

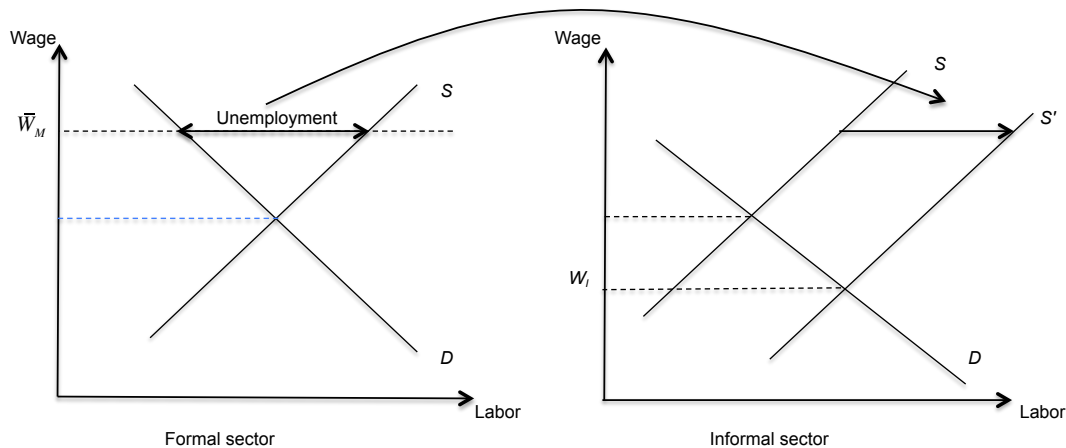
Section Chapter 12: Labor and Migration

Indicators of Employment

- Open unemployment: defined as people “actively seeking work”.
- Hidden unemployment: defined as “discouraged workers”. They are typically not counted in characterizing employment.
- Under-employment: when people who do not work full time due to seasonal unemployment or to part-time work, or when people are working in very low productivity jobs relative to their skills and effort level.

Formal and informal Labor

There is a close relation between the formal and informal sectors in an economy. High regulation in the formal sector can drive part of the labor force to the informal sector. High wages paid in the formal sector, above the full employment equilibrium, also push employment into the informal economy. These high wages can be due to high unionization, regulation, social benefits, or efficiency wages. Recent estimates are that informal employment makes up 48% of non-agricultural employment in North Africa, 51% in Latin America, 65% in Asia, and 72% in Sub-Saharan Africa.



According to the **efficiency wages** theory, employers pay higher wages to motivate workers to deliver a high level of effort, using unemployment as a disciplinary device. Workers that don't find jobs in the formal sector are driven to the informal economy, lowering the wage in this sector. Thus, the higher the formal sector wage, the lower the informal sector wage.

Think of an example that you have seen of the informal sector. Where was it? What type of economic activity was involved? How did labor conditions, social security, and wages compare to the formal sector in the same area. Do the above explanations for the difference between the formal and informal sector apply to the situation? Was the informal sector dominated by recent migrants?

Informal employment can be *pro-cyclical* or *counter-cyclical* relative to formal employment, depending on whether booms in formal employment generate demand for goods/services provided by the informal sector or periods of weak formal employment drive workers to find work in the informal sector.

Rural-Urban migration

The decision to migrate depends on the gap between wages in the urban and rural labor markets. Migration helps equilibrate the labor market, shifting labor toward higher productivity urban employment. In that sense, migration is “normal” and desirable, contributing to both efficiency gains and the reduction of poverty.

The Todaro Model

The model assumes that migration is an *individual decision*, and that it's driven by the gap between the wage in rural areas and the expected wage in urban areas. An individual migrates if expected urban wage is higher than the rural (agricultural) wage: $w_m^* = p\bar{w}_m + (1-p)*0 \geq w_a$, or, equivalently, as long as the probability of getting a job in urban areas is greater than the ratio of the wages: $p \geq \frac{w_a}{\bar{w}_m}$.

What are policy implications of this model? How should developing countries react to the spread of urban slums?

The New Migration Economics

The new migration economics try to explain the decision to migrate as one taken at the household level, rather than being the individual alone who decides to leave or not. The incentive to the household to send one of their members out is to receive **remittances**. The household makes an investment, paying the migration costs and absorbing the risk, and expects to receive remittances in exchange. Therefore, the benefits of migration are also seen at the household level. In this view, the decision to send a migrant is a first-best decision for maximizing household income.

Why would a migrant send money home? How is the problem of time-inconsistency solved?

An alternative approach to explain migration is to see the income from remittances as a response to local market imperfections. According to this view, household's assets are being used in an inefficient way, therefore the decision to send a migrant is optimal since that way they overcome credit or insurance market failures.

Positive and Negative Impacts of Migration

What are the positive and negative impacts of migration for the emitting (sending) country?

What are the positive and negative impacts of migration for the receiving country?