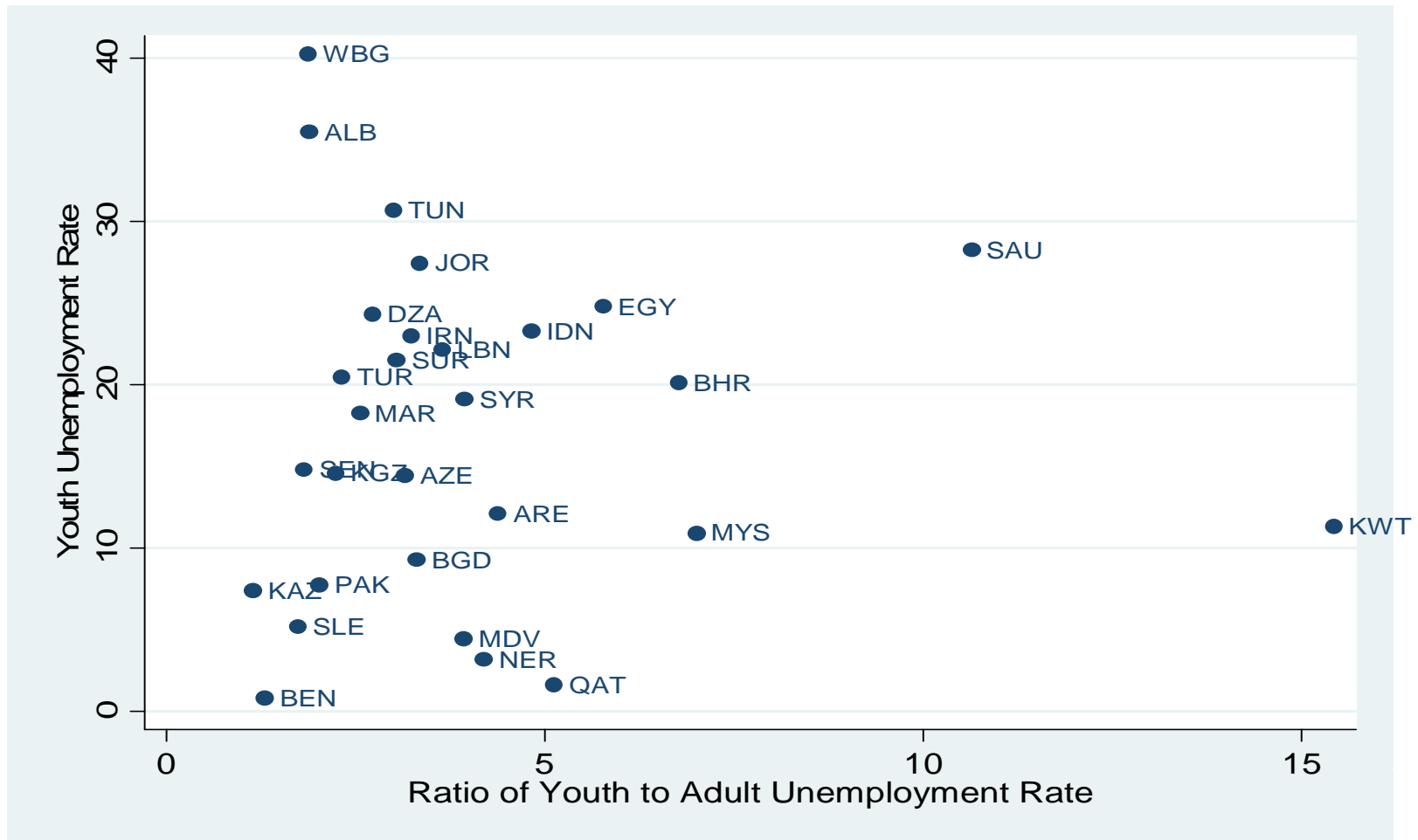
Employment Elasticity end Employment Growth



Size of Unemployment In ICs



Youth Unemployment



Size of Unemployment in ICs

- Average employment growth in ICs was 3.2 % pa almost equal to the growth of the labor force of 3.0 % which means that only a marginal decline in the unemployment could be achieved
- Here are no viable estimates of the level of unemployment in all Ics. From available data, we estimate the outstanding level of unemployment in 2007 as equal 46 million persons.
- Average unemployment rate in the same year was 12 %, but with large differences among the countries with a standard deviation of 6.4 % and minimum unemployment rate was 1.5 % and maximum of 32 %.
- In large population the unemployment level reached 11 millions in Indonesia, and more than 3 millions in Bangladesh.
- However in most countries unemployment level is below the one million mark.

Youth Unemployment

- Adult unemployment rate was only 5.7 % compared to 17 % for the youth.
- This rate could rise above the 30 % as in Albania or Tunisia.
- The ratio of youth to adult rate was 4 and could be as high as 15 times as is the case of Kuwait.
- The youth unemployed constitute 46 % of total unemployment.

Can The Unemployment Problem Be addressed

- How much growth is needed in order to substantially reduce unemployment in ICs.
- We use a time horizon in 2015, and assume that labor force growth rate will stay constant unchanged.
- We also assume that employment elasticity is constant and equal the average of the period 2004-2208.
- We put the target unemployment to be reached in 2015 to 5 %
- First we calculate the projected employment in 2015 using the Okun parameter

Labor Market Projection Model

$$E_{2015} = E_{2008} \cdot (1 + \varepsilon \Delta \ln(Y))^7$$

$$LF_{2015} = LF_{2008} (1 + \theta)^7$$

$$U_{2015} = 1 - \frac{E_{2015}}{LF_{2015}}$$

$$E^*_{2015} = (1 - 0.05) * LF_{2015}$$

$$Jobs = E^*_{2015} - E_{2015}$$

$$\Delta \ln(Y^*) = \frac{\Delta \ln(E^*)}{\varepsilon}$$

Can The Unemployment Problem Be addressed

- On the basis of these assumptions labor force in ICs will increase to 715 millions in 2015 and employment to 663.6 million giving a total number of unemployed of 15.5 million persons.
- The unemployment rate will increase to 12 % from 10 % in 2007.
- Many of the countries will still have unemployment rate below the 5% mark if they continue to grow at past rates.
- In order to reduce unemployment rate to 5 % in 2015 an extra 22 million jobs are needed.
- In fact by projecting employment on the basis of past trends, aggregate employment in ICs will grow by 2.8 % pa between 2007 and 2015.
- In order to achieve 5 % unemployment rate employment need to grow by 3.6 % pa during the same period.
- Given an average employment elasticity of 0.46, achieving a 5 % unemployment rate require an average growth rate of 7.8 % pa.

Conclusion and Recommendation

- Lcs face development problems of poverty and unemployment
- Historically population growth was high, however abated because of population growth transition
- Labor force inflows to the labor market are still robust (Female and past youth cohorts).
- Economic Growth solid and adult unemployment rate is about 5%.
- Youth unemployment may not respond to economic growth some active labor market policy is needed:
 - ▣ Human capital upgrading
 - ▣ Improve the quality of education
 - ▣ Send the right policy signals in order to correct labor market distortions
 - ▣ Make labor market more flexible
 - ▣ Encourage more job creation for the youth through targeted employment schemes, youth training, public employment programs.