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# Off-farm labor supply and labor markets in rapidly changing circumstances: Bulgaria during transition

Sumon Kumar Bhaumik<sup>a,d,\*</sup>, Ralitza Dimova<sup>b,d</sup>, Jeffrey B. Nugent<sup>c</sup>

<sup>a</sup> Aston Business School, Aston University, United Kingdom

<sup>b</sup> University of Manchester, United Kingdom

<sup>c</sup> University of Southern California, United States

<sup>d</sup> IZA-Institute for the Study of Labour, Bonn, Germany

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### ABSTRACT

This study examines off-farm labor supply in the rapidly changing conditions of Bulgaria during the 1990s. In doing so, we make use of three different waves of the Bulgarian Integrated Household Survey, each reflecting remarkably different environmental conditions. The results suggest that standard theories of off-farm labor supply provide little guidance in situations characterized by chronic excess supply in the off-farm labor market and/or rapidly changing circumstances. In particular, the results show (1) that off-farm employment throughout the transition was predominantly determined by demand rather than by supply, and (2) that the magnitude and statistical significance of the various determinants are very sensitive to changing environmental conditions. As such, the results can be extremely relevant for both theory and policy for the many countries which may still need to go through privatization and painful restructuring as a result of financial crises and globalization.

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## 1. Introduction

The literature on off-farm labor supply – the supply of paid labor by members of farm households for activities outside their own farms – has developed along two quite different lines.<sup>1</sup> In one of these,

\* Corresponding author.

E-mail addresses: [s.bhaumik@aston.ac.uk](mailto:s.bhaumik@aston.ac.uk) (S.K. Bhaumik), [momichentse@yahoo.com](mailto:momichentse@yahoo.com) (R. Dimova), [nugent@almaak.usc.edu](mailto:nugent@almaak.usc.edu) (J.B. Nugent).

<sup>1</sup> There is a large literature on off-farm labor supply in both developed countries like the USA and Canada (Huffman, 1980; Weersink et al., 1998) and much poorer countries like those of sub-Saharan Africa, Asia and Latin America (e.g., Escobal, 2001; Woldenhanna and Oskam, 2001; Woldenhanna and Oskam, 2001; De Janvry and Sadoulet, 2001; Deininger and Olinto, 2001; Lamb, 2003; Jolliffe, 2004).

the emphasis is on testing whether or not the so-called separation principle, whereby the production and consumption decisions of a farm household are independent of each other, holds. When it does, (a) the demand for labor by farm-owning households is independent of their own labor endowments, and (b) off-farm labor supply by members of these households is independent of the farm characteristics that define the labor input demand for farm activities. There is an extensive literature that tests both these hypotheses (e.g., Huffman, 1980; Benjamin, 1992).

In the other line, almost exclusively applied to poor developing countries, off-farm labor supply is seen as a way to smooth consumption across time (Lanjouw and Lanjouw, 1995). Such studies view off-farm labor supply as an *ex post* reaction to low farm income, leading to the testable hypothesis that agricultural income and off-farm labor supply would be negatively correlated.<sup>2</sup>

In the latter context, the implicit assumption is that off-farm labor demand serves as a shock absorber for farm families buffeted by changing weather and other supply conditions. The assumption of static demand conditions, however, would appear to be increasingly unrealistic. Indeed, demand can be very volatile due to important policy changes, financial or trade-related shocks and structural changes such as privatization. In recent years, a most suitable place for observing the effects of rapidly changing demand conditions including privatization is the transition economies of Central and Eastern Europe (CEE), which underwent sharp declines subsequent to the abandonment of central planning and the accompanying political changes, which were then followed by recoveries of varying intensity but often interrupted by sharp financial and economic crises. However, while a sizeable literature has developed on the nature of the transformation of the manufacturing and public sectors in these countries and its implications for jobs flows and employment,<sup>3</sup> to date there have been few attempts to use the transition experience to explore alternative views of off-farm labor supply, and indeed none that examine the impact of macroeconomic and structural changes on the nature of the off-farm labor market in these countries.

The transition economies are of interest because, aside from their rapidly changing conditions, they were fundamentally different from both developed and developing economies in two important respects. First, few if any had well-functioning labor markets that would be suitable for testing for the separation principle that underpins the off-farm labor supply analysis in developed countries. Second, their farm households were also fundamentally different from those in developing countries in that (1) because of higher levels of education, they were more employable off-farm, and (2) because of the comparative lack of traders, cooperatives and other intermediaries, the ability to sell their farm output was more restricted.<sup>4</sup>

In a transition economy, therefore, one could expect the supply of off-farm labor to be much less affected by farm characteristics or by farm income, even if these were fully measurable. This would be especially so if the marginal productivity of labor on the farms was quite low both absolutely and relative to the marginal productivity of labor in most non-farm activities, as would seem especially likely for the many farm households which had received their land by way of restitution and thus had little relevant experience in farming.<sup>5</sup> Also, since agriculture was largely a subsistence activity, off-farm non-agricultural employment would also have been especially important as a means of earning cash to finance (1) non-food consumption, (2) diversification of the food consumption basket and, (3) capital expenditure (given underdeveloped credit markets after the demise of state-owned banks).

In other words, in the transition economy context we hypothesize (1) that off-farm labor supply would be largely (if not entirely) determined by the rapidly changing demand for labor, perhaps

<sup>2</sup> Some researchers also use farm characteristics as proxies for farm income (Van den Berg and Ruben, 2001).

<sup>3</sup> See, for example, Bolton et al. (1992), Burda et al. (1993), Blanchard et al. (1995), Konings et al. (1996), Svejnar (1996, 1999), Walsh and Whelan (2001), Schnytzer and Andreyeva (2002), Faggio and Konings (2003), Bezemer (2004), Mickiewicz et al. (2005), Koford and Miller (2006).

<sup>4</sup> It should be recalled how drastic the decline in trade was within the CMEA in the early years of the transition so that along with the decline in government support for cooperatives, the commercial viability of agricultural activity declined precipitously. Nowhere was this decline any more noticeable than in Bulgaria, a country which had been a large agricultural exporter under the CMEA and where there was sudden and massive privatization of state enterprises and restructuring of off-farm activities which made industrial jobs extremely difficult to find.

<sup>5</sup> Restitution was a process begun in Bulgaria in 1992 (The Law of Privatization of State Property) but virtually never observed in developing countries. With restitution and privatization, collectivized land was returned (after several decades) to families that had owned the land prior to the collectivisation of agriculture. At the same time, the sudden mass privatization and restructuring of industrial firms made industrial jobs very hard to find.

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