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Trade liberalization, labor market regulations and labor demand in Cameroon

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ABSTRACT

In this article we analyze whether trade and labor market liberalization affects the demand for total, skilled and unskilled employment in the manufacturing sector. The analysis uses Cameroonian firm-level data before (1988–91) and after (1994–01) both reforms. Comparing treated and untreated (control) firms in a difference-in-differences framework, we find that the reforms have been successful in boosting the demand for unskilled jobs, explaining 1.3–9.5% increase in the demand for unskilled workers. We also find evidence of no clear effects of reforms on total and skilled labor demand. The sector-level results do not change the previous findings. The findings are also robust to changes in the definition of treated and control firms.

1. Introduction

In the early nineties, Cameroon has moved to liberalize its trade regime through e.g. tariff reductions and elimination of non-tariff barriers in pursuit of higher living standards and productivity growth in the aggregate. It is largely acknowledged by trade economists that trade liberalization impacts differently capitalists and workers. The standard Hecksher-Ohlin trade model predicts that trade benefits the abundant factor and hurts the scare factor. In particular, depending on whether the country's comparative advantage is in labor- or capital-intensive products, and in the presence of intersectoral factor mobility, trade liberalization will help labor and hurt capital or vice versa. Thus, in an unskilled-labor intensive economy like Cameroon, trade liberalization should be associated with a large improvement of prospects for the unskilled workers. Since the nature of labor market regulations is of paramount importance in realizing this potential, the Cameroonian government also adopted a new labor code in the early 1990s.

In the meantime, a new strand of literature brings to our attention more subtle ways through which trade liberalization may affect the welfare of workers. For example, Rodrik (1997) argues that a trade-induced increased in labor demand elasticities has the following consequences for the welfare of workers: (i) more uncertainty due to more volatile response of wage and employment to any exogenous shock to labor demand; (ii) a reduced bargaining power of workers; and (iii) a shift of the incidence of non-wage labor costs towards labor and away from employers. Within this process, the possibility for the elasticity of demand for labor to be higher with an increase in openness works through two main channels. First, the 'substitution effects' i.e. trade reform allows the import of cheaper and larger variety of inputs which are substitutes for the services of domestic labor. Second, the 'scale effects' which work through the Hicks-Marshallian law of factor demand which can be stated as follows: 'the demand for anything is likely to be more elastic, the more elastic is the demand for any further thing which it contributes to produce'

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(Slaughter, 2001). Product market elasticities are therefore likely to rise with trade liberalization, implying that with greater trade openness one should expect an increase in labor-demand elasticities as well.

However, the empirical evidence contrasts with the above prediction: increased relative wages for skilled labor are observed in many developing countries following openness. The primary cause for it is the skill-biased technological change i.e. trade liberalization leads to an increased demand for workers, but essentially the small minority of skilled labor (Wood, 1995, 1997; Mehta & Hasan, 2012). The benefit from trade openness as previously predicted will also depend on how regulated the labor market is i.e. the effects of trade liberalization on labor markets may vary with the nature of labor markets. For instance, employment protection laws (severance pay, restrictions on firing), minimum wage, unions and collective bargaining, mandated benefits (social insurance, vacation pay, maternity leave, etc.), hiring and firing laws can introduce distortions in the efficient functioning of labor market and impede trade reform induced adjustment (see e.g. Currie & Harrison, 1997; Harrison & Hanson, 1999; Bussolo, Mizala, & Romaguera, 2002; Bastos, Monteiro, & Straume, 2009; Kambourov, 2009).

In this paper, we sought to quantify the effects of two reforms e.g. trade and labor reforms initiated in 1993 and 1992, respectively, on labor demand. To do so, we used a difference-in-differences methodology which compares the labor demand pattern in the treated firms before and after reforms with the labor demand patterns in the control firms before and after reforms. We use Cameroonian manufacturing firm-level data. The time period spanned by the dataset is 1988–01. We took into account the fact that both reforms (trade and labor) overlap in time almost perfectly. Hence, the total period is split into two: pre-reform (1988–91) and post-reform (1994–01) periods.

Assessing how both trade and labor market liberalization affect labor demand has valuable policy relevance. First, it might help Cameroonian policy makers dismiss mounting pressures for protectionism, especially when trade is considered the main culprit for increasing inequality between skilled and unskilled workers. Second, the correct coordination of labor market and international trade reforms (implemented as parts of structural adjustment packages) can enhance their positive effects. In sum, policy makers in Cameroon can greatly benefit from having the information on the effects of trade and labor market reforms on labor market outcomes. The main findings of the paper can be summarized as follows. Trade and labor liberalization significantly fostered the demand for unskilled workers i.e. in response to reforms, firms increase their demand for unskilled employment by about 1.3–9.5%. We also find evidence that there were no clear effects of reforms on the demand for total employment and skilled labor. The results do not change when the analysis is performed across individual sectors. The findings are also robust to changes in the definition of treated and control groups of firms.

The rest of the paper proceeds as follows. In Section 2, we describe the main features of the Cameroonian trade reform as well as the legislative changes introduced by the Cameroonian labor market reform. In Section 3, we present the empirical methodology and present the estimation strategy. In Section 4, we describe the data. In Section 5, we present and discuss the results of labor estimations at both pooled and disaggregated levels, and discuss robustness checks. Finally, in Section 6, we summarize the findings and explain the policy implications of the results.

2. Cameroonian policy framework

2.1. The trade reform in Cameroon

From 1960, time of political independence, to the early 1990s, Cameroon's trade policy is one of import substitution policy to shield domestic firms from foreign competition. This trade strategy was characterized by a highly complex tariff regime and an extensive use of non-tariff barriers (NTBs). Concerning the tariff barriers, and at the domestic level, the degree of protection varied widely across industries. For example, imports from the most protected sector (e.g. textile & weaving) faced tariffs exceeding 200% in 1988, year for which the information are available. For the year, the remaining industrial sectors were subject to tariffs exceeding 100% in 1988 with the machinery & appliance industry leading. In particular, there were four individual taxes on imports: the custom duty, import turnover tax, fiscal entry duty, and the complementary tax. The custom duty was levied on the cost insurance freight (c.i.f.) value of the imported goods, and was subject to a wide variation (5 to 30%) both across and within sectors and regardless of origin. The import turnover tax was levied at 10% of the c.i.f. value inclusive of custom duty, fiscal entry duty, and the complementary tax. It could be zero for some imported first necessity goods, but sometimes reached 72% of the c.i.f. value for some luxury imports. The fiscal entry duty was a tariff levied on the c.i.f. value of imports whatever the country of origin at the rate between 5 and 90%. The complementary tax was levied on the ad valorem basis at the rate between 0 and 100%.

For the NTBs, an annual 'General Trade Program' classified goods by tariff lines into four categories: 'sensitive' goods imported under very restrictive conditions; 'twinned' goods necessitated a prior authorization to import a quantity in proportion to the local purchase; 'government-controlled' goods necessitated a prior authorization to be imported; and the 'freely imported' goods. Other protective measures were the price controls which were based on protected costs of production plus a margin for profit and marketing. Official reference prices were national prices used by the government as a basis for imposing tariffs. They were usually used as a means of combating under-invoicing of imports.

At the regional level, all imported goods were subject to the common external tariff (CET) in the 'Communauté Economique et Monétaire de l'Afrique Centrale - CEMAC' zone[1] plus Cameroonian surcharges such as the unloading fee, municipal tax, tax for the contribution to shipper national council, tax for inspection on meat, veterinary tax, and the special tax on fuel. In particular,

[1] The CEMAC consists of the following seven countries: Cameroon, Central African Republic, Chad, Congo Republic, Equatorial Guinea, Gabon, and Sao Tome & Principe.

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