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EFFECTIVELY INCREASING EMPLOYMENT - AN AGENDA FOR BUSINESS.

By

Leopold P. Mureithi

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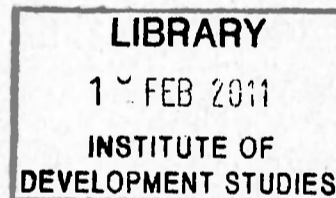
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EFFECTIVELY INCREASING EMPLOYMENT -- AN AGENDA FOR BUSINESS.

By

LEOPOLD P. MUREITHI

ABSTRACT

Unemployment is one of the most pressing problems in Kenya. Some remedial measures have been undertaken. The Tripartite Agreements of 1964 and 1970 purported to use the collective bargaining process to augment employment. Both achieved this objective in the short run. Neither had long-lasting effects on the situation basically because they, perhaps inadvertently, tried to induce extra-market behaviour. No positive economic incentives were incorporated in the Agreements.

The initial capital investment allowance, refund of customs duty on imported capital goods, and accelerated depreciation allowances amount to a substantial subsidy on capital so that capital-labour ratio is higher than would be the case otherwise. An attempt to counteract this by an Employment Allowance or similar subsidy on labour is opposed for fiscal reasons. It is recommended that the subsidies on capital be overhauled.

It is in the business interest to expand employment for such reasons as maintenance of a buoyant market and preservation of social and political stability which are ingredients in "investment climate". From a broader viewpoint, comparative cost doctrine dictates that a capital short economy should use the abundant factor - labour - more widely than it does capital. Of the three possible means of effecting a less unequal income distribution, namely institution of unemployment benefits, steeply progressive income tax, and provision of employment for those able and willing to work, only the last policy instrument has reasonable prospects of achieving the desired end.

Businesses can implement several measures in an endeavour to augment their work forces. They can, wherever possible, readjust their production techniques toward more labour intensity; utilise excess capacity by introduction of shift work; alter skill composition when that results in lowering or maintaining the same output-cost ratio but increasing the number of persons engaged; develop their markets with the aim of tapping the "mass" market; and apply objective criteria in job placement so as to maximise allocative efficiency and demand for supportive or auxiliary personnel.

In a nutshell, business can play a vital role in combating this problem of unemployment by, for example, sacrificing their privileged fiscal position and by implementing positive programmes for this purpose.

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Unemployment is part of Kenya's reality today. It is not a problem unique to Kenya for many of the late developing countries are afflicted by the same mishap. It is a mishap because it is an indication of a disequilibrium situation in that the demand for workplaces exceeds the supply of such workplaces. Remedial measures have been taken, are being taken, and must be taken. We will deal with some of these measures here.

The Tripartite Agreements.

We will recall the tripartite Agreement which were pioneering attempts to use industrial relations as a vehicle for employment creation. The first one was implemented in 1964, immediately after independence, between labour unions, private employers and the Government. The unions agreed to a year's wage freeze, private employers to increasing their labour force by 10% and the Government to hire 15% more employees. The Agreement lasted only one year and had very little long term impact on the employment situation. The Government faced a fiscal constraint and it largely left unhonoured its part in the agreement. The private employers took on additional workers but neglected to offset attrition by new hires so that in a few months the working forces in most of the private establishments had dropped to their former levels. As Professor Harbison has concluded, "The effort was a colossal failure."¹ This observation is corroborated by the finding that of the years 1964 to 1967, the year 1965 experienced the lowest rate of increase in the number of people reported as employed, either in manufacturing (0.58%) or in the economy as a whole (0.57%).² Another Tripartite Agreement was instituted in 1970. The hiring participants agreed to increase their employment by 10%. A recent mission sent by the International Labour Office to Kenya noted that

The additional employment generated almost certainly has had

1. Fredrick Harbison, "The Generation of Employment in Newly Developing Countries" in James R. Sheffield (ed.), Employment, Education and Rural Development (Nairobi: East African Publishing House, 1967), p. 183.

2. See Appendix Table 1.

no lasting effect. None of the firms we saw had undertaken any major or long-run reorganization in response to the 1970 Agreement. Those who had been forced to provide more employment than they needed were waiting for natural wastage and expansion to absorb it.³

Perhaps the main lesson from the Tripartite Agreements is that it is no use trying to operate as if markets do not exist. Economic incentives must be present for a meaningful solution to the employment problem to emerge.

Factor Subsidies

Talking of incentives, one prevalent form is fiscal allowances on factors of production. The Kenya Income Tax Management Act,⁴ in force since 1962, provides for very generous wear and tear deductions in respect of machinery and equipment in business. For tractors, combine harvesters, heavy earth-moving equipment, cranes and other heavy self-propelling machines of similar nature 37.5% of the written-down value is deductible; for other self-propelling vehicles 25%; for all other machinery 12.5%. Besides, there is an initial investment allowance⁵ of 20% of the cost of new industrial buildings, machinery and fixed equipment. Taken together, an industrialist can write off 120% of his investment against taxable income over a period of a few years. In addition to the accelerated depreciations and the investment allowance, refunds of customs duties are available to companies using imported raw materials and equipment.

What all this amounts to is a substantial subsidy on capital which in effect results in the price of capital being lower than it would otherwise be. We can envision a situation where the operative rental-wage ratio (r/w) is lower than the free market ratio (r/w)*.

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3. International Labour Office, Employment, Incomes and Equality: A Strategy for Increasing Productive Employment in Kenya (Geneva, 1972), p. 542.
 4. Kenya Income Tax Service, Published for members of the Foreign Law Association, Inc. (1963).
 5. Development Plan for the Period 1970 to 1974 (Nairobi: Government Printer, 1969) p. 322.

Given the possibility of substitution between capital and labour⁶, then the real-world expansion path results in a higher capital-labour ratio than the free market situation. This is depicted in Figure 1. While expansion path OB would have been chosen, the influence of a subsidy on capital-implicit or otherwise--results in the choice of OA as the relevant path.

The Kenyan investment deduction system makes capital cheaper than it would be in relation to labour. By effectively reducing the cost of capital, these concessions tend to bias investment decisions towards capital-intensive techniques.⁷ To redress this factor-prices imbalance, it has been suggested from some quarters that there be instituted an Employment Allowance. The Parliamentary Select Committee on Unemployment recommended

that either in place of or in addition to the present investment allowances (which gives an additional incentive to employers to use machinery rather than labour) that there be also an "employment creation allowance" for new industries geared to the amount of employment they generate.⁸

Such an action would tend to have the desired effect of making a firm's optimal choice move toward the labour intensive ray, OB.

6. For capital-labour substitution to be possible, the substitution elasticity coefficient between capital and labour has to be greater than zero. "Evidence for such a relationship is found in Henry J. Bruton, "The Elasticity of Substitution in Developing Countries". Research Memorandum No. 45, Centre for Development Economics, Williams College, Mass., (April, 1972); J.K. Maitha, "Capital-Labour Substitution in Manufacturing in a Developing Economy: The Case of Kenya". Paper presented at a Study Seminar on Strategies for Increasing Productive Employment in African Countries at Limuru Conference Centre (November, 1973); L.P. Mureithi, Employment, Technology, and Industrialization in Kenya: A study in Development Strategy. Ph.D. Dissertation, Claremont Graduate School (September, 1973). J. Ade Oyelabi, "Tests of Factor Substitution in Nigeria's Manufacturing Sector", Eastern Africa Economic Review, Vol.3, No.1 (June, 1971), pp. 29-33.

7. In fact, the Parliamentary Select Committee on Unemployment has recommended an imposition of import duty at the basic rate of 20 or 30 per cent in order to reduce the amount of imported capital and stimulate local production of capital suited to local needs. See Republic of Kenya National Assembly, Report of the Select Committee on Unemployment (Nairobi: Government Printer, 1970), p. 20. This recommendation should be given due consideration.

8. *Ibid.*, p. 21.

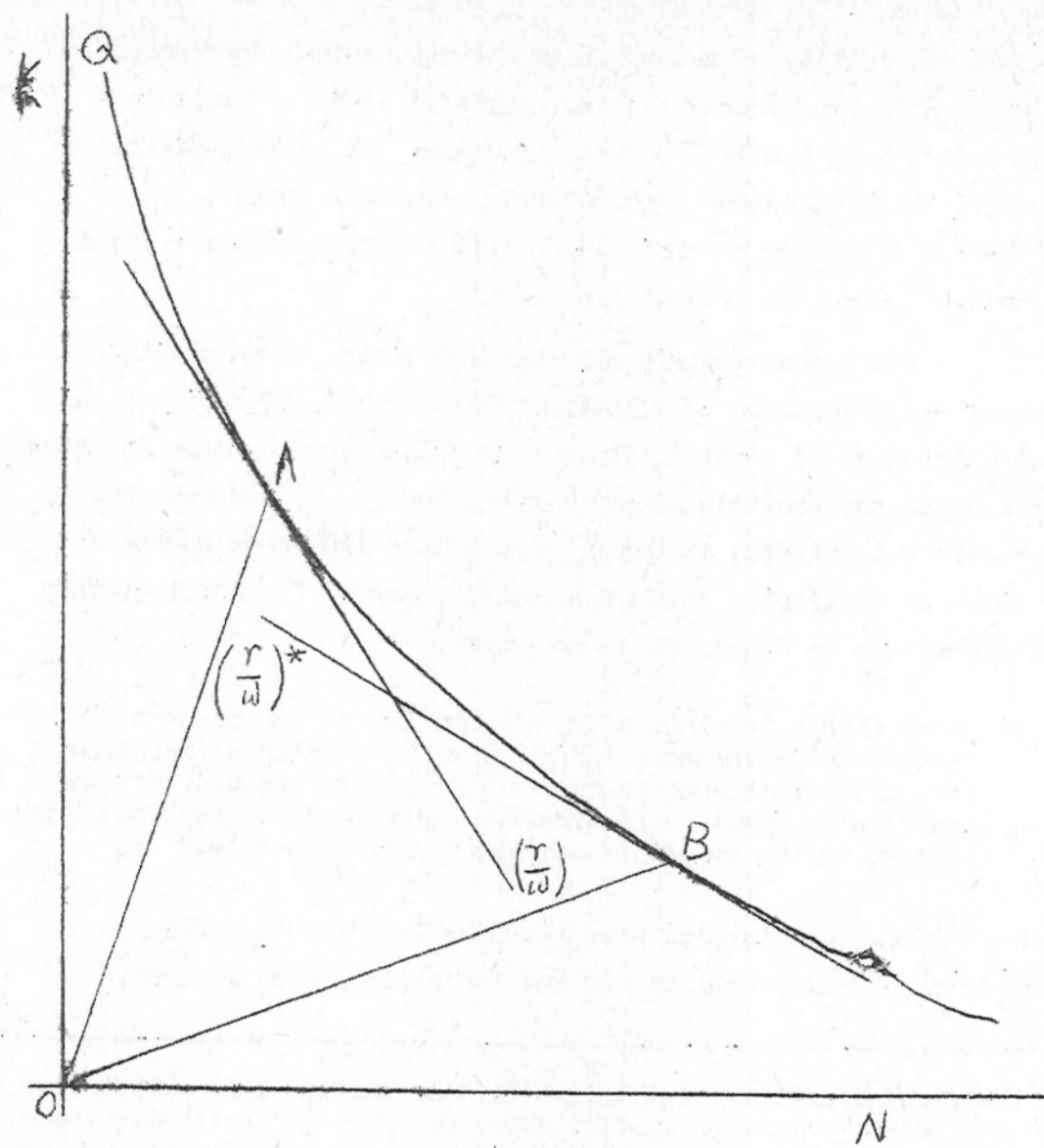


FIGURE 1

Fiscal Effects on Choice of
Techniques via Factor Price Ratio

However, we object to this proposal for two reasons. First, such a subsidy in the form of "tax reductions in proportion to the number of workers employed"⁹ entails a sacrifice of public revenue which could be justified only if there were no other cheaper means of counterbalancing the favouritism toward capital. Second is the notion that two wrongs don't make one right. If capital subsidy is a mistake then labour subsidy would be a mistake too. Rather, we would recommend abolition of all forms of allowances on capital.

Granting no fiscal deductions to either capital or labour would result in a more labour intensive mode of production than now exists, assuming, of course, that rational choice is made and that no other constraints exist. It would also bring a substantial quantity of money to the government treasury. The ILO Employment Mission to Kenya estimated that investment deductions had a revenue cost of about K£ 330,000 a year in 1966 and 1967.¹⁰ This is more than 1% of government revenue from direct taxation in those years. The investments in question would most probably have taken place without the investment deductions. In other words, the system probably has little effect on the incentive to invest. Such studies as exist suggest that investment deductions have negligible effects on the rate of industrial capital formation.¹¹ Hence, fiscal and employment

9. Ibid., p. 10. Besides the loss of tax revenue at a time when the need is to increase it, "the introduction of an employment subsidy would add to the administrative burden of tax assessment" and "open up a new loophole for tax evasion". ILO, Employment, Incomes and Equality, op. cit., p.275.

10. Ibid., p.438.

11. See, for instance, George E. Lent, "Tax Incentives for investment in Developing Countries," IMF Staff Papers (1967), pp. 249-321; Jack Heller and Kenneth M. Kauffman, Tax Incentives for Industry in Less Developed Countries (Chicago: Commerce Clearing House, 1963). Investment climate is largely a function of political, economic and social stability, and evidence of good behaviour on the part of a government.

considerations¹² favour elimination of allowances on capital. We therefore, would recommend an overhaul of subsidies on capital and granting no such subsidies to labour. In other words, we would like to see factor markets with no fiscal interference.

Why Aim at Fuller Employment?

There are basically four factors of production - land, labour, capital and entrepreneurship - and in the sphere of employment we are concerned with how these factors, especially capital and labour, are combined. When capital-labour ratio (or capital cost per job) falls, this gives potentiality to raise the amount of employment out of a given capital stock. Whether employment actually rises depends on several things, among which are: industrial relations, skill composition of labour (which determines employability), size of market, rate of capital utilisation, assessment of profitability, entrepreneurial tastes and preferences, etc .

Why is it in the entrepreneur's interest to have the economy approaching full employment, however marginally? Basically because

- a) he would like to see the market for his goods expand; employed people are better customers than the unemployed,
- b) he would like to perpetuate and improve the "investment climate"; social and political upheaval can be nurtured by chronic unemployment.

According to Barend A. de Vries,¹³

"the term unemployment covers a multitude of sins - among others, a scarcity of jobs in the organised economy and low labor utilization everywhere Most significantly, perhaps, unemployment means that large groups of the population do not participate in the nation's growth process it can be expected that fuller utilization of human resources will produce far

12. One important aspect is that the revenue accruing to the Government as a result of abolishing investment deductions and accelerated depreciation can be considered a "fiscal dividend". It can be earmarked for job creating projects like labour intensive public works, construction, etc. Provision for normal wear and tear would of course be allowed.

13. Barend A. de Vries, "Unemployment and Poverty - What remedies are Feasible?" Finance and Development, Vol. 9, No.1 (March, 1972), pp. 12 & 14.

higher growth and investment rates than have been achieved in the past decade".

In view of widespread unemployment — i.e., lack of work and steady income — it is clear that from the economic as well as from the larger social viewpoint, expansion of employment opportunities is an objective which claims high priority.

First, the comparative cost doctrine stipulates, as a basis for development policy, that a country will benefit most by producing commodities and adopting modes of production that use more of the relatively abundant factors of production. The late developing countries are "short" on capital and "long" on labour. It, therefore, follows that in order to make maximum and efficient use of their factor endowment they should push on the labour front. Second, just like there is "learning-by-doing," there is the obverse process of "unlearning-by-not-doing."¹⁴ Prolonged unemployment has purely economic costs in the form of depreciation and even disinvestment of human capital by way of loss of skill due to lack of practice. Unutilized manpower is wasted excess capacity.

Third is the income distribution argument. With widespread unemployment in Kenya, many people do not have the opportunity to participate in the generation of output and, therefore, do not have a chance to share, directly, in the resultant income. But production is by technical process while distribution is by social process. The latter can be pursued, when the former occurs, by, for example, 1) unemployment benefits, 2) steeply progressive taxation so that personal disposable income is less unequal than net income, and 3) provision of employment for those willing and able to work.

Due to the size of the problem, institution of unemployment benefits would be staggering and financially impossible. Traditional unemployment insurance by way of the Extended Family mechanism does not work very smoothly. For instance, a survey¹⁵ in

14. This term is used by A.G. Chandavarkar, in his article "More Growth - more Employment? A challenge for the Less Developed Countries", Finance and Development, vol. 9, No. 2 (June, 1972), p.31.

15. G.E. Johnson and W.E. Whitelaw, "Urban-Rural Income Transfers in Kenya: An Estimated Remittances Function." Institute for Development Studies, University of Nairobi, Discussion Paper No. 137 (1972).

1971 revealed a declining proportion of earnings remitted to members of the extended family as income of the donor rises! Fiscal action of steeply progressive taxation would not be very effective due to the fact that those who would be affected happen to be the most vocal, the most articulate, the most politically active. Hence, there is a limit to the action of leveling downwards. Perforce, generation of employment opportunities is the only sure way to effect a wide diffusion of economic and social benefits.¹⁶

Therefore, there are obvious moral, social, political, and economic arguments for creating more gainful employment.

Augmenting Business Work Force.

How could a businessman go about augmenting his labour force? One way is to re-adjust the technology used. At present, most firms in Kenya use a technology that originates in a developed country where market size, skill composition and capital availability are different from what prevails in Kenya. This happens because most entrepreneurs have a preference¹⁷ for the kind of techniques with which they are familiar. But, just because a firm has to get its machine inputs from source A, it could be source B is in fact cheaper and closer to the factor endowment conditions in the recipient country. What businessmen should do is to open themselves to "other" sources of technology, to allow themselves a wider latitude for market search and, from a whole spectrum of choice, to adopt the most labour intensive technology which can achieve the same "efficiency" objective that capital intensive technology would achieve.

There is excess capacity in many large scale firms in Kenya.¹⁸

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16. Dudley Seers argues that "the most effective way to end poverty, almost the only possibility in a developing country, would be to induce a sharp increase in employment at adequate wages." See Dudley Seers, "New Approaches Suggested by the Colombia Employment Programme" in Walter Galenson (ed.), Essays on Employment (Geneva: International Labour Office, 1971), p.180. This is in line with the utilitarianism of such political economists as Jeremy Bentham - namely, doing the greatest good to the greatest number.
 17. Interesting incidents on technological preference are to be found in L.P. Mureithi, "Demographic and Technological Variables in Kenya's Employment Scene". Working Paper No.135, Institute for Development Studies, University of Nairobi. (January, 1974), pp. 17 & 18.
 18. Case studies covering textiles, steel mills, cement, oil refining, and tyres and tubes are to be found in S. Kiggundu, "Some Aspects of Excess Industrial capacity in East Africa". Paper presented to the East African Universities Social Science Conference (Nairobi, December 1972), 11 pp. ; and S.D. Mehta, "Industrial Cost Patterns in East Africa" - A study prepared for the East African Development Bank (1970).

It is feasible to exploit the idle capital by, say, the institution of shift work. This would effectively increase the number of people engaged.¹⁹

Kenya is experiencing the same phenomenon as was found in Columbia. An ILO study on Colombia found that

"employers were attempting to keep their labour force as small as possible and to make it work for the longest hours possible more than 18% of the labour force was working a 64 hour week or more."²⁰

Oxfam observes that

"This is not the way to wring the greatest possible amount of employment from the smallest possible capital input, and large-scale improvements could be made if shift work and shorter hours could be combined with a larger total labour force."²¹

The ILO Employment Mission to Kenya reckoned that

"There is ... a considerable potential for increasing output and employment with the existing stock of capital ... output and employment are only half of what they would be with the reasonably full utilisation of 140 hours per week."²²

19.

Mary Ann Baily has shown that actual capital utilization rates in Kenyan manufacturing are less than the potential rates. See her "Capital Utilization Rates in Kenya Manufacturing". Working Paper No. 66, Institute for Development Studies, University of Nairobi (October, 1972).

20.

Oxfam, Unemployment: The Unnatural Disaster, An Oxfam Special Report (undated) p.12. Oxfam refers to the International Labour Office, Towards Full Employment (Geneva, 1970), esp. pp. 53-54 and p. 56.

21.

Ibid., p. 12

22.

International Labour Office, Employment, Incomes and Equality, pp. 182-183. See also p.188. With utilisation of capital for 140 hours per week, there is an allowance of 28 hours for repair, maintenance, etc., per week.

There may be a case for fresh re-thinking on the desired skill composition of the workforce. There may be an understandable element of prestige in hiring highly skilled personnel. Due to the scarcity of skilled manpower, an entrepreneur may "hoard" whatever stock he can lay hands on. But can we justify this behaviour in terms of efficiency-cost relationship? Is one highly skilled man more productive than, say, two semi-skilled men? And are the latter more productive than, say, three or more unskilled but eager learners? If the answers to these questions are "yes", then a firm may be justified in not expanding its labour force through substitution of different levels of skills. As it is, there could be considerable scope for job restructuring and redefinition of entry-level jobs, thus permitting employment of persons who cannot qualify under previous requirements.

Expansion of the market is a possible line of attack. How well a firm identifies the actual and potential markets for its product(s) is critical in this regard. Different markets may call for different products - different specifications, different characteristics, different delivery schedules, various "packaging" lots, etc. If these are properly scanned and their different requirements met, then volume of sale and turnover would increase. Demand for labour, being a derived demand, would thus be boosted. In a very interesting and enlightening paper, C.M.A. Dudeney²³ divided the Kenya market into four classes:

- a) 300,000 -- 500,000 individuals who form a market somewhat similar to a small industrial urban society in Europe.
- b) 500,000 - 750,000 who have shown a desire for improved living.
- c) A Pre-emergent market of perhaps 1 million people who rely on purely local markets.
- d) Marginal "markets" of perhaps 8 million people who now espouse "self-sufficiency", occasionally practice

23. C.M.A. Dudeney, "The Importance of Marketing in the Expansion of Kenya's Economy", East African Management Journal, Vol. 1, No. 3 (April, 1967), pp. 24-27.

barter, and are to a considerable extent in a subsistence economy.

The question is: Are entrepreneurs aiming at only the market with half a million people or so who, although they command considerable "purchasing power," by no means constitute a mass market. There is a need to develop the "other" markets, to accommodate their tastes and preferences, and to exploit their potentialities. Widespread and meaningful development is impossible without this.

Finally, job placement agencies can play a vital role in the employment scene. First, they increase knowledge of market conditions and, by bringing employers and employees together, they reduce frictional unemployment. Second - and this is very important - by putting the right person in the right job, they increase allocative efficiency. When the critical factor - skilled personnel - is efficiently allocated there would be maximal demand for supportive or auxiliary manpower. This calls for objective criteria in job allocation and resistance to influence, patronage, brotherisation, and other corruptive practices in job placement.

Creation of workplaces has to be done in an economic context, observing economic criteria. This requires a clear idea of what a job is. A job has to be "productive" work. It must lead to the production of a good or provision of a service which has value in the sense that that good or service has to satisfy a human want. It is not good economics to influence, decree or otherwise cause an entrepreneur to "create" a job when such creation may mean just payment of a wage and redundant personnel. It may result in someone getting money income but not earning a living. It may lead to cost-ridden enterprises which may fail in the long run thus killing the goose that lays the golden egg. It may lead to injection of money in the economy without real production rising pari passu, thus inducing an inflationary situation of too much money chasing too few goods.

Increasing employment is a national challenge, a concern for everyone. Business has a vital role to play in this by, for example, a sacrifice of its privileged fiscal position and by a positive commitment to devise a programme of action to this end.

APPENDIX

TABLE 1

RECORDED EMPLOYMENT IN KENYA.

Year	Total Employment	Rate of Growth	Employment in Manufactures and Repairs	Rate of Growth.
	('00)	%	('000)	(%)
1963	539.2	6.71	43.0	14.19
1964	575.4	1.16	49.1	6.11
1965	582.1	0.57	52.1	0.58
1966	585.4	2.07	52.4	8.40
1967	597.5	1.49	56.8	2.46
1968	606.4	3.43	58.2	-1.89
1969	627.2	2.76	57.1	7.36
1970	644.5		61.3	

Sources: Republic of Kenya, Statistical Abstract
(1967, 1968, and 1971).