

Beyond labor policies

Fundamentals need to be in place, and constraints to the creation of jobs with high development payoffs need to be removed or offset. Policy coordination across borders can help.

A prerequisite for improved living standards is a policy environment conducive to private-sector-led job creation. Macroeconomic stability, an enabling business environment, human capital, and the rule of law are all necessary ingredients. Adequate macroeconomic policies mitigate aggregate fluctuations and keep key relative prices aligned. The business environment provides the basic public goods needed for the private sector to operate: infrastructure, access to finance, and sound regulation. Human capital is formed through good nutrition, health, and education that builds human skills. The rule of law ensures the enforcement of contracts; it also includes the progressive realization of rights to avoid a situation where growth coexists with unacceptable forms of work. These are the fundamentals on which policies for jobs rest (figure 9.1).

Fundamentals alone may not be enough to facilitate job creation and address the jobs challenges faced by many developing countries. Labor policies need to be set within a sensible range—a *plateau* that avoids two cliffs: one is the misguided intervention that clogs the creation of jobs in cities and in global value chains; the other, the lack of voice and social protection especially for the most vulnerable.

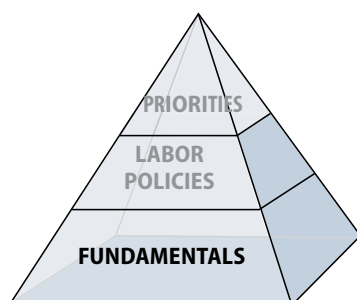
Markets might work without much friction but that may not be sufficient to make smallholder farming more productive in agrarian

economies, or to generate enough employment opportunities for young men in conflict-affected countries.

An active role of government, however, needs to be carefully considered. Jobs are mainly created by the private sector with government intervention justified when individual incentives are misaligned with social goals—when, for example, employment is not rewarding for women, when young people are “queuing” to be civil servants, when cities are too congested to productively absorb more rural migrants, or when logistics costs are too high for domestic firms to engage in international trade. In these cases, government policy should aim to remove the constraints that prevent individuals, farms, and firms from making the best choices for society. If constraints cannot be precisely identified, or reforms are not politically feasible, policies can aim at offsetting the constraints rather than relieving them directly. In most cases, the policies to create good jobs for development lie outside of the labor market.

Domestic policies for jobs are part of the solution, but there is also scope for international coordination. Rights are a global public good—their violation in one country harms the world. But policies for job creation in one country can affect employment and earnings in another, positively or negatively, while migration policies can generate opportunities abroad or shut them

down. Labor standards, rules for international trade and foreign direct investment (FDI), and migration agreements are among the instruments available to manage these international spillovers. International organizations have a role to play in coordinating the important global project of producing and using high-quality data on jobs, on which sound policy making must rest.



Establishing the fundamentals

A vast majority of jobs are created by the private sector—in formal sector firms as well as in microenterprises and farms. The relevant conditions for private sector investment and job creation are macroeconomic stability, an enabling business environment, human capital, and the rule of law.

Macroeconomic stability

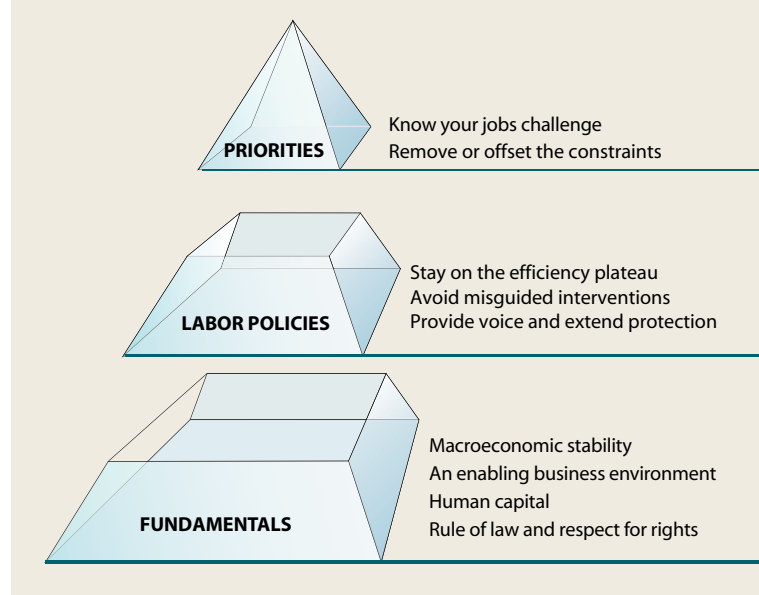
In its assessment of the policy ingredients of growth strategies across 13 successful developing countries, the Commission on Employment and Growth noted: “No economy can flourish in the midst of macroeconomic instability. Wild fluctuations in the price level, the exchange rate, the interest rate, or the tax burden serve as a major deterrent to private investment, the proximate driver of growth.”¹ Macroeconomic instability also affects employment and earnings in the short run. According to a recent estimate, a 1 percent decline in gross domestic product (GDP) is associated with an increase in the unemployment rate of 0.19 percentage point in Japan, 0.45 in the United States, and 0.85 in Spain.²

In developing countries, where income support mechanisms are more limited, the short-term impact of macroeconomic instability is often not so much on open unemployment as it is

on the composition of employment. Economic downturns lead to transitions to informal employment or to household-based activities, and not necessarily to joblessness. Hence, research focuses on how macroeconomic fluctuations affect the share of informal employment, rather than the unemployment rate.³ Country case studies of the impact of the global crisis have confirmed the resilience of employment in developing countries. But macroeconomic stability is not less relevant there: while aggregate fluctuations do not greatly affect the number of workers employed, they do affect the earnings of those at work as well as their access to basic social protection instruments.⁴

Macroeconomic instability is often the outcome of unsustainable budget deficits and lax monetary policy. In the 1980s, Brazil plunged into a debt and high-inflation crisis that slashed its economic growth and halved the share of exports in its GDP. Triggered by high international interest rates in the late 1970s, the crisis then was compounded by the difficulty of keeping spending by subnational governments in check. Tight budgets and rigid monetary policy rules may not be a magic wand, however. Budget deficits are more or less worrisome depending on how quickly an economy is growing, whereas

FIGURE 9.1 *Three distinct layers of policies are needed*



Source: World Development Report 2013 team.

the independence of central banks needs to be weighed against the overall coherence of a development strategy. An assessment of the soundness of macroeconomic management requires taking account of the impact of fiscal and monetary policies on economic growth.⁵

Not all macroeconomic instability is self-inflicted, however. Turbulence may result from shocks over which countries have little control, from natural disasters to crises originating abroad. Precautionary policies can be adopted to cushion those shocks if and when they occur. But most often there is a need to respond with short-term stimulus or adjustment packages. The effectiveness of these responses is a matter of controversy. A recent study based on the experience of 29 aid-dependent countries estimates that GDP increases by close to 0.5 percentage points for every percentage point of GDP in additional government spending. This so-called multiplier effect is substantially lower than in the United States, where a range between 0.8 and 1.5 is considered plausible.⁶

Wild fluctuations are only one way in which the macroeconomic context can adversely affect employment and earnings. The misalignment of key relative prices is another. Surges in a country's foreign exchange earnings often lead to an overvaluation of its currency, making imports more affordable and exports less competitive. Resource-rich countries in the developing world face similar currency appreciation pressures.⁷ The commodity booms of the last few years have only strengthened these pressures. Currency overvaluation can also happen in countries where large volumes of foreign assistance are needed to jump-start development, cope with natural disasters, or facilitate recovery after a conflict. In Afghanistan, for instance, civilian aid from multilateral and bilateral donors was estimated at around 40 percent of GDP in 2010/11.⁸ Currency overvaluation is a concern for many other countries where foreign aid does not reach the levels in Afghanistan but still funds a significant fraction of the budget. An analysis of 83 developing countries between 1970 and 2004 confirms that aid fosters growth (albeit with decreasing returns) but induces overvaluation and has a negative impact on export diversification.⁹

Avoiding exchange rate misalignment is necessary to sustain a vibrant export sector and hence create jobs that are connected to interna-

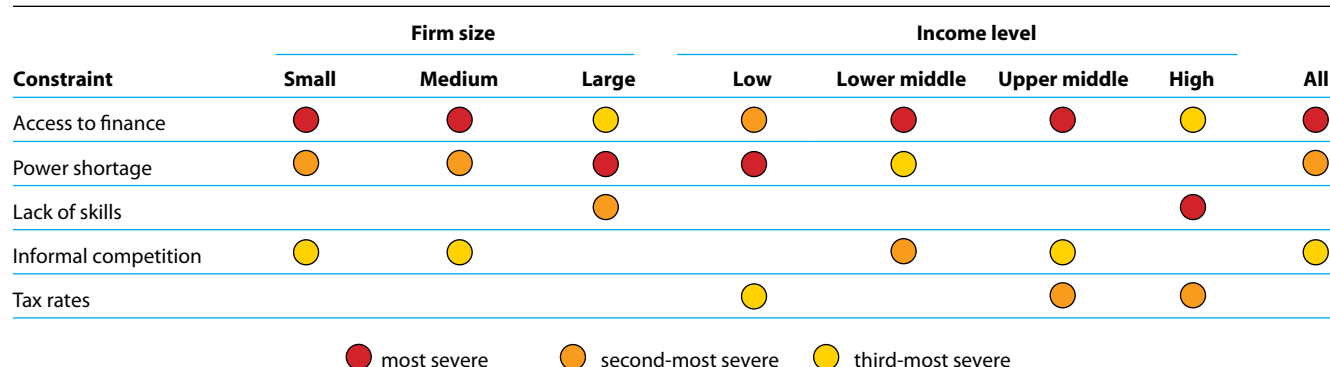
tional markets and global value chains.¹⁰ A case has even been made in favor of currency undervaluation, on the grounds that the export sectors of developing countries suffer disproportionately from institutional failures and market imperfections.¹¹ However, not all countries in the world can simultaneously have an undervalued currency. And while the argument that jobs integrated with world markets have positive growth spillovers is sensible, these jobs are not necessarily the ones with the highest development payoffs. Different countries have different jobs agendas, from creating employment opportunities for women to supporting the development of jobs in cities. The exchange rate is only one instrument and would seldom be able to deliver on such diverse agendas.

An enabling business environment

Across firms and countries at varying levels of development, the most important constraints on formal private sector businesses are remarkably consistent: access to finance, infrastructure, and aspects of regulation including taxation and unfair competition (figure 9.2). Skills shortages are also key, but mainly in the case of large firms and especially in richer countries.

Access to finance provides firms with the ability to expand, to invest in new technologies, or to smooth cash flow over time.¹² Financial markets also play an important role in the allocation of resources toward more productive uses.¹³ Transparency within the financial sector avoids resources being channeled to those with political connections or economic power, and it also supports financial inclusion. Expanded credit registries keeping track of positive as well as negative episodes in debtors' histories help people demonstrate that they are creditworthy. But regulatory oversight is needed to ensure transparency and competition in the allocation of funds. The financial crisis of 2008 has reopened heated debates about the appropriate level of regulation of the financial sector and the need to balance prudence and stability with innovation and inclusion.

Access to affordable infrastructure of reasonable quality is, often, another top constraint to firm growth and job creation. Electricity enables the use of more sophisticated technology. It also frees up time from domestic chores; in

FIGURE 9.2 Finance and electricity are among the top constraints faced by formal private enterprises

Source: IFC, forthcoming.

Note: The analysis is based on World Bank enterprise surveys covering 46,556 enterprises in 106 countries. Small firms have fewer than 20 employees, medium firms have 21–99, and large firms 100 and more.

rural areas, it can significantly increase women's employment.¹⁴ Telecommunications allows for better information flows among suppliers, producers, and customers, and the Internet and mobile technology facilitate the spread of new ideas. Roads provide greater access to markets, as do ports and airports.¹⁵

In many low-income countries, poor-quality infrastructure is an especially severe challenge. Part of the problem stems from how infrastructure services are regulated, however, and not only from insufficient resources to build additional facilities and roads. By one estimate, improved infrastructure was responsible for more than half of Sub-Saharan Africa's recent growth.¹⁶ But efficiency improvements stemming from better management of spending and maintenance, pricing policies, and regulations would be needed to close a significant portion of the remaining gap in infrastructure services. In many countries and infrastructure sub-sectors, monopolies—based on political connections—have resulted in lower quantities of services being provided, at higher prices and of lower quality than in areas where competition has been allowed to thrive.¹⁷

Regulation is another area that influences the opportunities for businesses to grow. Some regulations determine the rules of the game, encouraging—or discouraging—certain activities. Others affect firms at various stages of their life cycle, from getting started, to enforcing contracts, to closing down.¹⁸ Regulations impact on the cost of doing business, both in monetary

terms and in time needed to comply. Steps taken to meet requirements or to pay fees are a burden to businesses, as are delays in receiving permits or licenses. The time it takes to comply with regulations or to receive permits varies greatly across firms in the same location, suggesting discretionary power and corruption.¹⁹ Beyond these broader cost measures, regulations affect the types of opportunities that are available and how widely they are available. Regulations can relieve or exacerbate uncertainty and corruption, but they can also have a deeper influence on the degree of competition and thus the structure of industries in the economy.

Because business regulations affect the degree of competition, they shape the pressures to innovate and increase productivity. Competition contributes to the reallocation of resources from inefficient activities to more productive ones. Regulations that serve to protect an industry or deter new entrants can be particularly costly in terms of forgone output and employment growth.²⁰ Across countries, regulations on business entry are inversely correlated with productivity and firm creation, with stronger effects in sectors that tend to have higher turnover rates.²¹ Easing entry requirements helped increase business registration and employment and drove down prices for consumers in Mexico. The effect was achieved largely through creation of new firms rather than formalization of existing informal firms.²² Combining relaxed entry requirements with other regulatory reforms, such as investment promotion and trade

logistics, tends to be more effective than simply easing entry.²³

Human capital

Good nutrition, health, and education outcomes are development goals in themselves, because they directly improve people's lives. But they also equip people for productive employment and open job opportunities—and through this employment channel, human capital drives economic and social advances. According to the Commission on Growth and Development, “every country that sustained high growth for long periods put substantial efforts into schooling its citizens and deepening its human capital.”²⁴

Connections between human capital and jobs are manifold. There is robust evidence from around the world that each additional year of schooling raises labor earnings substantially, and that this earnings premium reflects the higher productivity of more educated workers.²⁵ Together, nutrition, health, and education form skills and abilities that have been clearly linked to productivity growth and poverty reduction in the medium to longer run.²⁶ Better health also brings, directly, higher labor productivity. For example, where malaria is endemic, workers can expect to suffer an average of two bouts of fever each year, losing 5 to 10 working days each time.²⁷ In rural Ethiopia, onchocercal skin disease lowers the earnings of affected workers by 10 to 15 percent.²⁸ As such, human capital becomes a fundamental ingredient for desirable job outcomes.

Human capital formation is cumulative. It is a life-cycle process that proceeds in consecutive stages, each of them building on the previous one. Of crucial importance are adequate health and nutrition during the first 1,000 days of life, from inception to two years of age. Brain development in this period affects physical health, learning abilities, and social behavior throughout life.²⁹ In the early years, a child develops all the basic brain and physiological structures upon which later growth and learning depend. Stunting in early childhood has been proven to have a significant negative effect on cognitive development; iodine deficiency can lead to poor brain development; and insufficient cognitive stimulation reduces learning abilities. Ensuring adequate nutrition, health, and cognitive

stimulation through a nurturing environment from the womb through the first years of life raises significantly the returns to later education investments.³⁰ Supporting young children born into poverty during these crucial development phases can significantly improve equality of opportunities. The later the support, the more difficult and costly it is to put that child back on a normal developmental trajectory. In Romania, during the early transition years, the cognitive performance of orphans was lower the older they were when they left state orphanages. Social, emotional, and cognitive isolation was common in these facilities.³¹

While foundations are laid early on, human capital and skills continue to be formed throughout childhood, young adulthood, and working life. Schooling is fundamental for the further development of cognitive and social skills until the end of adolescence, but learning abilities continue to be shaped by physical and mental health. Social skills remain malleable through adolescence and early adult years.³² Young adults can continue into more specialized skill-building, including at tertiary levels, but their success depends on whether they have acquired the generic skills needed to learn and adapt to different tasks and problem-solving environments. These abilities are especially important in more dynamic economies.

Unfortunately, the evidence shows that many countries are falling short in building up the human capital of their children and youth. The quality of delivery systems has often failed to keep pace with the expansion of access to basic social services. In education, for example, by 2010, the net primary school enrollment rate in low-income countries had reached 80 percent, primary school completion was at 68 percent, and gross lower secondary school enrollment exceeded 50 percent.³³ But learning outcomes were clearly lagging behind. In a large majority of developing countries that took part in the Programme for International Student Assessment (PISA) in 2009, at least 20 percent of 15-year-old students were functionally illiterate. For a number of countries, including Indonesia, the Kyrgyz Republic, Panama, Peru, Qatar, Tunisia, and the two Indian states that participated in the PISA, more than 60 percent of 15-year-old students failed to reach this level. Similarly, early reading tests taken at the end of second grade

revealed that, in diverse countries, a significant share of students were unable to read a single word: around 30 percent in Honduran rural schools, 50 percent in The Gambia and more than 80 percent in Mali.³⁴ Enrollment numbers, hence, do not necessarily signal actual learning and skill building.

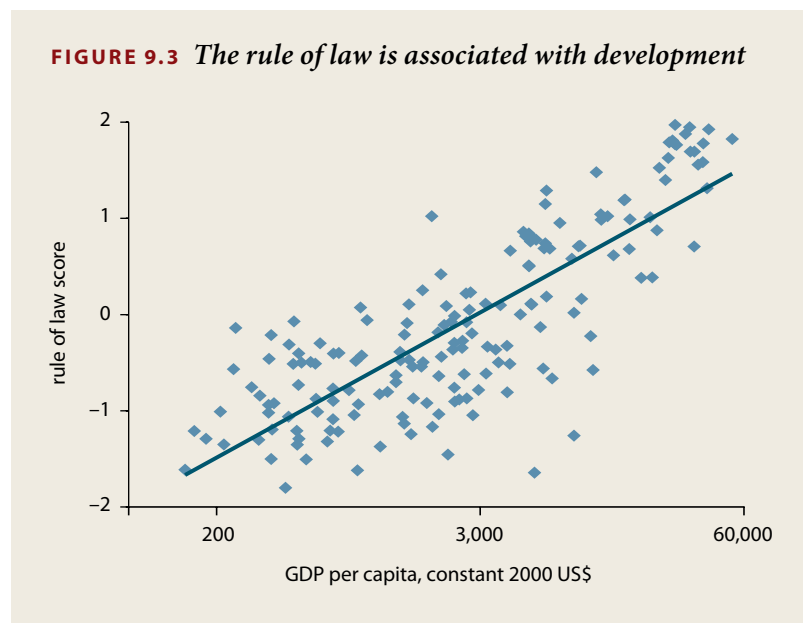
The rule of law and respect for rights

Across countries, the presence of institutions that uphold the rule of law is associated with higher levels of development (figure 9.3).³⁵ Clear property rights and institutional mechanisms that strengthen governance can create a climate in which firms are willing to make investments, enter into contracts, and create new jobs. In such a climate, individuals may be more inclined to take the risks needed to set up new businesses and become entrepreneurs.³⁶

The link between respect for property and development is well established.³⁷ Property rights foster private sector growth by allowing firms to invest without fearing that their assets will be stolen or confiscated. The ability to enforce contracts widens the circle of potential suppliers and customers, as personal connections become less important in establishing trust.³⁸ Entrepreneurs who believe their property rights are secure reinvest more of their profits than those who do not.³⁹ Increasing the security of property rights often involves setting up effective titling and registration processes. Mechanisms for valuing and protecting other types of property, including legislation governing intellectual property, are also important.

Rampant crime and violence can be devastating for development and for job creation.⁴⁰ Lawlessness can drive firms away and discourage domestic and foreign investment. Across countries, investment climate surveys consistently find crime and corruption to be obstacles to conducting business.⁴¹ Inclusive and responsive institutions, which lead to a reduction of violent behavior, increase safety and security. Strengthening efforts to detect and prosecute white-collar crime and malfeasance can reduce corruption.

An effective judicial system is a key ingredient for enforcing property rights and reducing crime and corruption. An independent, accountable, and fair judiciary can contribute to private sector growth and job creation by en-



Sources: World Development Indicators 2010 (database) World Bank, Washington, DC; World Governance Indicators 2010.

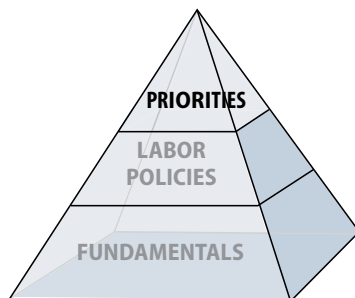
Note: GDP = gross domestic product. The rule of law score is a measure of the extent to which agents have confidence in the rules of society, including the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

forcing the rules that govern transactions and helping ensure that the costs and benefits of growth are fairly distributed.⁴² The justice system can enforce contracts, reduce transaction costs for firms, and create a safe and more predictable business environment.⁴³ The presence of effective courts increases the willingness of firms to invest.⁴⁴

An institutional environment that respects rights is another integral part of the rule of law. The International Labour Organization's core labor standards provide guidance on what is unacceptable in the areas of child labor, forced labor, discrimination, and freedom of association and collective bargaining.⁴⁵ Health and safety at work also necessitate attention by governments and employers. Ensuring that standards are enforced in practice requires providing access to information to workers and employers. Information can increase the extent to which workers are able and willing to hold employers and intermediaries accountable. It can also help ensure that all parties involved are aware of their obligations. Strengthening institutions for enforcement and grievance redress is another necessary building block.

Ensuring that rights and standards are upheld requires a focus not only on implementing acquired rights but also on expanding their reach to workers in jobs that fall outside of formal laws and regulations. Associations of informal workers can play a key role in informing them, helping them access legal mechanisms, and offering them collective voice. But often, information alone is not enough: garment workers in the Lao People's Democratic Republic reported that they were told about their basic conditions of employment, but they did not always understand the details, nor how to enforce their rights.⁴⁶ Not only can organizations of informal workers support workers in learning about and accessing rights and standards, but they can also bring cases to court on behalf of individuals and groups.⁴⁷

The quality of institutions for accountability affects the extent to which labor rights are enforced in practice.⁴⁸ Because court proceedings are often lengthy and costly, alternative mechanisms for resolving disputes, including conciliation, mediation, and arbitration prior to court hearings can expand access to justice and grievance redress.⁴⁹ These alternative mechanisms are especially valuable to workers who cannot access the court system due to high costs or other barriers.



Setting policy priorities for jobs

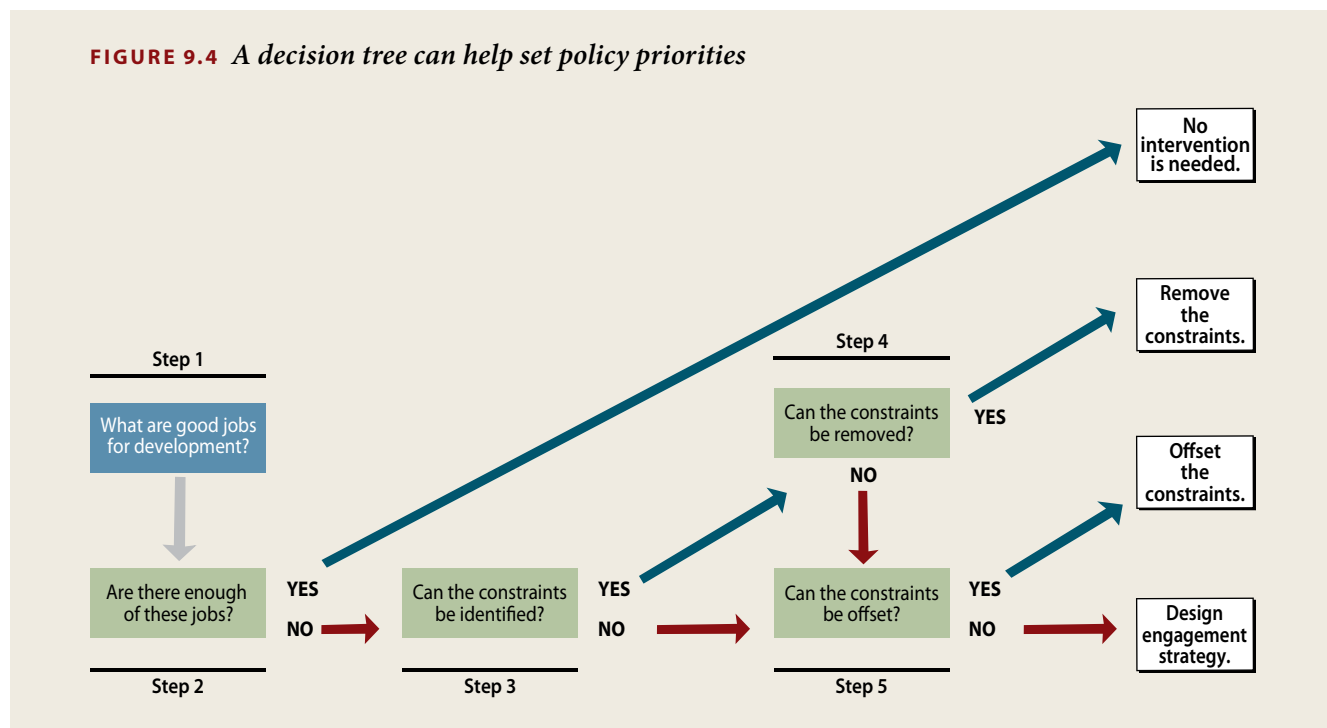
In addition to ensuring that the fundamentals are in place and that labor policies are set in a sensible range, decision makers can help realize the development payoffs that come from jobs. Some jobs do more than others for living standards, productivity, and social cohesion. What those jobs are depends on the country context—its level of development, demogra-

phy, endowments, and institutions. In some circumstances, there are no constraints to the emergence of good jobs for development and no specific policy is needed. In others, governments can support the private sector in creating more of these jobs. Sometimes removing existing constraints that impede the creation of jobs with high development payoffs is possible. In other cases, policies may need to circumvent the constraints.

A simple approach to setting policy priorities follows a series of steps. First, the country context must be assessed and the particular jobs challenge or challenges it faces must be identified. The second step is examining whether the jobs with the highest development payoffs are really the most attractive to individuals or the most profitable for firms. When incentives are aligned—with the individual and social value of jobs equal—there should be no shortage of good jobs for development and intervention is not needed. The third step is determining whether the institutional failures and market imperfections leading to misaligned incentives can be pinpointed or not. The fourth step is understanding whether politically feasible reforms can remove or correct those failures and imperfections. If not, the last step involves assessing whether incentives should be realigned through other policies (figure 9.4).

Step one: What are good jobs for development? Assessing the development payoffs from jobs in a particular country context is an important first step in identifying priorities. The nature of the jobs with the greatest payoffs varies with the characteristics of the country, including its phase of development, endowments, and institutions. Jobs challenges differ in agrarian economies, conflict-affected countries, resource-rich countries, and countries with high youth unemployment, as well as in other settings. And the jobs with the greatest development impact differ as well, resulting in diverse jobs agendas.

Step two: Are there enough of these jobs? A country may or may not face constraints in creating good jobs for development. For example, light manufacturing can offer employment opportunities for women, with significant impacts on reducing poverty. If a boom is under way, the development payoff of new manufacturing jobs

FIGURE 9.4 A decision tree can help set policy priorities

Source: World Development Report 2013 team.

might materialize. If so, it is difficult to justify government interventions beyond establishing the fundamentals and adopting adequate labor policies.

Misaligned incentives exist when good jobs for development are not rewarding enough to individuals or profitable enough to firms and firms. Data and analysis can be used to identify gaps between the individual and the social value of jobs. Arguably, many key areas in development economics deal with these gaps. For instance, the tools of public finance can be applied to measure the tax burden on capital and labor and to assess the extent of cross-subsidization between individuals or firms. Labor economics methods can be used to uncover gaps between the actual earnings of specific groups of workers and their potential earnings. Poverty analyses help in identifying the kinds of jobs that are more likely to provide opportunities to the poor, or the locations where job creation would have a greater impact on poverty reduction. Productivity studies can help quantify the spillovers from employment in FDI companies, in firms connected to global markets, or in functional cities. Environmental studies shed light on the carbon

footprint and pollution created by various types of jobs. And analysis of values surveys can discover which types of jobs link to networks and provide social identity.

Step three: Can the constraints be identified? Understanding why the individual and social values of specific types of jobs differ is next. Gaps of this sort indicate the presence of unexploited spillovers from jobs. The gaps typically arise from market imperfections and institutional failures that cause people to work in jobs that are suboptimal from a social point of view, lead firms to create jobs that are not as good for development as they could be, or connect people less through jobs than would be socially desirable. But identifying where those constraints are is not always easy. For instance, a broad set of cultural, social, and economic forces may result in insufficient employment opportunities for women. Similarly, it may be difficult to pinpoint whether the key obstacles to making cities functional lie in the land market, or in the institutional arrangements to coordinate urban development, or in the ability to raise revenue to finance infrastructure.

Step four: Can the restraints be removed? If the institutional failures and market imperfections leading to misaligned incentives can be identified, reforms should be considered. It is a good economic principle to target reforms to the failures and imperfections at the root of the problem. Where reforms are technically and politically feasible, policy makers should directly tackle the major constraints hindering the creation of more good jobs for development.

Step five: Can the constraints be offset? Reforms might not be feasible, technically or politically. Or perhaps the constraints for jobs are not identifiable. An alternative is to enact offsetting policies that can restore the incentives for job creation. For instance, if a diffuse but entrenched set of priors and beliefs makes it difficult for women to work, efforts could aim at increasing their employability through targeted investments and interventions in social

and physical infrastructure (box 9.1). Similarly, if politically charged regulations slow the reallocation of labor toward more productive activities, urban infrastructure and logistics could enhance the attractiveness of jobs in cities and jobs connected to world markets (question 9). But there are cases when constraints can neither be removed nor offset. An engagement strategy involving a deeper analysis of the options and buy-in by key stakeholders is needed then.

Policy making to remove or offset constraints has to be selective and supported by good public finance principles. The costs and benefits of policy options need to be assessed, but the calculations are different when the overall development impact is the guiding objective. But they are also more difficult. For instance, an employment program for ex-combatants in a conflict-affected country could be assessed in terms of whether the earnings gains of participants justify the pro-

BOX 9.1 *How does women's labor force participation increase?*

Some developing countries have experienced important increases in women's labor force participation over a relatively short period of time. Nowhere has the change been faster than in Latin America. Since the 1980s, more than 70 million women have entered the labor force, raising the women's labor participation rate from 36 percent to 43 percent. In Colombia, the rate increased from 47 percent in 1984 to 65 percent in 2006. By contrast, in the Middle East and North Africa, women's labor force participation has only grown by 0.17 percentage points per year over the last three decades.

Recent research attributes this rapid transformation to increases in labor force participation among married or cohabiting women with children, rather than to demographics, education or business cycles. Changes in social attitudes contributed to the transformation, but this is a complex area with limited scope—and justification—for direct policy intervention. For instance, women's participation rates are very low in the West Bank and Gaza, particularly among married women. But this cannot be mechanically attributed to religion, as countries like Indonesia have high participation rates. Other social norms and regulations prevent women from participating, despite their willingness and capacity to do so.

While the scope to influence social attitudes is limited, evidence suggests that public policies and programs in other areas have an important role to play. It also suggests that a combination of targeted investments and interventions in social and physical infrastructure can modify women's labor force participation and the

returns to their earnings. These investments and interventions can be categorized into three groups. They can address shortages in the availability of services (such as lack of electricity or daycare facilities) that force women to allocate large amounts of time to home production. They can make it easier for women to accumulate productive assets, such as education, capital, and land, facilitating their entry into high-productivity market activities. And they can remove norms or regulations that imply biased or even discriminatory practices, preventing women from having equal employment opportunities.

There are successful experiences with targeted investments and interventions of these three sorts. Public provision or subsidization of child care can reduce the costs women incur at home when they engage in market work. Examples include Estancias Infantiles in Mexico, Hogares Comunitarios in Colombia, and similar programs in Argentina and Brazil. Improvements in infrastructure services—especially in water and electricity—can free up women's time spent on domestic and care work. Electrification in rural South Africa, for instance, has increased women's labor force participation by about 9 percent. Correcting biases in service delivery institutions, such as the workings of government land distribution and registration schemes, allows women to own and inherit assets. Finally, the use of active labor market policies, the promotion of networks, and the removal of discriminatory regulations, are important to make work more rewarding for women.

gram costs. But a full accounting would need to incorporate the potentially positive effects on peace building. In the Democratic Republic of Congo, the cost of a reintegration program for ex-combatants was about US\$800 per beneficiary.⁵⁰ Such a program would likely be judged as cost inefficient by traditional standards. Whether or not it is still worth implementing depends on the implicit value policy makers attach to its social cohesion benefits. These spillovers from jobs may not be measured precisely, but at least they should be stated, for policy decisions to be transparent.

Diverse jobs agendas, diverse policy priorities

Following a protocol to identify constraints to the creation of good jobs for development, and then remove or offset them, may sound abstract. But some countries have successfully done this in practice, and it is possible to learn directly from their experiences (box 9.2). The stories of Vietnam, Rwanda, Chile, and Slovenia, show that policy can effectively support the creation of jobs with high development payoffs. Each of these countries faced a different jobs challenge, so their policy choices are relevant for other countries confronted with similar jobs agendas. Getting the fundamentals right by ensuring macroeconomic stability, improving the business environment, and adhering to the rule of law, featured prominently in all four cases. All four countries also embraced labor policies and institutions within a reasonable range. But it is telling that the main constraints they targeted were not in the labor market.

Agrarian economies: Vietnam

Increasing productivity in agriculture, thereby freeing up labor to work in rural off-farm employment and to eventually migrate to cities, is the main challenge facing agrarian economies. At the beginning of its economic reform process, in the late 1980s and early 1990s, Vietnam was a clear illustration of this challenge. In 1993, the first year for which reliable data exist, over 70 percent of employment was in agriculture, 58 percent of the population lived in poverty,

and famine was not a distant possibility.⁵¹ Two decades later, Vietnam is the world's second-largest exporter of rice after Thailand; the second-largest exporter of coffee after Brazil; the largest exporter of pepper; and a top exporter of rubber, cashew nuts, and seafood products. The poverty rate declined to 16 percent by 2006, the fastest reduction in poverty ever recorded. These two decades of accelerated progress took Vietnam out of the least-developed-country category and made it a lower-middle-income economy with upbeat growth prospects.

Vietnam's transformation from an inefficient agrarian economy into an export powerhouse started with land reform. In the late 1980s and early 1990s, the country abandoned collectivization by initially allowing local authorities to reallocate communal land to individual households and subsequently extending land-use rights to them. The devolution of land to rural households was remarkably egalitarian, especially in the north.⁵² By 1993, land-use rights could be legally transferred and exchanged, mortgaged, and inherited. Land reform was part of a broader package of reforms, or *Doi Moi*, which took Vietnam from central planning to a market economy with a socialist orientation.⁵³ The package included the gradual removal of barriers to entry in most sectors, including the commercialization of agricultural products. Competition brought farmgate prices much closer to international prices. Combined with a strong emphasis on agricultural extension, land reform and deregulation led to rapidly growing agricultural productivity on very small farm plots.

In parallel, policies aimed to create employment opportunities outside agriculture. Vietnam opened to foreign investors, first in selected sectors such as natural resource exploitation and light manufacturing, and then more broadly in the context of its accession to the World Trade Organization (WTO) in 2007. Registered FDI increased fourfold in just two years, from 1992 to 1994; by 2007, FDI inflows were consistently exceeding 8 percent of GDP.⁵⁴ Initially investors partnered with state-owned enterprises (SOEs), because of the complexity of a legal system still in transition. But SOEs had gradually been given the flexibility to make their own business decisions, and many were

BOX 9.2 *There have been successes in tackling jobs challenges around the world*

The Republic of Korea effectively used policies to bring out the agglomeration and integration benefits of an *urbanizing country*.^a Almost three-quarters of the population was rural in 1960, but by 2000, four-fifths were urban. Seoul, which has grown to more than 10 million people today, was a motor for the country's overall growth, especially from the late 1980s until the mid-1990s. Many industrial clusters were established in close proximity to the capital city. Carefully designed and phased urban development policies accompanied the transition from jobs in agriculture to jobs in light manufacturing and then to jobs in industries with higher value added. Land development programs were established first, followed by a land-use regulation system, and then by comprehensive urban planning. Housing and transportation policies held the diseconomies of urbanization in check. The global integration of Korea's urban hubs was a core driver of its growth dynamic. The country invested massively in skills to support its structural transformation. The mean years of education of the adult population increased from 4.3 in 1960 to 11.8 in 2010. International test scores now place Korea at the top of Organization of Economic Cooperation and Development (OECD) countries in reading, mathematics, and science outcomes for 15-year-olds.

Small island nations are characterized by their size, isolation, and exposure to climatic risks. In these circumstances, reaping the productivity gains from agglomeration and global integration is especially challenging. Tonga is using migration as an active instrument to connect to the world economy.^b Approximately 100,000 Tongans live abroad, almost as many as at home. Remittances account for an estimated 32 percent of GDP and reach 80 percent of households, raising the education levels and productive investments. Migration agreements also reach poorer and less-skilled workers. In 2007, New Zealand launched the Recognized Seasonal Employer (RSE) program, which provides temporary opportunities for seasonal workers from the Pacific to work in horticulture and viticulture. For the households of participants, the program has led to income gains of up to 38 percent, more purchases of durable goods, and a broader improvement in well-being. In addition to income, RSE workers brought home their newly acquired knowledge of agricultural techniques, computer literacy, and English-language skills.

Formalizing countries can envision increasing the coverage of their social protection systems to levels typical of industrial countries. But costs are high, as is the risk of distorting incentives and undermining productivity. Brazil is one country that has been able to not only grow quickly but expand the formal sector in the

process.^c Benefiting from a booming global commodities market and a competitive exchange rate, its economy was growing at around 5 percent a year before the 2008 financial crisis. But unlike other rapidly growing countries, Brazil's job creation in the formal sector was three times as high as in the informal sector. Just in the five years leading up to the crisis, the formal share of total employment increased by about 5 percentage points. In some ways, Brazil is an unlikely "formalizer"—it has a heavily regulated business sector and a costly labor system. Although its rapid formalization is too recent to be fully explained yet, it appears efforts to simplify and extend the reach of programs and regulations have been contributing factors. The government has expanded the coverage of its social protection system through noncontributory programs. It has also simplified tax rules for small businesses, increased incentives for firms to formalize their workers, and improved enforcement of tax and labor regulations.

In *aging societies* the increase in the old-age dependency ratio reduces the average productivity per person, while the growing costs of caring for the elderly undermine living standards. But the reforms needed to address these challenges are politically difficult to implement and often involve hard tradeoffs. Poland is an example of a country that has taken several successful steps.^d By the turn of the century, labor force participation rates were declining due to the growing incidence of early retirement and disability pensions. But several reforms that reduced the inflows of new beneficiaries led to an increase in the employment-to-population ratio from 60 percent in 2006 to 65 percent in 2009. Changes in the application of eligibility rules of disability pensions, enacted in 2005, sharply reduced the intake of new beneficiaries. In 2009, a pension reform tackled early retirement options. This reform is such that old-age pension benefits adjust downward as life expectancy increases. Hence, the country is expected to have a fiscally sustainable pension system in the long run. That sustainability came at a cost: benefits as a percentage of earnings at retirement became significantly lower than the average in the European Union. In 2012, a new wave of pension reforms raised the retirement age to 67 for men and women from the current 65 for men and 60 for women. This increase should help to raise the benefit level without adversely affecting fiscal sustainability. Policies and programs to ease labor market entry for the inactive and unemployed of all ages remain modest, however, and their impact still needs to be determined. Also, long-term health care continues to rely largely on informal arrangements, but reforms are now publicly debated.

Source: World Development Report 2013 team.

a. Park and others 2011; Yusuf and Nabeshima 2006.

b. Gibson, McKenzie, and Rohorua 2008; World Bank 2010a.

c. Fajnzylber, Maloney, and Montes-Rojas 2011; OECD and ILO 2011.

d. Styczynska 2012; World Bank 2011b.

totally or partially sold to private investors. By the turn of the century, greenfield FDI investments had become the norm, especially in sectors such as garments, footwear, appliances, and consumer electronics.⁵⁵ Firms in these sectors are employing workers in large numbers. Important challenges remain, but Vietnam is

by now a rapidly urbanizing economy, which is a testimony to its success.

Conflict-affected countries: Rwanda

Rwanda today seems far removed from the war and genocide of the mid-1990s, and jobs contrib-

uted to such a remarkable turnaround. The conflict has had a severe impact on society and the economy, with massive loss of life, destruction of infrastructure, a crisis of state institutions, and a drop in GDP that exceeded 50 percent.⁵⁶ The cessation of conflict and an aggressive package of reforms allowed Rwanda's economy to rebound to pre-crisis levels by 2000.⁵⁷ Growth has continued, reaching an estimated 8.8 percent in 2011, and the poverty rate fell by 12 percentage points between 2005 and 2010.⁵⁸

A precondition for sustainable job creation in countries emerging from conflict is securing peace and reducing risks of recurring violence.⁵⁹ In the wake of the conflict, the Rwandan government supported the reintegration and demobilization of more than 54,000 former combatants. Ex-combatants received a combination of cash assistance, counseling, vocational training, education, support for income-generating activities, and social reintegration activities involving community members.⁶⁰ More than a decade after the end of conflict, most former combatants were participating in vocational training or working, mainly in subsistence agriculture and self-employment, similar to the rest of Rwanda's population.⁶¹ Although many ex-combatants continued to experience social and psychological hardships, their relations with their neighbors were reportedly good, and trust was improving. In 2012, 73 percent of ex-combatants expressed satisfaction with their social integration, and 85 percent of community members felt that there was trust between the two groups.⁶²

While the number of ex-combatants only represents a small share of Rwanda's total population of 10 million, reintegration through jobs had social cohesion payoffs, which established a basis for the country to move forward. Rwanda has built on this start by rejuvenating the private sector through reforms to institutions and business regulations.⁶³ A good example of the government's private sector development strategy was its decision to revitalize its coffee industry through deregulation and investments in new technology, a decision that has led to new job creation.⁶⁴ Rwanda still faces serious jobs challenges. More than 80 percent of the population works in subsistence agriculture and household enterprises, where productivity needs to be improved. Also, opportunities for off-farm employment need to expand, and growth in the currently small manufacturing sector would

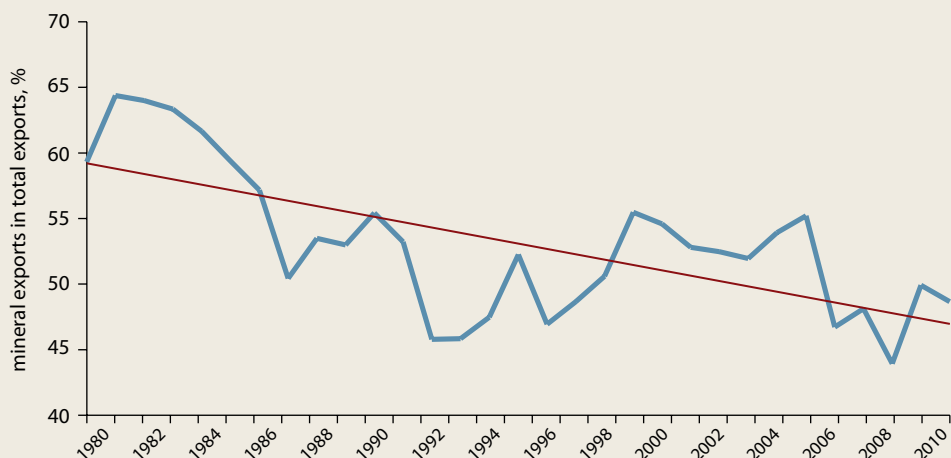
help.⁶⁵ But the economic reintegration and social cohesion through jobs have established a basis for future progress.⁶⁶

Resource-rich countries: Chile

While many countries rich in resources seem unable to diversify and are beset by poor governance, Chile's savvy management of its copper riches makes it a notable exception. In 2010, Chile was home to 28 percent of the world's copper reserves and about one-third of world copper production; for the past two decades, it has accounted for 17 percent of world copper exports.⁶⁷ But despite the prominence of copper in its economy, Chile has been able to diversify its exports and its economy while effectively managing resource-related risks such as currency appreciation and macroeconomic turbulence. Nonmineral exports increased significantly as a share of total exports after the 1980s, before retreating somewhat during the global commodities boom after 2007 (figure 9.5). Employment in the nonmining sectors has grown strongly at more than 2 percent annually over the past two decades.⁶⁸ The unemployment rate has averaged around 8 percent over the past decade, a far cry from the record 20 percent of the early 1980s.⁶⁹

A set of macroeconomic, institutional, export-diversification, and skill-building policies contributed to this broad-based job creation path. Chile combines the use of a resource stabilization mechanism (since 1987, with the current framework adopted in 2006) with a transparent fiscal rule (since 1999) that jointly regulate how copper extraction rents are used.⁷⁰ A structural surplus target is the anchor for determining inflows and outflows into two funds, one for pensions and other long-term government liabilities, the other for short-term stabilization purposes. The funds are authorized to invest their portfolio fully abroad, relieving pressures on the exchange rate.⁷¹ In parallel, governance reforms over the past decades in all areas of public sector management have led to significant success: Chile climbed 5 percentiles in its voice and accountability rating between 1996 and 2009 and also improved its political stability and control of corruption ratings.⁷²

Further, Chile adopted an active export-oriented growth policy, opening up to trade and welcoming direct foreign investment,

FIGURE 9.5 *Chile reduced its dependence on mineral exports*

Source: World Development Report 2013 team, based on export values data from Chile's Central Bank and copper price index from IMF's International Financial Statistics database. Note: The figure shows the share of mineral exports in total exports, measured at constant 1990 prices. Total exports and mineral export values were deflated using the export price index and the copper price index, respectively.

thereby enhancing the productivity spillovers from global integration. An ambitious innovation strategy to raise competitiveness was developed.⁷³ Public funds were used specifically to boost education expenditures, which almost doubled in real terms between 1990 and 2009.⁷⁴ While quality as well as equity in the education system are much debated today, the share of low-skilled workers declined in all economic sectors.⁷⁵

Countries with high youth unemployment: Slovenia

Slovenia has made inroads into the problem of high youth unemployment (figure 9.6). Throughout the first decade after the breakup of the former Yugoslavia, young people were three times as likely as adults to be unemployed. By 2010, this ratio had fallen to two to one.⁷⁶ The youth employment rate, which was 10 percentage points above the European Union (EU) average in 2000, was lower than the EU average in 2010.⁷⁷ By then, the share of Slovenia's youth not in education, employment, or training was just 7.5 percent among the 15- to 24-year age group, well below the EU average of 11.2 percent.⁷⁸ While the crisis has certainly been felt by

young people, European Commission President José Manuel Barroso recently highlighted Slovenia as an example of best practice in the employment of youth.⁷⁹

Slovenia's relative success in reducing youth unemployment does not strictly follow traditional recipes. Its spending on active labor market policies is about average for transition countries. Although some reforms have been made to liberalize the rules for contract and temporary work, Slovenia's labor regulations remain more restrictive than the Organisation for Economic Co-operation and Development (OECD) average, a policy stance that is usually associated with reduced job opportunities for young people. Minimum wages—also frequently cited as a barrier for youth employment—are on the high side. But potential distortions from these policies seem to be somewhat offset by a model of consensus-based decision making. In Slovenia, trade unions and employers' organizations, both with broad coverage, set wages that respond well to macroeconomic trends and sectoral productivity patterns.⁸⁰

Sustained growth supported by increased competition in product markets, is ultimately responsible for much of Slovenia's decrease in youth unemployment. Taking advantage of

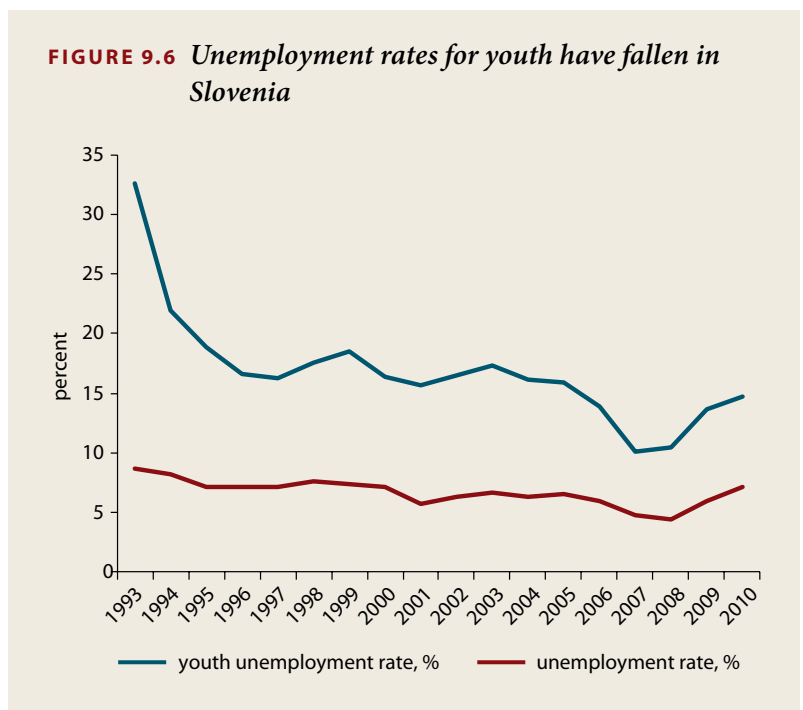
European integration, the economy successfully restructured its export sector to access EU markets. Very good infrastructure and a fairly skilled workforce helped as well. This dynamism, requiring the use of more advanced production and management techniques in modern sectors, was especially well-suited for youth. While the story is a good one in many ways, further policy reforms could help Slovenia realize more of the development payoffs that flow from jobs for young people. Some of these reforms are in the labor market, such as removing the incentives created by employment protection laws that tilt job creation for youth toward contract and temporary work. But others are outside the labor market, such as introducing measures to encourage more FDI.⁸¹

Connected jobs agendas: Global partnerships for jobs

Policies for jobs in one country can have spillovers on other countries, both positive and negative. An important issue is whether international coordination mechanisms could influence the decisions that governments make, enhancing the positive spillovers and mitigating the negative ones. Several areas lend themselves to coordination. Promoting compliance with rights and labor standards, a global public good, is the most obvious one, but the effectiveness of the mechanisms for doing so is limited. Measures to facilitate FDI flows, especially in services, would have substantial effects on productivity in developing countries but they may also have social implications. Migration has impacts on both sending and recipient countries, suggesting that bilateral agreements could lead to better outcomes for both parties.

Rights and standards: Pressure goes only so far

Several mechanisms operating across borders exist to set standards and provide channels for improving workers' rights and their working conditions. They include the issuance and ratification of ILO conventions, bilateral and multilateral trade agreements, and initiatives involving the private sector, civil society, and other stakeholders. These mechanisms operate either



Source: International Labour Organization, Key Indicators of the Labour Market (KILM) 2011.

Note: The youth unemployment rate refers to the 15-to-24 age group, whereas the general unemployment rate is for people aged 15 and above.

through peer pressure or by providing positive incentives for governments and firms to comply. But it is not certain that these kinds of pressures and incentives actually change working conditions on the ground, and the risk that improvements come at the expense of job creation cannot be ruled out.

ILO conventions provide a framework for rights, standards, and conditions at work. At the country level, conventions can influence domestic legislation if countries do align their laws with global standards. They can be a channel for voice and coordination internationally, as demonstrated by the adoption of conventions for home-based and domestic workers.⁸² Evidence from the ratification of the eight conventions included in the ILO's 1998 Declaration on Fundamental Rights and Principles at Work (the core labor standards) suggests that countries respond to pressure from the international community.⁸³ Yet, the persistence of forced labor, children working in hazardous conditions, discrimination, and lack of voice also suggests that ratification on its own is not sufficient.

Trade agreements have also been used with the intent of supporting workers rights. Some of them incorporate incentives to improve working conditions and access to voice. For instance, the 1999 bilateral trade agreement between Cambodia and the United States included provisions to increase Cambodia's quota for garment imports into the United States market if regular reviews showed improvements in working conditions.

Whether labor clauses actually lead to better outcomes for workers on either side of a trade agreement is the subject of a running debate. Skeptics point out that the agreements, on their own, can be weak instruments for improving rights and working conditions and cannot substitute for adequate enforcement of domestic labor laws.⁸⁴ There are also concerns about political capture and pressures from interest groups and uneven bargaining power between treaty parties.⁸⁵ Labor clauses could be used as a protectionist tool, undermining trade and employment opportunities in developing countries. Supporters claim that labor clauses in trade agreements not only improve the enforcement of existing labor and employment standards but also lead to increased FDI to developing countries, thus benefiting workers in developing countries in both direct and indirect ways.⁸⁶

Linking rights to trade agreements may have an impact on working conditions if complemented by investments in capacity for enforcement and compliance at the country level. After it signed the Central America Free Trade Agreement, the Dominican Republic increased the number of labor inspectors and invested in capacity building.⁸⁷ And after it entered the bilateral trade agreement with Cambodia, the United States funded two ILO projects there. One of them, Better Factories Cambodia, involved building capacity for compliance and monitoring of working conditions in garment factories. The other supported an arbitration council to resolve collective labor disputes.⁸⁸ Subsequent reviews have found improvements in working conditions and collective rights.⁸⁹

Beyond the initiatives of governments through conventions and trade agreements, there has been a growing emphasis on private sector accountability. Under the broader corporate social responsibility (CSR) agenda, companies voluntarily assume social and en-

vironmental concerns into their operations.⁹⁰ While some develop their own codes of conduct, collective initiatives are increasingly important for improving working conditions in global supply chains. Shared codes enable companies to collaborate with other businesses in industry-led platforms, and with trade unions and nongovernmental organizations in multistakeholder initiatives (sometimes with government observers).⁹¹

Almost all such initiatives have defined standards of practice, but they differ substantially in their governance structures, in their procedures for implementation, monitoring, and verification, and in whether they involve certification and labeling.⁹² CSR initiatives focused on labor issues are generally concentrated in sectors relying on global supply chains that are exposed to reputational risk, such as garments, sportswear, food and, increasingly, electronics.⁹³ Codes of conduct are most frequently adopted by companies based in the European Union and North America, which then make compliance with labor standards a condition for doing business with them. A small number of voluntary initiatives have also emerged in developing countries, although these are generally a response to external pressure more than a reaction to campaigning by local consumers.⁹⁴

There is limited evidence to demonstrate how far CSR initiatives go beyond good intentions to result in tangible and sustainable improvements in rights and working conditions. The clearest impacts are found in the area of health and safety and, to a lesser extent, in regularization of working hours. Improvements on freedom of association and discrimination are much less likely. Overall, the benefits are more pronounced for permanent workers than for migrants, agency workers, and seasonal and temporary workers.⁹⁵ Codes do not operate in a vacuum, so the capacity of local actors and the quality of domestic laws and institutions are critical to the effectiveness of the efforts.⁹⁶

These findings stress the need for approaches to improving working conditions that extend to sectoral and national-level engagement with governments, employers, trade unions, and civil society organizations. Voluntary labor initiatives cannot substitute for domestic efforts to set up adequate legal protections and put in place institutions to support compliance and provide av-

BOX 9.3 *Improving business practices facilitates compliance with labor standards*

The Better Work program seeks to improve compliance with international labor standards and national laws, while promoting business competitiveness. The program operates through partnerships with governments, employer and worker organizations, and international buyers. It currently includes global garment brands and retailers with supply chains outsourcing production to Cambodia, Haiti, Indonesia, Jordan, Lesotho, Nicaragua, and Vietnam.

The program involves thorough workplace assessments that examine compliance with international labor standards and national labor law, as well as advisory services to help employers and workers jointly create and implement improvement plans. Tailored training services support workplace cooperation and address specific issues, such as supervisory skills, human resource systems, and occupational safety and health. The program undertakes public reporting, which presents aggregate noncompliance data from all participating factories in a country and allows comparisons across countries according to specific indicators. A Better Work global team ensures quality, consistency, and effective knowledge man-

agement, supporting country teams with tools for advisory services, monitoring and evaluation, and impact assessment.

Better Work is modeled on the Better Factories Cambodia program, which was introduced in conjunction with the bilateral trade agreement between Cambodia and the United States. Results of evaluations of Better Factories Cambodia, covering more than 90 percent of participating factories, found that compliance on occupational safety and health improved 20 percent. Correct payment of wages, overtime, and benefits increased 37 percent. Initially, incentives to improve working conditions were driven by the quota increases called for under the trade agreement; however, with the expiration of the Multi-Fiber Arrangement (MFA), quota increases were no longer possible. Nevertheless, the Cambodian garment industry has continued to invest in monitoring, having identified labor compliance as an important part of its claim to a niche in the global garment industry. This niche exists despite the expiration of the MFA largely because of the role that reputation plays in the supply chain.

Sources: World Development Report 2013 team based on Better Work Programme, International Finance Corporation, Washington, DC, and International Labour Organization, Geneva; Robertson and others 2009; and Adler and Hwang 2012 for the World Development Report 2013.

enues for redress. The public and private sectors can work together, as in Brazil, where in 2003 the Ministry of Labor began publishing lists of companies found to be using forced labor. The increased public awareness led companies to subscribe to a National Pact to Combat Slave Labor, with civil society organizations establishing a committee to monitor the pact.⁹⁷

While most jobs in developing countries fall outside the scope of CSR initiatives, these efforts have the potential for a wider influence if they can be expanded to include workers, mainly women, who do not have formal contracts. At the same time, local governance and institutions could be boosted through activities to strengthen the capacity of actors and institutions and improve processes of dialogue and cooperation. Demonstration effects may also occur at the country level if CSR efforts increase the visibility of activities to improve rights and working conditions, and if labor inspectorates and third-party monitoring bodies gain experience and capacity. The potential benefits of local capacity building are illustrated by the experience of Better Work, a partnership program between the ILO and the International Finance Corporation (IFC) aimed at improving compli-

ance with labor standards in the garment sector (box 9.3).⁹⁸

Further liberalizing trade, but managing the tradeoffs

International trade in goods has been gradually liberalized, and the notion that freer trade is mutually beneficial for the transacting parties is now widely shared. Various mechanisms have been used in the liberalization process, including multilateral, regional, and bilateral agreements, as well as unilateral commitments. At the multilateral level, liberalization has been achieved through negotiations under the framework of the General Agreement on Tariffs and Trade (GATT) first, and then of its successor, the WTO. The most recent round of multilateral negotiations, the Doha Development Agenda, aims for better market access for the exporting industries of developing countries. Average bound tariffs would fall from 40 to 30 percent for agricultural products, and from 10 to 5 percent for manufactures. Actual tariffs could fall by 11 to 14 percentage points for the former, and by 2 to 3 percentage points for the latter. Cuts could be much sharper in sectors such as tex-

tiles and clothing. The least-developed countries could even benefit from duty-free quota access on almost all of their exports to industrial countries.⁹⁹ For developing countries, the success of the Doha Round could therefore have a substantive impact on the creation of jobs connected to global value chains, which are typically good jobs for development. But the Doha negotiations are in limbo.

Despite the progress in trade liberalization, many developing countries still lack the competitiveness to harness the benefits from global integration. Providing them with direct assistance to reduce logistics costs and improve the competitiveness of firms and farms is thus a priority. The Aid for Trade initiative aims to increase aid to developing countries so that they can tap existing market opportunities. Aid for Trade has increased substantially and now accounts for about a third of total aid to developing countries. To date, most of the resources have been channeled to infrastructure investments and trade facilitation. But the assistance could be made more effective by focusing on the export activities most suited to addressing the specific jobs challenges facing recipient countries. Increasing the involvement of the private sector would also enhance the effectiveness of the assistance provided.¹⁰⁰

In contrast to trade in goods, services liberalization has made slow progress, at both the multilateral and the regional levels. Services are subject to more pervasive regulations, because they are characterized by well-known market imperfections. These range from natural monopolies in the distribution of electricity to network externalities in telecommunications, and from asymmetric information and moral hazard in finance to market power in retail trade. While the liberalization of trade in goods is associated with domestic liberalization, the liberalization of trade in services usually requires domestic regulation. Setting up markets for electricity, ensuring universal service in telecommunications, adopting appropriate banking supervision, and managing the social impacts of large distributors on retail trade are challenging tasks.¹⁰¹

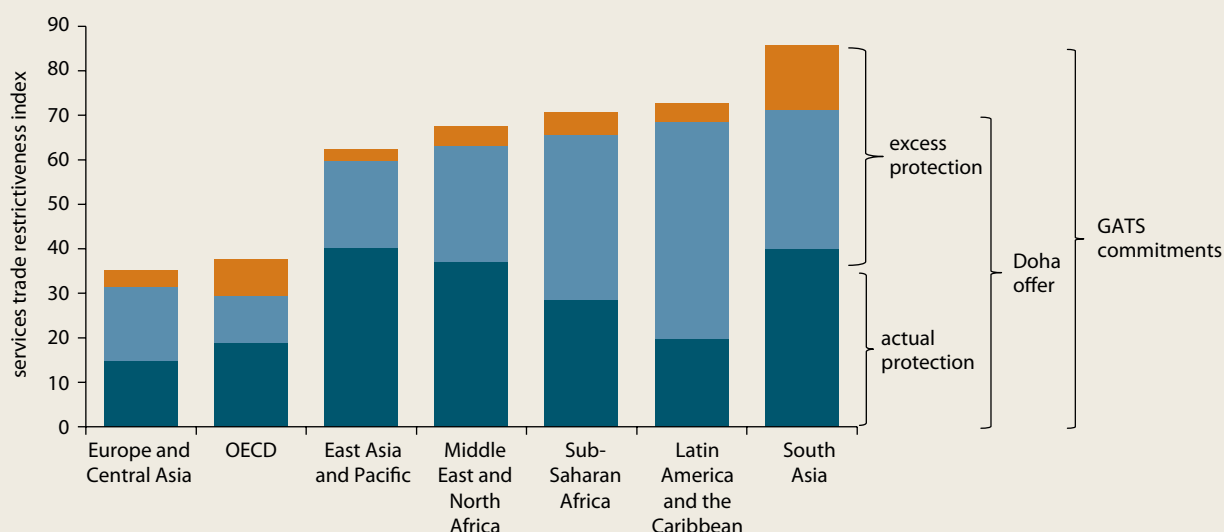
Not surprisingly, liberalization in services is much less advanced in developing countries than in industrial countries. The former are also reluctant to make additional commitments. Neither existing agreements under General Agreement on Trade in Services (GATS) nor

proposals in the Doha agenda and in regional trade discussions offer prospects for significant liberalization (figure 9.7).¹⁰²

However, the productivity gains from services liberalization would be substantial. Electricity, finance, telecommunications, and trade have a direct impact on production and transaction costs, making downstream sectors more competitive. By boosting job creation and raising labor earnings, these productivity gains should also lead to improved living standards. Social impacts can be more mixed. They are clearly positive when cell phones connect people (especially the poor) to markets for their products, to employment opportunities, or to government services. They can be negative when the disappearance of retail trade leads to the decline of traditional urban areas and affects the livelihoods of older shopkeepers who may not find alternative employment easily.

An adequate sequencing of services liberalization and domestic regulation can help manage these tradeoffs and, in doing so, address the concerns of developing countries. For instance, in telecommunications, enhanced domestic competition improves welfare more than handing over existing providers to better-performing foreign operators. Evidence from 86 developing countries between 1985 and 1999 suggests that both competition and liberalization can independently improve performance. But penetration of telecommunications services, measured by main-line access, is lower if competition is introduced after liberalization, rather than at the same time.¹⁰³

A careful design of liberalization, can also cushion social impacts. For instance, in its preferential trade agreement with the United States, Oman chose a sequential approach for the liberalization of its retail trade. Foreign nationals were initially permitted to own up to 100 percent of the equity in established retail enterprises valued at more than US\$5 million, with the threshold subsequently declining to US\$1 million. This agreement allowed for gradual adjustment. At the same time, it was generous in relation to foreign ownership, which is restricted to 49 percent in Oman's prevailing multilateral agreements.¹⁰⁴ Similarly, concerns about the impact of liberalization on urban centers are addressed through land-zoning restrictions, as some industrial countries do. But these restrictions can also be used as entry de-

FIGURE 9.7 *Offers to liberalize services are generally modest*

Source: Borchert, Gootiiz, and Mattoo 2010.

Note: GATS = General Agreement on Trade in Services; OECD = Organisation for Economic Co-operation and Development. The figure compares the applied trade policies in major services sectors with countries' commitments under GATS and the best offers that they have made in the Doha negotiations. The figure is based on data from 62 countries. The country services trade restrictiveness index is a weighted average of a country's policies or commitments to market access by foreigners in financial, retailing, telecommunication, transportation and selected professional services sectors. Weights are sectoral gross domestic product shares. The regional index is a simple average of country indices.

terrents, reducing competition and undermining job creation.¹⁰⁵

The limited traction in services liberalization is due largely to the potential tradeoffs involved. Developing countries may lack knowledge on the gains from opening markets, the on preconditions for realizing such gains in light of existing tradeoffs, and on the policy options available for maximizing the gains and handling the tradeoffs. Similar to the case of trade in goods, many countries also lack the ability to implement policies and agreements. International collaboration is thus needed to address such knowledge gaps and facilitate implementation.¹⁰⁶

International agreements can also be used to promote global public goods. One case in point is gender equality. Trade is not gender neutral. Its liberalization, including services trade, changes women's access to jobs. Traditionally men were more likely to have "brawn jobs," involving stronger physical requirements. But "brain jobs" involving dexterity, attention, or communication—from stitching garments to processing data—present more opportunities for women. In Delhi and Mumbai, call centers employ more

than 1 million people, most of them women. Preferential access for developing country imports from sectors with more "brain jobs" can thus be used to create employment opportunities for women in countries where gender equality is far from being attained.¹⁰⁷ However, as countries move up the ladder of global value chains, women may also lose job opportunities. This was the case in Malaysia, where the share of women working in manufacturing declined in the mid-1980s.¹⁰⁸

Migration policies: Toward bilateral agreements

Movements of people across borders have elicited diverse policy reactions by recipient countries over the course of history. These have included physical walls that keep foreigners away, policies preventing forced and bonded labor across oceans, and policies of open migration. In addition, there has been a range of specific measures including amnesties for irregular migrants, statutes controlling entry by refugees, and complex systems for granting visas. In most

cases, these policies have been introduced unilaterally by the recipient country and have involved little or no international dialogue or cooperation with sending countries.

In contrast to the movement of goods and services across borders, few international agreements concern migration in general and migration of workers in particular. Those in existence have limited coverage. ILO Conventions 97 and 143, in force since 1952 and 1978, respectively, seek to protect migrants from discrimination and abuse, and call for penalties and sanctions against those who promote clandestine or illegal migration. But these conventions have been ratified by only 49 and 23 countries, respectively. Mode 4 of GATS covers exports of services conducted through individuals present in another WTO member country.¹⁰⁹ It entered into force in 1995 and covers all signatories to the WTO, but only a limited number of services have been liberalized by either developed or developing countries, with very few moving ahead in sensitive areas like health services. Finally, the United Nations International Convention on the rights of all migrant workers and members of their families aims to “contribute to the harmonization of the attitudes of States through the acceptance of basic principles concerning the treatment of migrant workers and members of their families.” This convention entered into force in 2003 but has been ratified by only 22 countries, mostly sending countries.

Growing differences in ages, incomes, skills and economic perspectives between countries are likely to create mounting pressures for migration. Despite the interest of both industrial and developing countries in “talent” migration, low-skill migrants will still account for the bulk of cross-border flows in the years to come.¹¹⁰ But readiness to make the most of these growing differences between countries, and manage migration in a mutually beneficial way, is limited. Multicountry agreements have been slow to develop. Bilateral agreements that take into consideration geographical and historical trends, protect basic rights of workers, and take into account the social impacts of migration, could benefit both host and sending countries.

Migration is an area where a global perspective is warranted, but views on what needs to be done are quite diverse. One view focuses on

the large earnings differentials between countries, suggesting that the free movement of labor would accelerate global productivity growth and poverty reduction enormously.¹¹¹ Another perspective focuses on national security and the protection of communities and their cultures, implying the need for barriers to contain migration. Yet another highlights the moral imperative to protect the human rights of migrants, no matter their legal status, and to give shelter to those who suffer any form of persecution.¹¹² None of these views suffices, because none of them alone can address the complex tradeoffs that migration poses for policy design.

There are many examples of such tradeoffs. The more that is spent in protecting the welfare of migrants, which sending countries and concerned citizens everywhere demand, the more expensive the use of migrant labor will become, and the fewer the number of workers who will be hired. The more that is done to assimilate and integrate the migrants, which some host-country groups favor, the less likely migrants will be to return to their home countries. The more active the policies to attract “talent” migrants, the greater the “brain drain” concerns among sending countries. The higher the protection of sectors such as agriculture by industrial countries, the more likely are migrants from developing countries to work in those sectors. Conditioning foreign aid on banning migration seems unacceptable and would affect fundamental rights of workers by constraining their freedom to move. Stern visa restrictions and deportations usually backfire and may turn overstayers into irregular migrants. These examples indicate that unilateral policies cannot address all these dilemmas. However, the adoption of global agreements setting the conditions of migration and superseding country legislation, seems unlikely. This is why an intermediate solution can be more effective.

In many instances, both sending and host countries can benefit from migration through a collaborative approach. Most abuses perpetrated by traffickers, firms, or workers are associated with illegal migrant flows. The formalization of these flows is a basic tool for protecting the rights of migrant workers, while at the same time having them honor the terms under which they were welcomed. This formalization, however, is difficult to enforce without

the cooperation of institutions in both sending and receiving countries.¹¹³ Bilateral agreements can include provisions regarding quotas by occupation, industry, region, and duration of stay. They can distinguish between temporary movements of workers and steps to permanent migration, with conditions and protocols for moving from one country to another and regulation of recruitment agencies and intermediaries. They can include considerations about taxation and social security, including on benefits to be provided, portability of contributions, and cost-sharing arrangements. These agreements can design incentives so that firms, worker associations, and governments in both sending and receiving countries have an interest in enforcing the provisions.¹¹⁴

Formalizing and extending temporary migration agreements could capture part of the wage gain from migration that is currently absorbed by intermediaries, to the benefit of both migrants and their employers. Agreements in the financial sector could lower the cost of remittances to migrants and avoid the prevalence of illegal transactions. Reconsidering the financing of higher education in both developing and developed countries could favor a more balanced sharing of the returns to investments in the case of talent migrants. More generally, bilateral coordination is a sensible way to manage migration and ensure mutual benefits for sending and recipient countries.

Jobs are center stage, but where are the numbers?

Policies for jobs need to be based on reliable data and rigorous analysis.¹¹⁵ Given that a large share of the people at work in developing countries are not wage employees, and that even a larger share lacks social security coverage, the measurement of employment must look beyond whatever formal employment data the country gathers. Determining which jobs have the greatest payoffs for poverty reduction requires linking information on a household's income or consumption with information on the employment of its members. Understanding which firms create more jobs, or whether labor reallocation leads to substantial growth rather than just churning, requires information on the inputs and outputs of

very diverse production units, including micro-enterprises. Assessing whether employment experiences affect trust and willingness to engage in society requires information on individual values and behaviors. Such information is necessary to tackle an emerging research agenda on jobs and development (box 9.4).

However, the paucity of empirical analyses on the employment impact of the global crisis in developing countries and the difficulty of comparing measures of informal employment across countries suggest that data quality and availability are limited. Much effort goes into measuring unemployment rates, even with a relatively high frequency.¹¹⁶ But open unemployment is not a very telling indicator in countries where an important fraction of the labor force is not salaried. Four indicators are listed to monitor progress toward the employment target under the Millennium Development Goal (MDG) on eradicating poverty. This target calls for “achieving full and productive employment and decent work for all, including women and young people.” But the four indicators considered only partially capture advances in the quantity and quality of jobs in the developing world.¹¹⁷ Many available employment figures are actually inferred through interpolation between years and extrapolation using data from “similar” countries, but how reliable these methods are remains an open question.

These remarks are not meant to criticize statistical agencies at the country level or data collection efforts at the international level. Their efforts are filling important gaps and mobilizing expertise to improve definitions, reach agreements on best practices, and provide technical assistance to those generating primary data.¹¹⁸ Despite the limitations, data on informal employment, the unemployment rate, or the MDG employment target serve an important objective, namely, increasing awareness on the importance of jobs for promoting development. However, moving jobs center stage could remain an aspirational statement in the absence of a sustained effort to improve the amount and comparability of data.

Today's challenges regarding labor statistics can be regrouped into three key areas: data gaps; data quality issues; and planning, coordination, and communication issues. In some countries, labor statistics do not exist at all or are collected

BOX 9.4 Knowledge gaps on jobs and development chart the research agenda

Increased reliance on disaggregated survey data, together with rigorous program evaluation and controlled experiments, has pushed the knowledge frontier on jobs and development in recent years. On almost all relevant issues a substantive body of evidence already exists. Current efforts of the research community promise its expansion in the coming years, in ways that should contribute to better informed policy making. However, knowledge gaps remain in several areas.

Jobs and living standards. An abundance of high-quality work has been done on the measurement of poverty and the assessment of poverty alleviation programs. Less is known on how employment dynamics affect household living standards and movements in and out of poverty. Research on transitions between different employment statuses, occupations, industries, and types of jobs can shed light on incentives to work and formalize, as well as on impacts of jobs on household well-being. Knowledge is also limited on the subjective value workers attach to various characteristics of their jobs, including to social security benefits such as old-age and disability pensions.

Jobs and productivity. Many studies are available on firm dynamics, including births, growth, and deaths. There is also a growing literature on the impacts of trade liberalization and foreign direct investment on productivity and earnings at the plant level. Much of this research focuses on formal sector firms, however. Much less research is available on the dynamics of micro- and small enterprises in the informal sector, despite their importance for employment. There is also some disconnect between studies based on plant-level surveys and the growing literature on the effects of urbanization. The dialogue between these different literatures is in part hampered by different visions of production processes on issues such as returns to scale or externalities.

Jobs and social cohesion. Research in this area is tentative and the empirical evidence is scarce. The importance of the topic and the paucity of robust results mean that the payoffs to high-quality research in this area could be very high. Natural experiments combined with longitudinal data spanning relatively long periods of

time may shed light on the links between jobs and behaviors. Interdisciplinary research could provide insights on the broader relationship between jobs and institutional development processes. Anthropological approaches may provide insights on the mechanisms at play; for instance on how jobs affect perceptions on fairness and the willingness to trust others.

Spillovers from jobs. Research on the magnitude of spillovers from jobs is patchy. The agenda is long, but a promising area concerns the impact of jobs on the acquisition of cognitive and noncognitive skills, and how this impact varies depending on the characteristics of the job and those of the person who holds it. Evidence on agglomeration effects across cities with different characteristics is also scarce, as are estimates of the environmental impacts of different types of jobs.

Labor policies. A growing number of empirical studies focus on the impact of labor policies and institutions, and many of these studies are very rigorous. However, a careful review suggests that the relationship between policies and institutions on the one hand, and outcomes on the other, is not linear. Rather, it evokes a "plateau" of modest effects, but with "cliffs" at both ends where the impacts on efficiency and the distribution of jobs can be sizeable. Empirical work to determine where these cliffs lie and how to identify the institutional characteristics that demarcate the limits of the plateau would be of much value for policy makers.

Connected jobs agendas. More research is needed on how international trade, investment at both ends, and migration affect the composition of employment across countries. Knowledge gaps are common in all of these areas. The ability of national policies and supranational mechanisms such as trade agreements to affect jobs in different countries is only partially understood. More solid knowledge on the right sequencing of international commitments and domestic policies related to services could address the reluctance of developing countries to make further progress in the direction of liberalization. Rigorous evaluations of migration policies would also be helpful.

Source: World Development Report 2013 team.

only sporadically. Where labor statistics do exist, data quality is a concern throughout the statistical production chain, from the use of appropriate definitions to questionnaire design, from sampling frames to interviewing protocols, and from data entry and coding to verification and estimation procedures. Planning, coordination, and communication issues are exacerbated when different institutions are responsible for collecting and disseminating the data.¹¹⁹ The most urgent priorities are to standardize the employment modules attached to the household surveys used for poverty analysis, and to

ensure that establishment surveys include informal firms and microenterprises.

A quarter of a century ago, a renewed emphasis on poverty reduction as the key objective of development policy launched a long-term data effort. Across the world, information on household living standards was collected through standardized surveys, the sampling methods and the variable definitions used were duly documented, and the data and documentation were made available to researchers and practitioners whenever possible. A similar approach should be envisioned to move jobs center stage.

How to accelerate labor reallocation?

Creative destruction, the mainstay of economic growth, happens to a large extent through labor reallocation. As workers move from jobs in low-productivity farms and obsolete firms to jobs in more dynamic economic units, output increases and the economy moves closer to the efficiency frontier. Differences in productivity across economic units underlie this creative destruction process. Such differences can reflect a healthy ecosystem driven by competition which offers the basis for efficiency-enhancing job reallocation. Market imperfections and government failures may hinder labor reallocation, however, resulting in a wider dispersion of productivity and many missed opportunities for growth.¹²⁰

Stringent regulations that obstruct the movement of workers from low- to high-productivity areas or that prevent their separation from obsolete firms are a case in point. These regulations may stem from good intentions, such as containing congestion in cities or providing earnings stability to workers. But their cost in productivity growth can be substantial. Regulations of this kind do not sit on the efficiency “plateau” where labor policies are mainly redistributive; they are rather on the cliff, and have unambiguously negative effects on economic efficiency.

India is arguably an example of a country whose complex and cumbersome labor policies have pushed it off the “plateau.” The country has more than 40 national and state-level labor laws. Most of them apply to the organized (or formal) sector and to firms above a certain size. As firms’ employment increases, they fall under the purview of a growing number of regulations.¹²¹ The Industrial Disputes Act (IDA) of 1947 is particularly restrictive. Governing employee-employer relationships, the IDA makes it extremely difficult for firms to terminate employment.¹²²

The stringency of labor regulations is consistent with the “missing middle” phenomenon, characteristic of India and other developing countries, where medium-size businesses make up a disproportionately small share of the total. Also consistent with the stringency of labor regulations is the substantial dispersion of

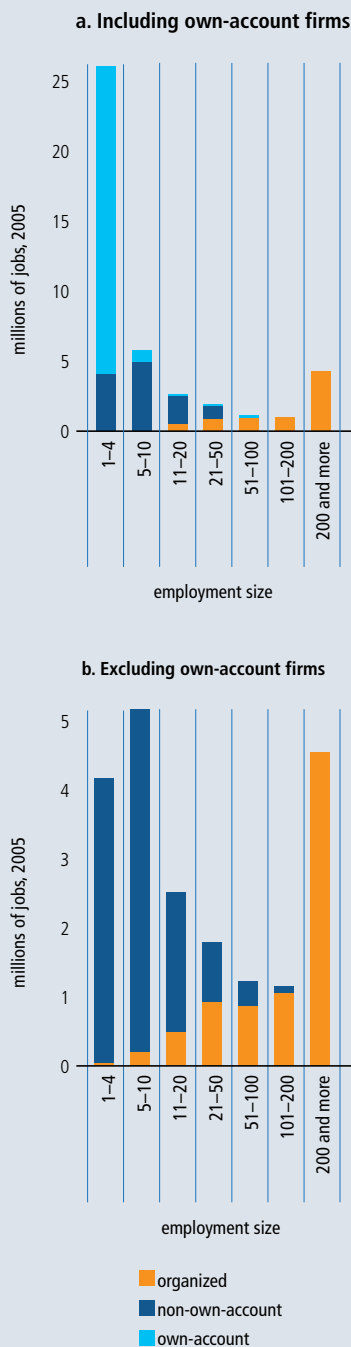
productivity. If the dispersion observed within each industry narrowed to the point of matching the dispersion observed in the United States, India’s average productivity in manufacturing could increase by more than half.¹²³ Instead, despite India’s buoyant economic growth during the past two decades, the performance of the labor-intensive manufacturing sector has been sluggish.¹²⁴ The bulk of the growth in nonfarm employment has been in the informal sector.

The conventional wisdom, when a country is riddled with misguided labor regulations, is to repeal them. This repeal may be easier said than done, however. India’s complex labor regulatory system has been in place for 60 years; even the ambitious reform program triggered by the balance-of-payment crisis of 1991 left labor regulations largely untouched.¹²⁵ The IDA of 1947 has been amended at the state level but not always toward the plateau. Between 1958 and 1992, seven states amended the IDA to give employers more latitude in labor decisions. These states subsequently experienced higher growth in output, employment, investment, and productivity in their formal manufacturing sector. But six other states changed the IDA in the opposite direction, which resulted in a worsening in firm performance and an expansion of the informal sector.¹²⁶ Overall, the dispersion of productivity in India’s manufacturing sector remained stable, or even increased, between 1987 and 1994.¹²⁷

From bypassing regulatory obstacles . . .

India’s response to these regulatory obstacles has been to learn how to live with them, and this has been achieved through widespread noncompliance.¹²⁸ For example, large firms rely on contractors, who in turn hire workers; thus total employment is “sliced” into smaller packages, each escaping the most stringent labor market regulations. Short-term contracts and temporary employment agencies are other mechanisms used to circumvent the regulations. The propensity of firms to hire contract workers has increased over time for all firms employing 10 or more workers and is highest among medium-

FIGURE 9.8 *Is there a “missing middle” in the distribution of manufacturing firms in India?*



Source: Hasan and Jandoc 2010.
 Note: Data for the organized, or formal, sector are from the Annual Survey of Industries (ASI) conducted by India's Central Statistical Organisation; data for the unorganized or informal sector are from the National Sample Survey Organisation (NSSO) Survey of Unorganized Manufacturing Enterprises. Own-account manufacturing enterprises are those operating without hired workers employed on a regular basis.

sized firms (50–99 workers).¹²⁹ A 10-year study of 1,300 firms also finds insignificant differences between medium and larger firms in their hiring of manual workers.¹³⁰ The share of informal workers in total employment in organized firms grew from 32 percent in 2000 to 52 percent in 2005 to 68 percent in 2010.¹³¹

Consistent with noncompliance, the distribution of firms by size does not show substantial discontinuities around the threshold levels where regulations become more stringent. Considering the entire distribution, including informal firms, the biggest discontinuity is between firms employing up to 4 workers and those employing 5 to 10 (figure 9.8a). However, there is no 5-worker threshold in the applicable labor market regulations. On the other hand, there is no discontinuity in the distribution when crossing the 50-worker cutoff point, despite it being the threshold above which firms fall under the purview of the IDA (figure 9.8b).

Admittedly, other factors could influence India's distribution of firms by size.¹³² But overall, these patterns are consistent with firms bypassing labor regulations.

... to actively offsetting them ...

While India has learned how to live with cumbersome regulatory obstacles, other developing countries with similar constraints have accomplished more efficiency-enhancing labor reallocation. Sri Lanka inherited the same labor regulations from the British colonial administration as India did. Without reaching the extremes in India, many Latin American countries face similar regulatory obstacles. Although China's labor regulations were less stringent until the 1990s, its household registration (*hukou*) system represented the ultimate obstacle to labor reallocation.¹³³ Yet, all of these countries have managed to spur growth in high-productivity sectors and locations.

Sri Lanka gradually liberalized many of its markets during the 1980s and 1990s but did not reform its complicated and costly employment protection legislation. Under the Termination of Employment of Workman Act (TEWA) of 1971, firms with 15 or more employees cannot lay off workers without official authorization and are liable for termination payments of up to four years of salary, depending on the em-

ployee's length of service. Yet the country's garment industry was a runaway success. Replacing tea as the country's major source of export revenue, the industry now accounts for half of Sri Lanka's sales abroad, up from almost nothing in the 1970s. It also accounts for much of the increase in employment in manufacturing.¹³⁴ The success of the garment industry has been a magnet for rural migrants, with 45 percent of them moving to the western provinces where the garment industry is concentrated.

Restrictive labor market regulations are a common feature of many Latin American countries too. In Brazil, after years of economic reforms, hiring workers remains as burdensome as ever. If anything, the sustained increase in formalization over the past decade has made compliance with labor regulations more common. Yet, Brazil's labor market has been characterized by massive internal migration and remarkably high labor turnover rates. Lifetime interstate migration is estimated to have doubled between the 1980s and the 1990s, reaching two-fifths of the population by 1999. In the 1990s, one-third of the workers who changed jobs in Brazil's formal sector had migrated

across state borders to find employment. And an estimated two-fifths to one-half of formal sector workers change jobs every year.¹³⁵

Nowhere is the extent of labor reallocation more striking than in China, and much of it happened under the *hukou* system. Since its introduction in the 1950s, this system governed where people could live, effectively preventing rural-to-urban labor flows and reserving employment in cities for their residents (box 9.5). With market-oriented reforms, the system was gradually liberalized, and many restrictions on internal migration were lifted. But the *hukou* system has not been completely abolished; even today it may still inhibit migrant flows and reduce the incidence of workers moving with dependents. Despite this barrier to labor mobility, China experienced phenomenal growth in labor-intensive manufacturing, involving massive internal migration from the hinterland to coastal areas, and from villages to towns and urban centers. This geographically concentrated development absorbed an important share of rural surplus labor, while integrating China into international value chains and making it the "world's factory."¹³⁶

BOX 9.5 *China's hukou system has been partially liberalized*

A *hukou* is analogous to an internal passport. Legal residency in a city, town, or village is determined by an individual's birth place. Rural and urban populations are registered separately. The *hukou* system regulates many social entitlements of citizens, including education, housing, utilities subsidies, and social protection. Together with other policies such as urban food rationing during the period under central planning the *hukou* system prevented the rural labor force from moving out of agriculture. It maintained an exclusive urban labor market with basic social welfare, and supported industrial policy, effectively creating rural-urban segmentation.

At the beginning of the reform process, cities and towns could afford basic social welfare only for a limited population. Inflows of rural workers were therefore seen as a double-edged sword that could increase the well-being of rural residents but also lead to congestion and overcrowded infrastructure. After reforms in urban areas were under way in the mid-1980s, and the growth of township and village enterprises stagnated, farmers were allowed to work in small and medium cities—but only on the condition that they continued to be self-sufficient in terms of staples, in accordance with

the food ration scheme that was still in force. Restrictions were not lifted until the mid-1990s, when reforms were well under way. By then, the fast growth of labor-intensive and export-oriented sectors and the dramatic surge of private sector activities in urban areas generated a substantial demand for low-skilled labor. Only at that point was the *hukou* system substantially liberalized.

The implementation of this liberalization process has been conducted in a decentralized way. Most medium and large cities have gradually lowered the criteria for migrants to change *hukou* identities, and hence their accompanying entitlements. However, the criteria remain exceptionally strict in major cities and in cities with high income levels, including Shanghai, Beijing, and Guangzhou. For example, Shanghai was the first city to make the residence permit system open to all, but its qualifying conditions are among the strictest. Shanghai's system favors immigrants with college degrees or special talents, and those who do business or invest. It also requires seven years of social insurance contributions before applying. In addition, the city has a tight overall quota on *hukou* conversions, and the actual number of conversions has to date been very low.

... through productivity spillovers

These examples point to a successful second-best approach to offset regulatory obstacles. Instead of trying to avoid or evade labor regulations, this approach involves actively taking advantage of productivity spillovers from jobs in industrial clusters, dynamic cities, or global value chains to make the regulations less relevant in practice.

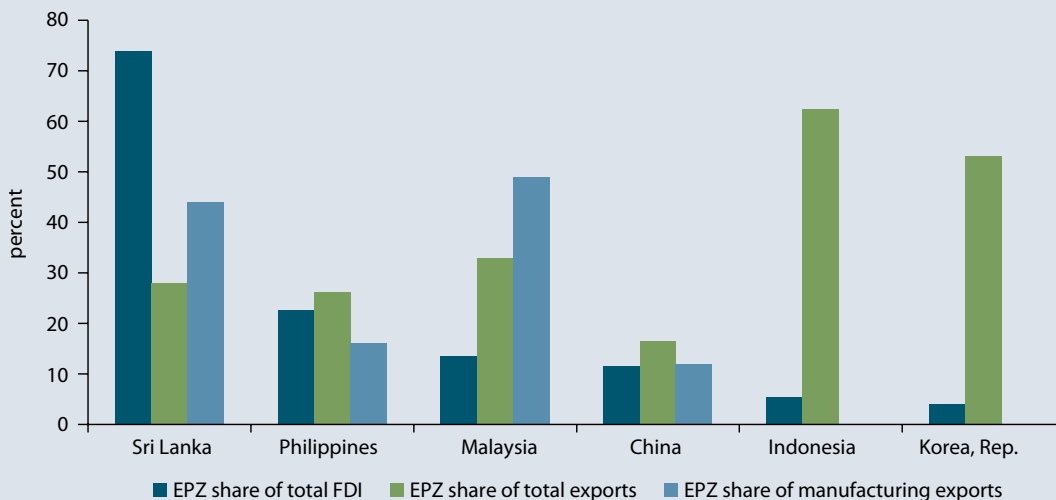
In Sri Lanka, the development of export processing zones (EPZs) drove the takeoff of the garment industry. These economic enclaves offered better infrastructure and a more favorable regulatory environment than the rest of the economy. As a result, they attracted large inflows of FDI and became the source of a large fraction of Sri Lanka’s exports (figure 9.9).¹³⁷ Local producers in these zones were able to benefit from cluster effects. Outperforming competitors in many other developing countries, the industry has managed to move up the value chain, transforming factories into design centers.

In Brazil, the surge of internal migration is closely associated with the country’s continuing integration into the global economy and a development policy that favors agglomeration effects. In the 1990s, Brazil implemented major trade liberalization measures, gradually relaxed restrictions on FDI, and devalued its currency. In this context, development policy was increas-

ingly left to subnational governments, emphasizing the importance of regional hubs and facilitating a location-specific policy agenda built on local strengths. These efforts supported the relocation of industries toward previously less-favored regions. While local policies were largely targeted at fostering small and medium firms, they also attracted bigger firms and multinational companies. The impact on internal migration was significant. A 1 percent increase in the concentration of FDI in a particular location was associated with a 0.2 percent increase in the location’s immigration rate. And a 1 percent increase in employment in export sectors was associated with a 0.3 percent reduction in outmigration.¹³⁸

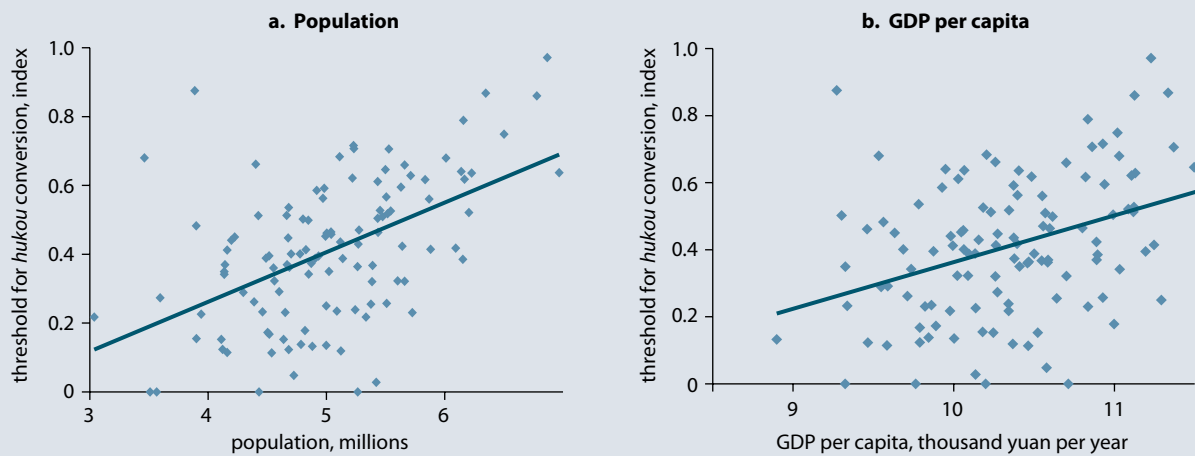
In China, labor reallocation is rooted in the development of competitive cities. The urban share of the population jumped from just 27 percent in 1990 to almost 50 percent in 2010. This transformation is unprecedented, with the urban population increasing from 170 million in 1978 to 456 million in 2000 and 665 million today. The increase was supported through a phenomenal expansion of commercial power supply, urban infrastructure, highways, and ports. In 1988, China had barely 100 kilometers of expressways; 10 years later, the total length

FIGURE 9.9 *Export processing zones were a driver of foreign direct investment in Sri Lanka*



Source: Jayanthakumaran 2003.

Note: EPZ = Export Processing Zone; FDI = foreign direct investment. The figure summarizes EPZ activities during the 1980s.

FIGURE 9.10 Restrictions to hukou conversion increase with city size and income

Source: Wang, Song, and O'Keefe 2012 for the World Development Report 2013.

Note: GDP = gross domestic product. The index measuring the threshold for hukou conversion takes into account requirements on investment, employment and family reunion. Each dot represents one of 120 cities in 30 provinces.

was second to the United States; and by 2009, more than 60,000 kilometers were in use.¹³⁹

Regional competition and experimentation in part underpin these successes. In China, local governments have substantial autonomy to raise fiscal and nonfiscal resources. They thus have considerable scope to take responsibility for local development. The Chinese Communist Party also rewards local officials based on local performance, prompting them to actively engage in economic competition.¹⁴⁰

This decentralized institutional setting allowed cities in China to experiment with reforms to the *hukou* system as a tool for urbanization. It has been argued that a large fraction of cities in China are too small because of it.¹⁴¹ But the decentralized implementation of the system allowed major globalizing cities to use the *hukou* system as a screening tool to select more skilled migrants and enhance the productivity spillovers from jobs. Most medium and large cities have gradually eased the criteria for migrants to change *hukou* identities. However, bigger and richer globalizing cities have embraced a more skill-intensive pattern of growth, putting more weight on productivity growth than on poverty reduction (figure 9.10).¹⁴² Ac-

cordingly, the criteria for changing *hukou* identities in these cities are generally defined by skills, investments, income, and residence requirements. The numbers of migrants meeting these criteria have been small.¹⁴³

Back to India, then, where the slow pace of urbanization is even more striking than the rigidity of its labor regulations. In 1990, the share of India's population living in cities was the same as China's: 27 percent. Two decades later, it had grown only to 30 percent.¹⁴⁴ The functionality of the cities also poses severe challenges. For instance, large swaths of Delhi or Mumbai have access to no more than four to five hours of water supply a day. Energy shortfalls have increased in recent years and are perceived as the top constraint for doing business. A company can expect 17 power shut-downs a month. The cost imposed on firms by the power problem is among the highest in the world.¹⁴⁵ Judging from the experiences of Brazil, China, and Sri Lanka, and after 60 years of partial success in making labor regulations more flexible, the key for India to accelerate labor reallocation and thereby realize its development potential may lie in its urbanization policy.



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Worker at a construction site in Jakarta, Indonesia

Sebastião Salgado / Amazonas—Press Images

Notes

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3. Bosch and Maloney 2010; Fiess, Fugazza, and Maloney 2010.
4. World Bank 2012b, various issues.
5. Commission on Growth and Development 2008.
6. Kraay 2012.
7. Frankel 2012.
8. World Bank 2012a.
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10. Options to cope with the abundance of foreign exchange earnings include creating professionally managed sovereign funds to smooth the impact of surges in earnings, adopting countercyclical fiscal policy to stabilize aggregate demand, and targeting monetary policy on a rate of inflation more directly influenced by the abundance of foreign exchange than the change in the consumer price index. Arezki, Sy, and Gylfason 2012.
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35. IMF 2003; Rodrik 2000.
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37. Keefer 2009; North 1981, 1990.
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39. World Bank 2004b.
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42. World Bank 2012e.
43. World Bank 2004b.
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46. World Bank 2012c.
47. Chen and others 2012 for the World Development Report 2013.
48. Locke, Amengual, and Mangla 2009.
49. Purcell 2010.
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52. Ravallion and van de Walle 2008.
53. Rama 2009.
54. World Bank 2012f.
55. World Bank 2009b; World Bank 2011e.
56. Up to 800,000 lives were lost from civil war and genocide. About 3.8 million people were displaced, of whom about 2 million fled to refugee camps in the Democratic Republic of the Congo and Tanzania. World Bank 2007.
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58. World Bank 2012d.
59. World Bank 2011h.
60. MDRP 2008.
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84. Aaronson and Zimmerman 2008; Elliott and Freeman 2003.
85. Hafner-Burton 2009.
86. Mosley 2011.
87. Schrank 2009.
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89. Berik and Rodger 2010; Polaski 2006.
90. Levi and others 2012 for the World Development Report 2013; Newitt 2012 for the World Development Report 2013.
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92. Levi and others 2012 for the World Development Report 2013; Newitt 2012 for the WDR 2013; UNCTAD 2011.
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94. These include the Wine Industry Ethical Trade Association in South Africa, <http://wieta.org.za.www34.cpt3.host-h.net/>; and Fibre Citoyenne, a multistakeholder initiative in the Moroccan garment sector, <http://www.fibrecitoyenne.org/>.
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111. See, for instance, Winters and others (2002) and World Bank (2005).
112. See, for instance, EFRA (2011), and Angenendt (2012).
113. Regional agreements also exist, for example, for the European Union's Schengen area.
114. For a discussion on these issues, see Pritchett (2006).
115. Kanbur and Svejnar 2009.

116. Around the world, 65 countries produce monthly or quarterly labor force surveys, whereas 116 produce annual surveys.
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118. International standards on labor statistics are of two types: those outlined in Conventions and Recommendations adopted by the ILO International Labour Conference, and the Resolutions and Guidelines adopted by the International Conference of Labour Statisticians (ICLS). The first type of standards is part of the international labor code and is legally binding in ratifying countries, whereas standards adopted by the ICLS are intended to provide guidance to countries, promote international comparability of labor statistics, and encourage coherence in concepts and methods across sources and domains.
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121. For example, once employment in a firm using power reaches 10 workers (20 for firms that do not use power), the firm enters the organized sector and becomes subject to the Factories Act of 1948. Once it reaches 50 workers, it is subject to the IDA of 1947 and must offer mandatory health insurance under the Employee State Insurance Act of 1948. Once it reaches 100 workers, it effectively loses the rights to terminate workers.
122. Panagariya 2008.
123. Hsieh and Klenow 2009.
124. Panagariya 2008. The entire decline in the share of agriculture since 1990–91 has been absorbed by services. Agriculture as a share of GDP fell from 46 percent in 1970–71 to 27 percent in 1990–91 and to 21 percent in 2004–05; industry's share of GDP rose from 22 percent in 1970–71 to 27 percent in 1990–91 and remained at the same level through 2004–05; the share of manufacturing, consequently, rose from 13 percent in 1970–71 to 17 percent in 1990–91 through 2004–05.
125. The reforms focus on the liberalization of trade and foreign investment and the dismantling of the License Raj system introduced in 1951 to impose central control over entry and production in the organized manufacturing sector.
126. Ahsan and Pagés 2009; Besley and Burgess 2004. Also see Bhattacharjea (2006) for concerns about the evidence presented by Besley and Burgess (2004) because of the interpretation and enforcement of the amendments to the IDA of 1947.
127. Hsieh and Klenow 2009.
128. Bhattacharjea 2006.
129. Hasan and Jandoc 2012.
130. Deshpande and others 2004.
131. Preliminary estimates by Santosh Mehrotra (Planning Commission of India).
132. Hasan and Jandoc 2012.
133. Several labor laws have been enacted in China since 2000, including a revision to the Trade Union Law in 2001; the Labor Contract Law, the Employment Promotion Law, and the Labor Dispute Mediation and Arbitration Law in 2008; and the Social Insurance Law in 2011. The implementation of these regulations may lead to lower flexibility in the labor market.
134. World Bank 2004a.
135. More interesting, the migration flows of formal sector workers were directed toward unconventional destinations: a few states in Brazil's Center-West, North, and Northeast. These flows contradict the assertion that the typical migrant flow runs from the low-income North to the higher-income South. Aguayo-Tellez, Muendler, and Poole 2010.
136. World Bank 2009c; Lin 2012.
137. Jayanthakumaran 2003.
138. Aguayo-Tellez, Muendler, and Poole 2010; Amaral-Filho 2003; Lastres, Cassiolato, and Campos 2006.
139. Bardhan 2010.
140. Bardhan 2010.
141. Au and Henderson 2006.
142. Wang, Song, and O'Keefe 2012 for the World Development Report 2013.
143. Cai 2011; Cai, Du, and Meiyang 2002; Cai, Park, and Zhao 2008; Chaudhuri and Datt 2009; Giles, Wang, and Park 2012.
144. World Bank 2012f.
145. Bardhan 2010; World Bank 2011c.

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