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**DETERMINANTS OF LABOUR DEMAND, A  
CASE OF MOGADISHU CITY, SOMALIA**

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## DETERMINANTS OF LABOUR DEMAND, A CASE OF MOGADISHU CITY, SOMALIA

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### Abstract

**Purpose:** The purpose of this study was to investigate the determinants of labour demand, a case of Mogadishu City, Somalia.

**Methodology:** The paper employed desktop methodology, which involved review of existing literature relating to the study topic. The design involves a review of existing studies relating to the research topic.

**Results:** Based on the findings the study identified cost as a key determinant of labour demand, especially, in the formal sector. Previous studies indicate that most firms demand for cheap labour. The study also identified education as an important determinant of demand for labour in the World. Owing to the increasing global competitiveness, firms demand for highly skilled and competent workforce. Unfortunately, majority of workforce in developing countries such as Somalia do not have the right skills and competence. Further, the study concluded that a country with a stable economic growth enjoys high demand for labour. This is because the available workforce is skilled and competent enough. However, in developing countries such as Somalia, the demand for labour is very low. Somalia has experienced long period of economic slowdown, and this has affected the quality of workforce.

**Unique contribution to theory, practice and policy:** Based on the study findings the study recommends that the federal government of Somalia should adopt measures to regulate labour cost. The study also recommends that the government should adopt more measures to promote education. The study further recommends for international interventions to ensure that Somalia's economy gets back on its fit. Stable economic growth will lead to increased demand for labour.

**Keywords:** *Determinants, labour demand, Somalia*

## 1.0 INTRODUCTION

### 1.1 Background of the Study

Unemployment is a major problem in most developing Countries. There is less agreement, however, on the nature and cause of the problem and on why employment creation is desirable. In part this is because the reasons for concern differ from country to country. They include: (1) increasing relatively high-productivity employment opportunities outside the agricultural sector to absorb the low-income agricultural population; (2) increasing employment opportunities in the urban sector to reduce the number of urban unemployed; and (3) providing employment opportunities for the poor to increase their real income and improve the distribution of income (UNDP, 2012).

Urban labour markets in developing countries are widely recognized as having two distinct sectors/segments: regulated/protected formal sector and an unregulated/unprotected informal sector (Pradhan & van Soest, 2015). Mazumdar (2009) describes an urban labour market structure in a typical developing country as being subdivided into three main categories: the formal sector (public and private), the informal sector (comprising the informal sector wage labour, self-employed, paid domestic workers, those earning a monthly salary or those working on casual basis) and the unemployed. This categorization ignores unpaid workers (people who work without pay in an economic enterprise operated by a related person), who form a significant proportion of urban and rural labour force.

Among the most important challenges facing governments in developing countries, including Somalia, is the task of identifying development strategies that can generate new employment and income opportunities, and reduce under-employment and unemployment (UNDP, 2012). The urgent need to create employment opportunities is underscored by the higher rate of labour force growth than population growth. Persistent slow economic growth, particularly in the public sector, has forced many people, notably school leavers and college graduates, into marginal activities in small-scale agriculture and the urban informal economy. In recent years, many economies in both developed and developing countries have experienced transformations in their labour market structures resulting from such trends as globalization and economic restructuring.

China is the most populous country boasting of tremendous workforce in the world. Since its pursuance of reform and opening-up policy in late 1970's, Chinese national economy has witnessed a sound, sustainable, and rapid growth. Nevertheless, the employment issue, resulted from economic system reform, industrial structure adjustment and technological innovation, remains a strenuous, arduous and pressing task for Chinese government (Yan, 2006).

Yan (2006) further notes that the Chinese government attaches great importance to the issue of employment, and takes employment as the first priority of people's livelihood and as the top strategy for ensuring the stability of its society. Proceeding from the national conditions, the Chinese Government has explored and drawn on international experiences in its practice, gradually improves its relevant legal system, and formulated and implemented a set of proactive employment policies. The Chinese government adheres to promote employment through developing national economy, adjusting industrial structure, furthering the reform on its political and economic system, harmonizing economic development between urban and

rural areas, and improving social security system. It has adopted various effective measures and done everything possible to increase job opportunities, expanded the scale of employment, and kept the unemployment rate within a socially tolerable range.

According to the statistics of National Bureau of Statistics, in 2005, Gross Domestic Product (GDP) in China reached 18.2321 trillion Yuan (2.23 trillion USD), with an increase of 9.9 percent than in 2004. In the last ten years, Chinese GDP has been increased at an annually average rate of 8.5 percent in a sustainable and stable manner.

The determinants of employment and real wages in LDCs are complex, covering virtually every aspect of the development process. For the rural economy there are questions about the degree to which there may be “disguised unemployment” and about the determinants of average and marginal labor productivity and real incomes. For the urban economy there are extremely difficult questions about the determinants of the structure of real wages, the links between the “formal” and the “informal” sectors, and the factors that influence the level of urban employment and the rate at which it increases. There is another set of issues related to the determinants of migration between rural and urban areas and of the links between the two parts of the economy. Finally, all the factors affecting the rate of population growth are important for analysis of labor markets, largely because it is rapid population growth that underlies concern about the “employment problem” in most developing countries (Adam Smith International, 2013).

Ghana’s growth performance has been quite impressive since 1984, prompting Leechor (1994) to describe the country’s economy as a frontrunner in the economic reform process. Ghana recorded about 5.2 per cent annual average growth between 1984 and 2010 and became a lower middle income country after the rebasing of its national accounts in 2006, which pushed the country’s annual average growth to 8.5 per cent between 2006 and 2011. Ghana’s real GDP growth reached about 15.2 per cent when the country began its commercial oil production in 2011. In spite of this strong growth performance, employment generation remains a challenge. Ghana recorded a decline in employment elasticity of output from 0.64 in the 1990s to 0.4 during 2005–2008 (ILO, 2008). The country continues to battle with high incidence of joblessness and job-seeking particularly in recent times. Estimates from the 2010 Population and Housing Census indicate that 14 per cent of the country’s working age population was inactive outside the school system while 633,994 people, representing 5.8 per cent of the labour force, were unemployed (Baah-Boateng, 2013).

Unemployment constitutes one of the key labour market challenges in Ghana. It reflects the willingness and desire of jobless individuals to work and an indication of the health of an economy. Limited job openings available to the labour force suggest policy failure with socio-political and economic implications. The inability of jobseekers to secure gainful employment tends to create disaffection among these people and causes some of them, especially the youth, to resort to social vices such as robbery, prostitution and political unrest. Indeed, unemployment constitutes underutilization of human resources and the failure to prevent these resources going to waste which does not only make them vulnerable to poverty but it is also a loss of potential income tax revenue to the nation (Baah-Boateng, 2013).

Somalia is defined as a Least Developed Country and is one of the ten poorest countries in the world. In 2003 UNDP estimated that over 43% of the population live in extreme poverty on less than one US dollar per day and over 73% of the population live in general poverty defined as less than two US dollars per day. Overall, only 56% of the labour force was estimated to be economically active, with 62% of the urban labour force and 41% of the rural/nomadic labour force reported to be unemployed. The most common source of household income is self-employment (50%), with remittances from the Somali Diaspora the second most important source of income in Somalia (UNDP, 2012).

With some of the worst human development indicators in the world, Somalia has faced years of protracted conflict, geo-political upheaval and severe drought. As a result, traditional markets have been heavily disrupted and critical infrastructure such as roads and irrigation systems have eroded after continual neglect. Between 2005 and 2011, GDP fell from around 2.3 billion USD to 1.1 billion USD (UNStats, 2013), and Somalia is currently entertaining a trade deficit of around \$190 million (African Development Bank, 2013). The 2012 Human Development Report estimates per capita GDP at \$284, which is the fourth worst in the world (UNDP, 2012). Under these circumstances, the newly created Federal Government of Somalia (FGS) has been preoccupied with addressing security and donor funding (Adam Smith International, 2013) and has had little opportunity to invest in stimulating domestic economic growth. Although economic growth is a central policy priority of the President's Six Pillars Policy (Bryden, 2013): Somalia Redux? Report written for the Center for Strategic and International Studies (CSIS), and the Government's Peace building and State building Goals (PSGs), the government is hamstrung by a lack of technical expertise and low capacity to design, implement and monitor necessary commercial legislation. Legislative reform at this level will be slow.

The Somali economy is heavily reliant on informal sectors in agriculture and livestock, which have greatly suffered from drought and conflict. Mass internal displacement has exacerbated the challenge of rebuilding the economy as rural populations have abandoned their livelihoods in search of aid and protection in urban IDP camps. It is estimated that around 1 million people are internally displaced (IOM, 2013). The ongoing AMISON mission to combat Al-Shabaab could affect a further 3 million people, many of whom could flee to urban areas in Baidoa and Mogadishu (HCT, 2014). In addition, Kenya has recently embarked on a programme of voluntary repatriation of Somali refugees that will further disrupt local markets. This means that local markets are constantly adjusting to new population dynamics and fluctuating demand for certain products according to the pattern of exodus and influx.

Few employment opportunities and a weak enabling environment for starting new business ventures has resulted in high levels of unemployment – just over half (54%) of 15-64 year olds are unemployed (Danish Refugee Council, 2012). Young people are especially at risk from poor labour market conditions, and may be drawn towards criminal or terrorist elements, both of which are highly active in Somalia. The situation is critical. According to the UNDP, youths are the largest population cohort in Somalia today, 73% of the population is below the age of 30, with 67% unemployed (UNDP, 2012). The problem is exacerbated by some of the poorest Human Development Indicators (HDI) for education (0.118). On average

Somalis are expected to attend 1.8 years of schooling in total, compared to 9.6 years in neighboring Kenya. Women are even more at risk from poor market conditions. Strong social customs such as early marriage, polygamy and high fertility rates make it difficult for women to participate in economic activity as they are forced to take on unpaid home-based work

## **2.0 LITERATURE REVIEW**

### **2.1 Theoretical Review**

#### **2.1.1 Human Capital Theory**

Schultz (1961) quoted in Dae-Bong (2009), recognized human capital as one of the important factors necessary for national economic growth in the modern economy. Schultz also recognized human capital as something similar to a property, which entails the knowledge and skills embedded in an individual. Similar to his views, Rastogi (2002) conceptualizes human capital as knowledge, competency, attitude and behavior embedded in an individual. Another viewpoint of human capital is related to the accumulation process of it, which encompass knowledge and skills acquired by an individual throughout educational activities such as compulsory education, postsecondary and vocational education. However, this perspective neglects the fact that human beings acquire knowledge and skills throughout their own experience.

Sheffin, (2003) quoted in Dae-Bong (2009), states that “human capital is the stock of skills and knowledge embodied in the ability to perform labour to produce economic value.” An individual’s human capital endowments can influence his or her status both in the internal and external labour market. In the internal labour market, human capital can translate to increased earnings resulting from an individual’s productivity. Because of the increment of an individual’s productivity resulting from his or her human capital endowment, most employers prefer to hire productive individuals in order to maximize their profits(Dae-Bong, 2009). On the contrary, in the external labour market, an unemployed individual’s human capital affects his/her job-seeking and employable opportunities. Moreover, an individual with high level of human capital easily holds the possibility to access job related information and thereafter he/she can easily obtain the occupational chances compared to otherwise. Therefore, the human capital theory underscores the relevance of skills and knowledge in influencing an individual’s access to opportunities. This theory was relevant to this study because it helped in understanding how individuals’ human capital endowments influence their access to formal employment in Somalia.

### **2.2 Empirical Review**

In a well-functioning labour market, the demand of labour is inversely related to its price (Nickell, 2007). The higher the price of labour, the lower its demand, and the relative price of labour can also change the demand for labour by inspiring the more concentrated use of the relatively cheapest input. In other words, relatively cheap capital will prompt firms to be more capital-intensive, while relatively cheap labour will necessitate more labour-intensity.

Ngure (2012) conducted a study on the determinants of labour turnover among the micro finance institutions in Kenya. This study was a survey, which was carried out on the existing employees within the microfinance institutions in Kenya. The general objective of the study

was to find out the likely factors influencing labor turnover in the micro finance institutions and the specific objectives was to examine whether pay packages, job prospects, prevailing working conditions, unionization of employees, selection procedures, placement, induction process, and the demographic factors influence labor turnover among MFIs. The findings indicated the factors influencing labor turnover in the MFIs sector. Low pay was cited as the most influential factor followed by lack of job security, lack of job prospects, pursuit of further education, and demographic factors among others. The findings further indicated that young employees were more likely to quit than old employees; female employees were more likely to quit than male employees and graduates were more likely to quit than non-graduate.

Firms will rather use more of the comparatively cheap skill category, which means that a change in the comparative wages of different skills categories might also cause a change in the blend of skills utilized by firms (Kraay & Van Rijckeghem, 2010). For instance, if increased unionization among unskilled or semi-skilled workers causes their wages to increase moderately more than that of skilled or highly skilled workers, firms might decide to use less unskilled and semi-skilled labour and more highly skilled labour.

Jones (2011) points out that it is not only the direct cost of labour that influences the demand for labour, but also the indirect costs. The increased labour market inflexibility raises the indirect cost of labour for firms, since more time and money have to be spent negotiating with unions, and an increasing amount of time and money is lost due to strikes. High indirect costs may warrant a substitution of labour with capital, which means that labour will grow slower than output.

Demekas and Kontolemis (2011) argue that reductions in public sector employment in the formal sector (or reduction in recruiting rates) have led in some countries to higher employment in the informal sector. In most countries employment and wage decisions are made differently clearly resulting in segmentation in terms of treatment of public sector employees and their counterparts in the private sector. Additionally, Kraay and Rijckeghem (2010) provided strong evidence that government wages are positively correlated with the level of government resources, and negatively correlated with the level of private sector employment.

Kamuruana (2011) study set out to analyze the factors that determine female labour force participation in Kenya Using 2005/2006 Kenya Integrated Household Budget Survey data the study employs a logit model to estimate the labour force participation status of women with a view to identifying the intervening socioeconomic variables. The study findings show that educated married women with bigger family members are more likely to engage in wage employment and women with children under the age of six are less likely to engage in wage employment. The study concludes that policies should be designed to ensure more women enroll in schools and that local social programs such as child care services could be designed to support females with children under six years of age.

One of the factors that appear to have a significant impact on wages and employment growth is minimum wage (Agenor, 2015). There is clearly a potential role for minimum wages to push up overall wages. The imposition of a minimum wage raises the incomes of those who would otherwise be earning below the minimum threshold but it is also likely to have some impact on higher levels of income as attempts to, at least partially, restore pay differentials.

Thus, minimum wage appears as a form of labour market inefficiency if wages are not determined by demand and supply.

Revenga and Bentolia (2015) note a clear positive relationship between changes in output and changes in the employment rate. They examine a sample of 11 OECD countries and find the link between employment and output to differ significantly across countries. Output-employment elasticity varied across OECD countries, as high as 0.57 for United Kingdom, to as low as, 0.01, for Japan. Further, their result imply that some structural and institutional factors such as wage bargaining by trade unions, unemployment benefit, the degree of competition in the product market did affect this relationship. Freebairn (1977), in a survey of the Australian literature, finds significant role for both output and real wages in employment equations.

Ogwumike, et al. (2012) showed that the structure of the labour market has a significant consequence on employment status and it served as an important determinant of household income and welfare. The paper analyses, among other things, the distribution and structure of main job earnings, determinants and income inequality in the Nigerian labour market. The study descriptive statistics, Gini Coefficient, Theil's Entropy Index, Ordinary Least Squares technique, Heckman's two-stage selectivity bias correction procedure and Tobit analytical technique. Findings from the study show that inequality was more evident in paid employment than in self-employed segment of the Nigerian labour force. It was generally higher in the rural areas than in the urban areas. The paper noted that necessary and adequate steps to optimally address the various sources of labour market and earnings inequality in Nigeria will pave the way for the opportunities in the Nigerian labour market to be optimally utilized by all participants.

Kien (2016), paper examines the effect of firm ownership on labour demand in Vietnamese manufacturing over the period 2000-09. The core focus of the paper is an econometric analysis of the determinants of labour demand in a manufacturing firm using firm-level data. The results show that the labour demand of domestic private firms and FIEs has responded slowly to wage changes while wholly owned FIEs and joint ventures are found to have higher employment elasticity with respect to output, compared to domestic firms, in particular in the export-oriented industries. Interestingly, the impact of firm ownership on labour demand has been missing after further outward-oriented reforms since 2006.

The existence of labour market institutions and regulations as well as mismatch between job seekers and vacancies represent important sources of labour market segmentation. A number of studies have been conducted to evaluate the impact of labour market institutions on employment across countries. According to Agenor (2015), trade union activism and the rise of the various types of employee protections have reformed the legal framework of the labour market. While rigid wage differentials and union activities are known to have slowed down resource shifts between formal and informal sectors; in several countries employment-protecting measures have made firms reluctant to expand their labour force. Morgan and Mourougane (2011) articulate similar arguments. In their study of the impact of labour market institutions and other structural factors on unemployment in Europe, they find that labour market institutions significantly have an influence on employment decisions of the firms and thus affect unemployment.



Barakat, Holler, Prettnner, and Schuster (2010) paper examined the impact of the economic crisis on labour and education in Europe. The findings revealed that during the economic downturn educational attainment had a strong influence on job security. The unemployment rates of low-skilled workers increased by 3.9 percentage points, while the unemployment rate of medium-skilled and high-skilled workers only increased by 1.9 and 1.7 percentage points respectively. This variation can again be attributed to the strength with which different economic sectors were hit by the economic crisis. The manufacturing and production sector, which mainly employs low and medium-skilled workers, was hit strongest, leading to a higher increase of unemployment for the corresponding skill groups. The variation of unemployment for certain skill levels highlights that the grade of substitutability for labour decides about the reaction of unemployment to an economic downturn. Easily substitutable labour will be affected most strongly

Doğrul (2012) study examines the determinants of formal and informal sector employment in the urban areas of Turkey. The analysis is carried out for men and women separately. The findings show that determinants of formal and informal employment in Turkey's urban labor market vary by gender. Special emphasis is placed on the importance of sex (being male rather than female), marital status, household-headship and education variables, of which the first three presents the disadvantaged position of women in the labor market. Most women work in the informal sector despite significant improvements in their education attainment. Overall results confirm that the urban labor market is heterogeneous and reveal how labor supply factors are valued in the labor market. They also indicate the existence of sex discrimination in the labor market. The study presents a geographical gap since it was conducted in Turkey while the current study focuses on Somalia.

Onwioduokit, Adamgbe, and Buno (2009) paper investigates the determinants of labour market in Nigeria arising from the economic transformation in recent years, and how public policy affects in particular labour market outcomes. A two-equation model for Nigeria's labour demand and supply was estimated using the Seemingly Unrelated Regression (SUR). On the supply side, labour force participation is largely determined by its own backward looking expectation and demand elasticities while real minimum wage and population growth were insignificant but positively related to labour force participation. The results also showed that demand was negatively related to labour force supply and the level of the working age population, while capacity utilization and real minimum wage though not significant had positive relationships with demand for labour. Own elasticity was significant and has a positive impact on the demand for labour. It is evident from the results that to fix the disequilibrium in the Nigeria's labour market, macroeconomic stability is needed to sustain prices at levels that will drive labour market activities to optimal levels.

Floro and Meurs (2009), in their analysis of Global Trends in Women's Access to Decent Work, argues that while women's participation in paid employment has increased worldwide, women are still segregated into certain types of employment. This is due to a complex mix of factors such as, household duties, educational background, discrimination, social norms, and personal choice (Floro&Meurs, 2009). For instance, they argue that culture and the strength of patriarchy exacerbate low rate of female labour force participation. Additionally, norms regarding family and kinship ties have been a central force in shaping women's lives in many parts of the world.

Maglad (2008) argues that human capital investment in women through education increases their access to work because education directly affects women's decision to engage in market work. Ercan et al., (2010), has also emphasized the relevance of women's education in access to employment opportunities in Turkey. They argue that women's access to higher education is of vital importance; however, it does not solve the problem of women's low labour force participation rate. In many cases, even if women have access to education, other sociological factors hinder women's employment. For instance, they state that even if women attain higher education, the interpretation of the sexual division of labour related to reproduction at home and division of social roles in the family do not change consequently affecting their involvement in employment activities.

### **3.0 RESEARCH METHODOLOGY**

The paper adopted a desk top research design. The design involves a review of existing studies relating to the research topic. Desk top research is usually considered as a low cost technique compared to other research designs (Beal et al., 2012). In this case, the researcher collected information relating to the topic of the study. The purpose of the study was to investigate the determinants of labour demand; a case of Mogadishu City, Somalia. As such, the researcher reviewed previous studies that have addressed the concept of labour demand.

#### **4.0 Research Gaps**

Ngure (2012) conducted a study on the determinants of labour turnover among the micro finance institutions in Kenya. This study was a survey, which was carried out on the existing employees within the microfinance institutions in Kenya. The study presents a conceptual gap since it focused on labor turnover while the current study focused on labor demand.

Kien (2016), paper examines the effect of firm ownership on labour demand in Vietnamese manufacturing over the period 2000-09. The core focus of the paper is an econometric analysis of the determinants of labour demand in a manufacturing firm using firm-level data. There exists a scope gap since the study was conducted in Vietnam. Further, Doğrul (2012) study examines the determinants of formal and informal sector employment in the urban areas of Turkey, thus presenting a scope gap.

Kamuruana (2011) study set out to analyse the factors that determine female labour force participation in Kenya Using 2005/2006 Kenya Integrated Household Budget Survey data the study employs a logit model to estimate the labour force participation status of women with a view to identifying the intervening socioeconomic variables. The study presents a methodological gap since it employed a logit model while the current study used literature based model.

### **5.0 CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Conclusions**

Based on past literature the study concluded that cost, education and economic stability had a significant impact on demand for labour. The study identified cost as a key determinant of labour demand, especially, in the formal sector. Previous studies indicate that most firms demand for cheap labour. At the same time, the available workforce demand high

compensation. The study also identified education as an important determinant of demand for labour in the World. Owing to the increasing global competitiveness, firms demand for highly skilled and competent workforce. Unfortunately, majority of workforce in developing countries such as Somalia do not have the right skills and competence. Despite, the high supply of labor in Somalia; the people lack the required training and skills.

The study further identified economic stability as a crucial determinant of demand for labour. A country with a stable economic growth enjoys high demand for labour. This is because the available workforce is skilled and competent enough. However, in developing countries such as Somalia, the demand for labour is very low. Somalia has experienced long period of economic slowdown, and this has affected the quality of workforce.

## **5.2 Recommendations**

This study provides implications for both policy and practice. Based on the study findings the study recommends that the federal government of Somalia should adopt measures to regulate labour cost. It is evident from past studies that cost is one of the major factors affecting demand for labour in developing Countries. Therefore, the government should adopt policies that will ensure that the workforce is well compensated. At the same time, the government should also protect the interests of the firms.

The study also recommends that the government should adopt more measures to promote education including post-secondary schooling for youths in technical/science fields as well as arts and humanities and to collaborate with the private sector in order to create programs aimed at enhancing access to labour market information as well as adopting flexible working conditions for the workforce.

The study further recommends for international interventions to ensure that Somalia's economy gets back on its fit. Stable economic growth will lead to increased demand for labour.

## **5.3 Areas for further studies**

The study sought to investigate the determinants of labour demand, a case of Mogadishu City, Somalia. This study, therefore, focused on Somalia only, thus further studies could consider other developing Countries for the purpose of making a comparison of the findings with those of the current study.

In addition, the study examined only three determinants of labour demand. Further studies should expand the scope and consider the effect of other factors on demand for labour.

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